INTERNATIONAL MONETARY FUND

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# PANAMA

June 2014

## 2014 ARTICLE IV CONSULTATION - STAFF REPORT; PRESS RELEASE; 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 2014 Article IV consultation with Panama, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 9, 2014, following discussions that ended on February 21, 2014, 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 April 24, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Debt Sustainability Analysis**.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 9, 2014 consideration of the staff report that concluded the Article IV consultation with Panama.
- A **Statement by the Executive Director** for Panama.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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# PANAMA

## STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

April 24, 2014

## KEY ISSUES

**Background.** Panama's economic performance remains buoyant. Real GDP growth slowed to 8.4 percent in 2013, after the strong expansion in 2011–12, and is projected at above 7 percent in 2014. Inflation is declining, though it is resilient and still higher than in major trading partners, and unemployment is at historically low levels. The 2013 fiscal deficit was within the revised Social and Fiscal Responsibility Law (SFRL) ceiling despite strong public investment. The current account deficit remains elevated, reflecting high investment, but is financed mainly by FDI. The banks are well capitalized, profitable, and liquid.

**Outlook and Risks.** Near-term risks arise mainly from shifts in global trade and financial conditions (such as the normalization of global monetary conditions or a protracted economic slowdown in trading partners), domestic overheating pressures, persistent economic and political difficulties in Venezuela, and the risk of further significant delays in the Canal expansion. Strong domestic fundamentals and the ability to implement countercyclical fiscal policies would, however, mitigate the impact of external shocks.

**Fiscal and Financial Policies.** Targeting a fiscal balance below the SFRL ceilings would help contain overheating pressures and build policy buffers against possible adverse shocks. It is imperative to strengthen the financial safety net and to enhance financial supervision and integrity in line with the recommendations of the 2011 FSAP and the 2014 IMF's Detailed Assessment Report on Anti-Money Laundering and Combating the Financing of Terrorism.

**Medium-term Challenges.** Structural, social, and institutional reforms should continue to boost productivity, competitiveness, and inclusiveness. This will be essential to ensure a smooth transition towards strong and sustainable medium-term growth when large public investment projects are completed. In particular, further investment in the quality of education, training, and health, as well as promoting female labor force participation, should complement capital accumulation, raise labor productivity, and improve living standards.

Approved By
**Charles Kramer and Mary Goodman**

Discussions took place in Panama City during February 11–21, 2014. The staff team comprised Mr. Ricci (head), Mmes. Yang and Shi (all WHD), Messrs. Jafarov (MCM) and Noumon (STA). Mr. Macia (OED) also participated in the meetings. The team met with Minister of Economics and Finance De Lima, Minister of Education Molinar, other senior public officials, and private sector representatives.

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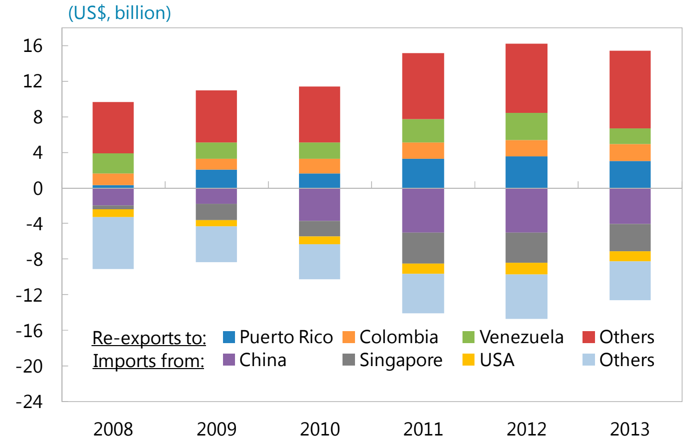
# RECENT DEVELOPMENTS

1. **Panama's economic growth remains buoyant.** Growth averaged about 8.5 percent over the past decade, the highest in Latin America. In 2011–12, real GDP grew at around 11 percent, driven by strong private demand, the implementation of an ambitious public investment program, and the Canal expansion project (see Figure 1). In 2013, despite continued support from public investment, growth declined to 8.4 percent, reflecting mainly a decline in Colon Free Zone (*Zona Libre de Colon*, ZLC) activity—in part associated with the controls on foreign exchange payments in Venezuela, and the import tariffs imposed by Colombia on textile and footwear (see Chart 1)—and in Canal traffic.[1] The strong growth performance unfolds against a backdrop of continued policy reforms, broadly in line with past Fund recommendations (see Box 1).

**Chart 1. Panama: Colon-Free Zone**
(US$, billion)

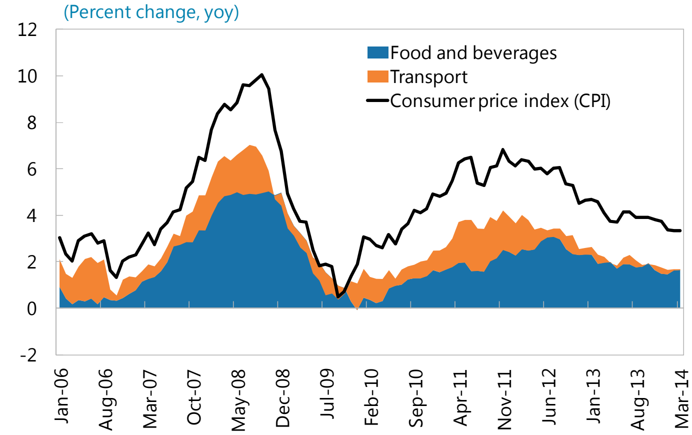



Sources: Panama National Authorities.

2. **GDP figures are being revised upward.**[2] In March 2014 the authorities started releasing preliminary figures for revised national accounts statistics for the period since 2007, which however are as yet incomplete. The upward revision to nominal GDP is between 5 and 8 percent, depending on the year. Unless otherwise noted, this Staff Report is based on the 1996-base national accounts statistics, the data officially available at the time of the staff mission.

3. **Inflation is moderating, in part due to the deceleration of food and fuel prices, but remains higher than in trading partners** (see Chart 2). Average headline inflation declined to 3.3 percent (yoy) in March 2014 from the 2012 average of 5.7 percent, while core inflation decreased only from

**Chart 2. Panama: CPI Contribution**
(Percent change, yoy)




Sources: Emerging Markets Economic Data (EMED) Database.

[1] In March 2014, Colombia moderately lowered the tariffs and indicated they would remain unchanged for two years.

[2] The revision encompasses changing the base year from 1996 to 2007 as well as enhancing the computation methodology, especially for the transportation, trade, financial, public, and household sectors.

5.1 percent to 3.5 percent over the same horizon. The contribution to inflation from components other than those associated with food or transport has become quite resilient, and there are risks that persistent inflationary pressures may feed into wage dynamics. Public and private wage inflation increased to 11.6 and 9.3 percent in 2012, from 4.5 and 4 percent respectively in 2011. In December 2013, the authorities announced an increase in the minimum wage (previously set in December 2011) by 13 to 27 percent depending on the type of job.[3] In February 2014, the government announced a wage increase of up to 50 percent for school teachers, who comprise about 3 percent of the labor force.

4. **The 2013 fiscal deficit was 3 percent of GDP (or 2.9 percent when using the new GDP statistics), within the revised ceiling allowed under the Social and Fiscal Responsibility Law (SFRL)** (see Figure 2).[4] The large increase from the 2012 deficit to GDP ratio (1.5 percent) was due to a strong public investment program: revenue excluding grants of the Non-Financial Public Sector increased by 9.9 percent, while current and capital expenditures grew by 9.6 percent and 30.2 percent respectively.[5] The contribution from the Canal Authority declined slightly, mainly owing to a slowdown in transit. In cyclically adjusted terms, the 2013 primary balance as a percent of GDP is estimated to have deteriorated by 1 percentage point.

5. **Public debt is on a declining path.** The ratio of public debt to GDP (including external debt contracted for the Canal expansion) fell from about 66 percent in 2005 to about 41 percent in 2013 (see Figure 2, Table 8, and Annex II). Sovereign spreads have been in line with other main emerging markets in Latin America, including Brazil, Chile, Colombia, Mexico, and Peru over the past few years (see Figure 3). On April 22, 2013, Panama issued a US$750 million 40-year global bond with a coupon rate of 4.3 percent. At that time, all three rating agencies confirmed its BBB rating, one notch above investment grade, on par with Brazil, Mexico, and Peru. Since then, the spread rose by about 45 basis points (from April 2013 to March 2014). As part of the debt management strategy, in order to smooth the future amortization profile, in November 2013 the authorities bought back US$583.6 million of the US$962 million global bond maturing in March 2015 and replaced it with a combination of global and domestic bonds with longer maturity. To encourage the development of domestic capital market, the authorities have also increased local debt issuance: the domestic share of new debt issuances rose from less than 10 percent in 2009 to about a quarter in 2013.

6. **The current account deficit remains elevated, reflecting high public and private investment.** The worsening of the current account deficit in 2013 (to 11.9 percent of GDP), however, mostly reflects the slowdown in exports (particularly Canal and related services) and an increase in

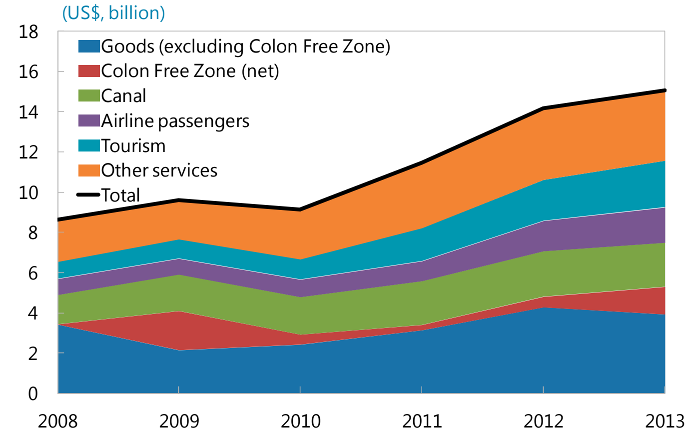
[3] The monthly minimum wage in Zone 1 (roughly corresponding to the urban area) was raised 27 percent from US$490 to US$624, and in Zone 2 (rural area) by 13 percent from US$432 to US$488. The new minimum wage should benefit about 270,000 workers, who constitute about ¼ of the working population.

[4] The 2013 SFRL deficit ceiling was raised to 3.1 percent from 2.7 percent, after approval of a supplementary budget to cover the costs of reconstruction related to the 2012 floods. For subsequent years, the ceiling then declines from 2.7 percent of GDP in 2014 to 0.5 percent in 2018.

[5] The 2012 deficit was revised from 2.1 to 1.5 percent of GDP, as only part of budgeted expenditures materialized in 2012.

FDI reinvested earnings. The current account deficit is projected to remain high (close to 11 percent of GDP) in 2014 and 2015, and improve in 2016 when the Canal expansion should be completed. Exports remain well diversified: services account for the bulk of exports, and tourism and air travel account for as much as the Canal (see Chart 3). In October 2012, the Free Trade Agreement (FTA) with the U.S. entered into force, while the FTA with Canada became effective in April 2013. An association agreement between Central America (including Panama) and the European Union entered into force in August 2013. An FTA with Mexico was signed in April 2014.

**Chart 3. Panama: Exports Composition**
(US$, billion)

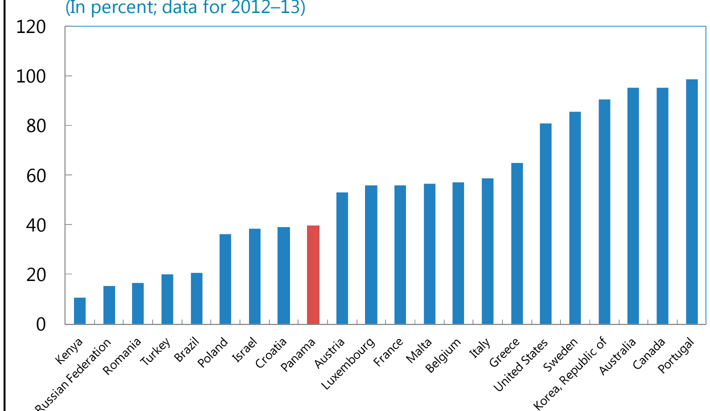



Sources: Panama National Authorities.

**7. FDI remains the main source of financing.** Buoyant FDI inflows are projected to continue to finance most of the current account deficit.[6] The copper mining project is expected to bring about US$6½ billion over 2013–17, of which about US$1½ billion was already invested in 2013. Overall, the large negative international investment position (about 71 percent of GDP in 2012) corresponds mainly to a large inward FDI position (see Table 10), while both the assets and liabilities of the banking sector (including currency and deposits) amount to about 100 percent of GDP.

**8. The financial sector is generally healthy.** Most local banks have a traditional business model with limited wholesale funding and are well capitalized, profitable, and liquid (see Figure 3 and Table 5). In recent years, overall credit to the private sector has grown in line with nominal GDP. The loan portfolio is balanced, with loans to the real estate and commerce sectors each accounting for about 25 percent of total credit. Due to the difficulties in the ZLC, growth in credit to commerce slowed from 23 percent in 2012 to about 3 percent in 2013, while growth in credit to construction, mining, real estate, and

**Chart 4. Panama: Household Debt-to-GDP Ratio**
(In percent; data for 2012–13)




Sources: Panama National Authorities; and IMF Financial Soundness Indicators Database.

[6] Official statistics currently report only small FDI outflows. However, such outflows as reported by recipient countries in the Coordinated Direct Investment Survey are large. The authorities are working on reconciling this inconsistency.

consumers continues to be robust. In January 2014, the Superintendency of Banks (SBP) required banks to increase their provisioning for exposures to Venezuela (through ZLC) by about 1–1.3 percent of total capital. Interest rates remain at historically low levels, while household debt (at about 40 percent of GDP) is on the high side compared to other emerging markets (see Chart 4).

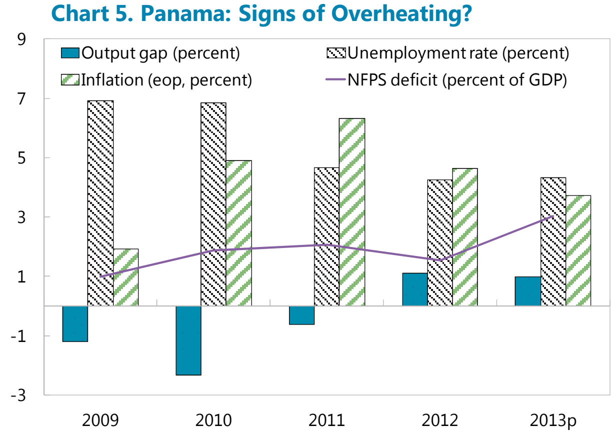
9. **The regulatory framework for financial sector supervision is being enhanced in line with FSAP recommendations** (see Annex I). The authorities are applying risk-based supervision to most banks and expect to complete coverage by mid-2014. The SBP has adopted a regulation on credit risk management (Acuerdo No. 4, May 18 2013) and is working to enhance the countercyclical capacity of the dynamic provisioning component, which will become effective by end-2014. The recently approved Insurance Law enhances the independence and enforcement capacity of the Superintendency of Insurance (SSRP); the SSRP is making efforts to build its analytical capacity and upgrade regulations. The controversy around the recent intervention in a brokerage company by the respective supervisory agency revealed critical weaknesses in the enforcement of the regulatory framework for capital markets.

# MACROECONOMIC OUTLOOK AND RISKS

10. **Growth is expected to remain healthy**. Real GDP growth is expected to moderate (as difficulties in the ZLC are expected to continue and public investment starts its normalization), but to remain healthy at above 7 percent in 2014 owing to robust private investment. Growth should gradually converge to its medium-term potential of about 6 percent, as capital spending unwinds and fiscal consolidation continues along the SFRL path.

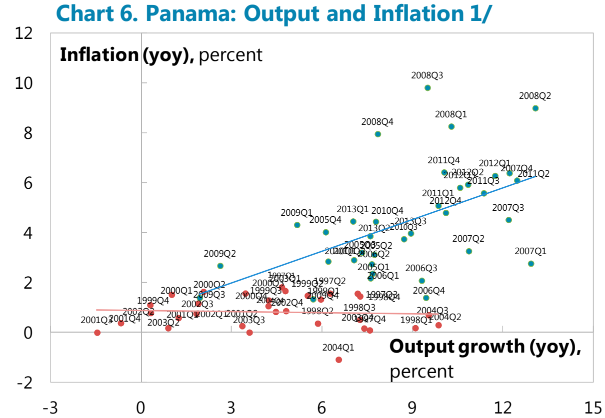
11. **The economy shows some signs of overheating**. The combination of strong domestic demand, robust credit growth, negative structural primary balance, positive output gap, tight labor market, an appreciating real exchange rate (reflecting persistently higher inflation than that of major trading partners), and a large current account deficit points to the risk of overheating and loss in competitiveness. Buoyant domestic conditions have been a contributing factor in driving inflation since

**Chart 5. Panama: Signs of Overheating?**




Sources: Panama National Authorities; and IMF staff calculations.

**Chart 6. Panama: Output and Inflation 1/**




Sources: Panama National Authorities; and IMF staff calculations.
1/ Pre-2005 in red, post-2004 in blue.

mid-2000s, in addition to external factors (food and gasoline prices). Indeed, the typical positive relation between inflation and the economic cycle seems quite evident since mid-2000s—when growth and investment rose substantially—after having been dormant for more than a decade (see Chart 5, Chart 6, and Box 2). There are risks that inflation may become entrenched in wage dynamics (especially in light of recent increases in minimum wages and public teachers' remuneration).

**Panama Risk Assessment Matrix[1]**

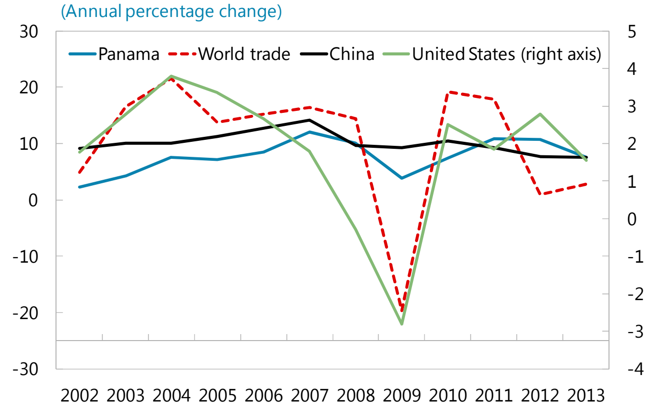
| Nature/Source of Main Threats | Risk | Impact | Effect | Policy Response |
|---|---|---|---|---|
| **External** | | | | |
| Surges in global financial market volatility (related to UMP exit), leading to economic and fiscal stress, and constraints on country policy settings. | H | M/H | Reduction in capital inflows/increase in capital outflows; difficulty rolling over financing; freeze of foreign credit lines. Rise in spreads and domestic rates. | State to provide fiscal and liquidity support. Deficit financing more tilted to domestic market. Current account to adjust automatically through lower imports. |
| Sharp slowdown in growth in China and/or protracted period of slower growth in advanced and emerging economies. | M | H | Reduction in exports and receipts from the canal and lower growth contribution from ZLC. Knock-on impact on credit to ZLC. | Current account to adjust automatically through lower imports. State to offer liquidity support if necessary. |
| Protracted failure in the United States to agree on a credible plan to ensure fiscal sustainability (medium-term). | L | H | Decline in Canal, ports, and ZLC activity. Freeze in U.S. credit lines. Knock-on effects on credit and non-canal activity. | Current account to adjust automatically through lower imports. State to provide fiscal and liquidity support. Strengthen financial safety net. |
| Persistent payment difficulties in Venezuela for imports from the Colon Free Zone (ZLC). | H | L/M | A decline in activity in ZLC with knock-on effects on the financial sector and the rest of the real sector. | Intensify monitoring and supervision. Impose high provisioning when necessary. |
| **Domestic** | | | | |
| Resilience of inflation | M | M | Secondary round inflationary pressures, afffecting wage dynamics and hurting competitiveness. | Tighter fiscal policy. |
| Further disruption to the Canal expansion | L | H | Negative effects on growth and employment in the short term and exports and revenues in the medium term. | Alternative Canal expansion plans. Reduction in medium term fiscal expenditure plans. |
| Further relaxation of deficit targets | M | M | Larger borrowing and contribution to overheating. Reduced market confidence. | Build fiscal buffer and commit to fiscal targets below the FSRL ceilings. |

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 of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). 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.

12. **Panama's extensive external linkages bring strong economic and financial benefits, but also make the country vulnerable to shifts in global economic and financial conditions** (see Figure 5, Chart 7, Box 3, and Box 4).[7] The normalization of U. S. monetary policy, and the uncertainty regarding its pace, may expose vulnerabilities, including through

**Chart 7. Panama: Growth Rates**

(Annual percentage change)



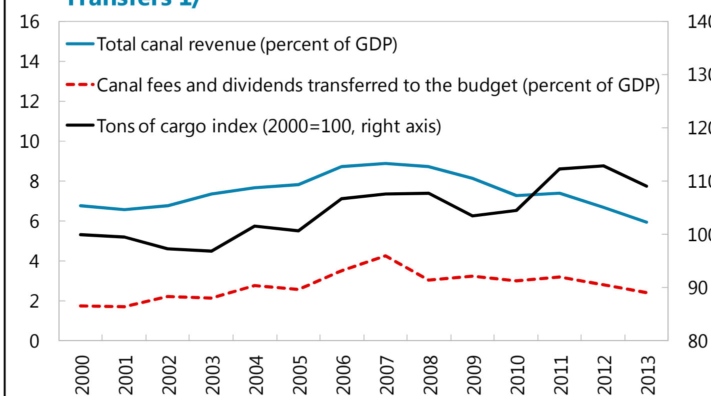

Source : World Economic Outlook.

[7] Staff's analysis indicates that negative external real and financial shocks could have a significant impact on output growth (see "Spillovers to Panama: Impact of Trade and International Financial Shocks", Country Report No. 13/89).

rising interest rates and capital outflows.[8] The authorities consider such risks manageable, especially if the process happens gradually, mainly because public debt maturity is long (about 11 years for total debt and 13 years for external debt), and domestic bank rates are not very responsive to U.S. interest rates (see Box 5).They also indicated that an increase in interest rates would contribute to taming the risks of overheating. A protracted economic slowdown in trading partners would significantly affect Panama's exports, particularly Canal revenues.[9] Persistent political and economic tensions in Venezuela would continue to have a negative effect on the ZLC, but may also induce capital inflows. Overall, strong fundamentals and the ability to implement countercyclical fiscal policies would mitigate the impact of possible external shocks.

**13. Public debt is deemed sustainable even in the presence of significant shocks**. Assuming that over the next few years the fiscal deficit path matches the declining SFRL ceilings path and that economic growth converges towards its potential, public debt is projected to decline to about 32 percent of GDP in the medium term (see Table 7 and Annex II).[10] Additional relaxations of the SFRL ceilings would erode the credibility of the SFRL framework and investors' confidence. Starting in 2015, the amount of Canal transfers that can be used for current period fiscal expenditure will be capped at 3.5 percent of GDP, with the Sovereign Wealth Fund (*Fondo de Ahorro de Panama*, FAP) absorbing any excess in total Canal transfers. The government will be able to use FAP's assets to run countercyclical fiscal policy in the event of economic downturns or natural disasters, and to reduce debt.[11] Canal transfers generally comprise a large portion of nontax

**Chart 8. Panama Canal Traffic, Revenue and Transfers 1/**




Sources: Panama National Authorities; and IMF staff calculations.
1/ The coefficient of variation of canal revenue as % of GDP is 0.11.

[8] Panama has large gross external positions (see Tables 4 and 10), and the banking sector plays a regional banking hub role (Figure 5). International funding risks can be significant in case of potential deleveraging in Europe, due mainly to Panama's large exposures—particularly of nonbank entities—to European banks (Box 3).

[9] Panama Canal traffic reflects about 5 percent of world trade.

[10] The debt sustainability analysis (DSA) also indicates that debt would remain sustainable in the occurrence of a simultaneous interest rate and growth shock similar to the one occurred in 2008–09, but more persistent. Should a temporary shock similar to the 2008–09 be coupled with a banking crisis that required fiscal intervention of about 17 percent of GDP, debt will obviously rise, but still remain sustainable.

[11] Law 38 2012 instituted the FAP and endowed it with the assets of the *Fondo Fiduciario* (about US$1.3bn). The newly appointed board and management aim to align the asset allocation to the objectives of FAP. Funds can be transferred to the National Treasury under the following conditions: (i) if a state of emergency is declared by the Cabinet, FAP can be called to cover the associated cost exceeding 0.5 percent of GDP as long as FAP assets are above 2 percent of GDP; (ii) in the occurrence of an economic slowdown (from 2015 onwards), defined as growth less than 2 percent for two consecutive quarters, FAP can be asked to contribute as long as FAP assets are above 2 percent of GDP; (iii) the government may decide to use FAP assets to repay sovereign debt for up to 0.5 percent of GDP per

(continued)

revenue, historically have been fairly stable (see Chart 8), and are expected to increase significantly in 2016.

**14. The Canal expansion presents some downside risks in the short term and upside risks in the medium term.** In December 2013, the Panama Canal Authority (ACP) and the Grupo Unidos por el Canal (GUPC)—the consortium handling a US$3.2 billion contract in the Canal expansion—entered into a dispute, over a cost overrun of US$1.6 billion claimed by GUPC. As a consequence, the expansion activity slowed down and then halted completely for two weeks in February 2014. An agreement was reached in late February 2014, and the project completion is now expected by end-2015. Should additional tensions arise, the ACP is confident that work can be completed with small additional delays and costs. Once the expansion is finished, Canal traffic should increase significantly due to the transit of larger (New-Panamax) ships, and in particular the transportation of Liquefied Natural Gas. Over the long term, the possible construction of a canal in Nicaragua could increase competition for ACP.

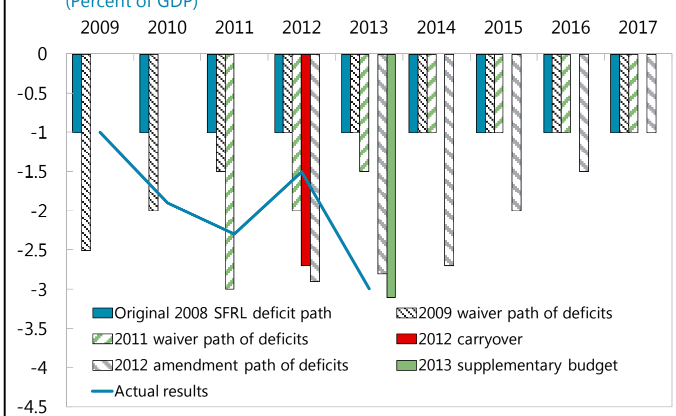
# POLICY DISCUSSIONS

*Discussions focused on the appropriate fiscal stance to reduce risks of overheating and build policy space, policies to bolster financial system's resilience and transparency, as well as medium-term growth efforts to boost productivity, competitiveness, and inclusiveness. The beginning of the new political cycle in the second half of 2014 may be a propitious time to push ahead with reforms.*

## A. Fiscal Policy

**15. Staff recommended targeting a fiscal deficit below the revised SFRL ceiling.** First, tighter fiscal policy in the near term will help rein in domestic inflationary pressures and prevent them from becoming entrenched in wage dynamics (especially in light of the authorities' inability to rely on monetary policy). Second, further fiscal restraint would leave room for maneuver in case of a serious deterioration of the external environment. Third, a tighter fiscal policy would help build up public assets that may be valuable in financing the liquidity facility under discussion (more below).Fourth, targeting a fiscal deficit below the

**Chart 9. Panama: Deficit Ceilings**
(Percent of GDP)




Sources: Panama National Authorities; and IMF staff calculations.

year, as long as FAP assets are above 5 percent of GDP. Article 4 of the Executive Decree 1068 of 2012 also calls for the transfer of overall investment returns to the Treasury on an annual basis.

ceiling would reduce the risk of revising or exceeding the ceiling, which would erode the credibility of the fiscal rules and investors' confidence (see Chart 9). In this regard, the significant revision of nominal GDP in 2014 offers an opportunity to remain below the SFRL ceiling, by maintaining the moderate fiscal tightening imbedded in the nominal deficit path that would have otherwise been envisaged with the unrevised GDP. However, the 2014 fiscal deficit presented in the budget corresponds to about 3 percent of the 2014 unrevised GDP projection (see Table 1) and may require small adjustments in order to remain within the SFRL ceiling (2.7 percent) on the basis of revised GDP. The authorities indicated that they managed to keep the fiscal balance below the SFRL ceilings in recent years (in part due to lower than budgeted expenditures, but also to improvements in tax collection), that they expect substantial underspending in 2014 vis-à-vis the budget due to the election and the transition between administrations (as in 2009), and that they are committed to adjusting expenditures if necessary to keep the 2014 fiscal deficit within the ceiling. Regarding the potential overheating risks, the authorities expect inflation to come down, due in part to the effect of the ongoing U.S. monetary policy normalization.

**16. Staff and authorities agreed on the fiscal reform agenda to strengthen the capacity in budgeting and public financial management.** Authorities are confident that tax evasion has been declining owing to the strengthening of fiscal institutions, including the recently created independent revenue agency (*Autoridad Nacional de Ingresos Publicos*, ANIP). The Large Taxpayers' Unit is operational and being enhanced. The authorities plan to make public the first debt strategy plan in the spring of 2014. The authorities should press ahead with the creation of a Single Treasury Account and the establishment of a Medium-Term Expenditure Framework. Staff also highlighted the importance of enhancing the strategy for a joint management of public assets and liabilities: a consistent vision should jointly guide the government decisions related to the management of the sovereign wealth fund, public debt management, the path for fiscal tightening, the funding of the financial liquidity facility, the management of public enterprises' liabilities, and the use of contingent instruments (such as catastrophic insurance).

## B. Bolstering Financial System Resilience

**17. The mission called for enhanced monitoring of risks to financial stability stemming from large gross external positions, rapidly rising real estate prices, and the leverage and liquidity positions of both banks and enterprises.** As of end-2013, onshore banks reported about US$32 billion in foreign assets (79 percent of GDP), mainly in the form of loans to Latin American countries, and US$26 billion in foreign liabilities (64 percent of GDP). Most of these exposures belong to foreign-owned banks operating in Panama.[12] Banks' foreign lending and foreign deposits have increased less than GDP in recent years, owing in part to the strong growth record of Panama (see Table 4). Information on corporate foreign borrowing and on leverage of corporate and household sectors is limited. While no data are available on real estate prices, anecdotal evidence

[12] Foreign-owned (Panamanian) banks account for about 80 percent of foreign deposits and about 85 percent of foreign lending.

suggests that housing prices may have doubled in the last five years, with some signs of oversupply in the tourism and high-end real estate segments.

**18. The authorities see no tangible systemic financial sector risks at present**. While acknowledging that more information on foreign exposures is needed, the authorities pointed out that the SBP coordinates closely with other banking supervisors within the region. They claimed that most Panamanian firms have limited foreign borrowing and that most of the nonbank private sector foreign liabilities relate to foreign companies with limited operations in Panama. The authorities indicated that they intend to start collecting data on real estate prices but argued that the presumed doubling of real estate prices in five years is consistent with fundamentals, as nominal GDP grew by about 76 percent during the same period, prices were previously suppressed due to the withdrawal of U.S. troops, and mortgage credit has been growing in line with GDP. Banks claimed that their exposures to the tourism and high-end real estate segments are limited, and their mortgage-related risks are kept low by the practice of automatic payroll deductions. The authorities explained that they are closely monitoring banks' exposures to Venezuela and may take further measures if needed.

**19. The mission urged the authorities to swiftly implement the remaining recommendations of the 2011 FSAP (Annex I) and of the 2014 IMF Detailed Assessment Report on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).** The authorities indicated that implementation of key FSAP recommendations is ongoing, with priority being placed on the liquidity facility for banks and the issuance of an AML law. While concurring with the priorities, staff encouraged the authorities to make progress also on other financial sector reforms.

- *Introducing a formal financial safety net*. Staff and the authorities agreed that creating an adequately financed and well designed liquidity facility would help absorb liquidity shocks (at present, Panama has neither a lender of last resort facility nor a deposit insurance scheme, inducing banks to be conservative in lending and to hold more liquidity than required by regulation).[13] The current proposal for the facility envisages the possibility that Banco Nacional de Panama (BNP), a public bank, is in the board of the facility. Staff argued that it is important that (i) the facility has a tangible and explicit funding plan, such as a gradual build up of assets from public and ideally private sources; (ii) the choice of the fiduciary and management of the facility avoids generating potential conflicts of interest and ensures a level playing field for all banks; and (iii) adequate liquidity and solvency standards for eligibility are carefully specified. The authorities argued that the potential conflict of interest related to the possible BNP involvement in the board of the facility is limited, because the BNP undertakes also public functions, has never abused the private information it has on commercial banks' operations, and has provided liquidity to the banking system in the past.

[13] The authorities are receiving technical assistance from CAPTAC in this area, and details of the operational framework would need to be elaborated.

- *Maintaining momentum in financial sector reforms to enhance financial and corporate transparency.* The law issued in 2013 providing for the custody of bearer shares and the publication of the 2014 IMF AML/CFT assessment report are positive steps towards improving the transparency of the corporate and financial sectors.[14] Staff discussed with the authorities the possible economic impact of the FATF and Global Forum initiatives to increase compliance with their respective standards, particularly given Panama's role as a financial and business services center. The economic impact is likely to be limited if authorities step up their efforts. Foreign deposits and insurance premiums are at risk of decline, and a decrease in activities related to legal and accounting services may, at least temporarily, affect output and employment. Otherwise, in a highly unlikely scenario, limited progress in this area might lead to international sanctions that could hinder broad access to international capital markets. In this context, staff encouraged the authorities to step up their efforts to comply with the FATF and Global Forum standards, including through technical assistance. The authorities argued that banks are required to know the beneficial owner of bank deposits and have generally not been accepting bearer shares accounts for several years, but acknowledged the need to improve Panama's compliance with the FATF standards in line with the AML/CFT assessment's key recommendations. They have requested technical assistance from the IADB, the Fund, and the U.S. Treasury, to support with the assessment of the economic impact, the implementation of the recommendations, and the enhancement of the Financial Intelligence Unit.

- *Building the capacity to monitor systemic risks and conduct macroprudential policies, as well as enhancing supervision*. The SBP has identified systemically important banks and initiated a Financial Stability Report series. Coordination among the supervisory agencies has been improved through the establishment of a council of supervisors (FCC), which has taken measures against emerging risks, and cross-membership in supervisory boards. Nevertheless, no institution in Panama has the overall mandate to monitor systemic risks, and capacity constraints as well as data gaps (e.g. on real estate prices, loan-to-value ratios, and corporate sector financial conditions) prevent adequate monitoring of systemic risks. Staff welcomed the introduction of dynamic provisioning and urged the authorities to enhance its countercyclical capacity. The authorities should continue to improve the capacity for supervising nonbank financial institutions. Draft legislation and regulations on cooperatives, conglomerates, trust funds, public accountants, as well as capital adequacy and regulatory reporting standards for holding companies should be finalized and adopted. Efforts to enhance banking supervision should continue. The authorities should also promote the development of the interbank market.

- *A deposit insurance scheme could complement social policies.* Deposit insurance capped at US$10,000 would offer protection to the majority of depositors (estimated at about 90 percent in the 2011 FSAP) while entailing a relatively small potential loss (5 percent of deposits). The cap would ensure that this scheme would particularly benefit the middle and poorer segments of the

[14] The law will come into force in 2015. For shares issued prior to the law coming into effect, there is a three-year transition period for compliance ending in 2018.

population. The authorities are adverse to deposit insurance as they fear that it may generate moral hazard and limit market monitoring of banks' behavior.

## C. Ensuring a Smooth Transition to Medium-term Growth

**20. Staff analysis suggests that there are moderate signs of an excessive current account deficit**. The current account has recently been wider than consistent with the current policies and fundamentals, but there is no compelling evidence of a significant real exchange rate misalignment (see Box 6). Staff and authorities agreed that the widening of the current account deficit is associated with the strong-but-temporary investment agenda and is expected to continue being financed mainly by FDI, while external debt remains sustainable (see Annex II).[15] The authorities indicated that the dollarization served them well for over a century and that the Panamanian economy has strong self-adjusting mechanisms; staff argued that the recent strong domestic demand may induce risks of unusual persistence in inflation and strain the self-adjusting mechanism. Hence, going forward staff recommended containing inflationary pressures to prevent further appreciation of the real exchange rate, monitoring the buildup of external liabilities, and continuing improving external sector statistics, thus allowing a more informed assessment of the external position.

**21. Staff and the authorities agreed that emphasis on social and institutional reforms should continue.** Reduction in poverty and income inequality has been sizable in recent years, thanks not only to strong growth, but also to social reforms.[16] The authorities highlighted that they are continuously enhancing social protection. For example, they recently increased the cash transfer to the elderly from 100 to 120 dollars a month (*120 a los 70*) and launched a program for citizens with severe disabilities (*Angel Guardian*).[17] The effectiveness of social programs has been favorably assessed on the basis of opinion surveys answered by program beneficiaries, and the authorities are working on additional (and more neutral) assessment tools. Nonetheless, poverty still affects about one-quarter of the population, and incidence is higher in rural areas. Institutional reforms (such as to enhance the judicial system and reduce corruption) would be necessary to address shortcomings often highlighted in international comparison statistics (see charts in Box 6).

**22. Staff and the authorities concurred that, with the large infrastructure projects nearing completion, further improvements in training, education, and health will be necessary to facilitate job reallocation, complement capital investment, raise productivity, and improve living standards.** In the high-growth period of 2007–13, capital accumulation contributed to more than a third of GDP growth, with the remaining contribution resulting equally from labor and total

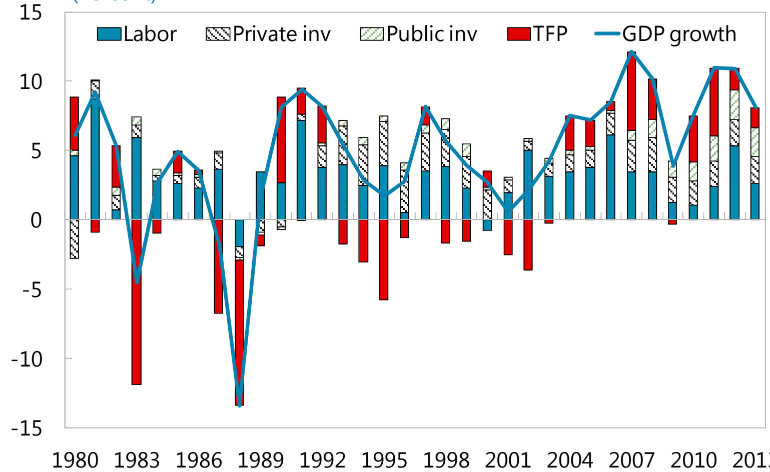
[15] Net of gross foreign asset accumulations, external debt to GDP would decline in all the risk scenarios envisaged.

[16] The poverty rate fell from 36.8 percent in 2003 to 27.6 percent in 2011. Between 2003 and 2011, income growth of households in the bottom 40 percent of the income distribution reached 8.9 percent, compared with an average for Latin American countries of 4.8 percent, and with Panama's average household income growth of 6.6 percent. The Gini coefficient dropped from 0.56 in 2003 to 0.53 in 2011.

[17] Other social programs aim at addressing poverty and adult illiteracy, or at promoting community empowerment, crime prevention, child development, and job training.

factor productivity (see Chart 10 and Annex III). Going forward, staff and the authorities agreed that public investment is likely to decelerate, and supporting sustainable growth will need to rely more on promoting the role of other contributing factors. Staff reiterated the importance of undertaking measures to improve the quality of public education and the availability of vocational training—particularly in rural areas—as well as to ensure better access to secondary and tertiary education, in order to enhance human capital and job mobility as well as to reduce skill mismatches and youth unemployment.[18] Staff highlighted that stimulating female labor force participation—for example by providing wider access to childcare and flexible working hours—may not only relax labor market capacity constraints, but also enhance the average productivity of the labor force, given the comparatively high level of education attained by women (see Box 7). The authorities emphasized that there are no legal restrictions to female labor force participation. They also recently promoted several enhancements in the education programs (aiming at the acquisition of soft skills and the knowledge of foreign languages), improved training programs for teachers, and deepened the dialogue between teachers and firms to address skill mismatches. School dropouts declined from 5.1 percent in 2009 to 3.1 percent in 2012, and school enrollment (especially for middle and high school) increased.

**Chart 10. Panama: Growth and Input Contribution**
(Percent)




Sources: WEO; and IMF staff calculations.

## D. Data Reporting Standards

**23. Staff urged the authorities to swiftly progress with efforts towards the SDDS subscription and to close data gaps that hinder effective macroeconomic policy management.** Improvements in timeliness, coverage, and quality of macro-statistics data would help improve the capacity of policy-making and boost investor confidence.[19] Since the 2011 SDDS TA mission from the Fund, partial progress has been made towards SDDS subscription. The main remaining obstacles relate to the lack of budgetary allocations and inadequate coordination among the relevant

[18] There is recent compelling evidence that enhancing the quality of the teachers strongly and significantly raises the likelihood that students will obtain better test scores, reach higher education, and earn higher income in their lifetime (see NBER working papers 19423 and 19424, as well as Eric Hanushek's contributions (http://hanushek.stanford.edu/). Overall, the quality of the education seems to be at least as important as—if not more than—spending per pupil.

[19] Recent studies suggest that subscription to SDDS may lower sovereign spreads by up to 20 to 50 basis points (Cady, J., 2005, "Does SDDS Subscription Reduce Borrowing Costs for Emerging Market Economies?" IMF Staff Papers, Vol. 52, No.3, pp. 503–17; and J. Cady and A. Pellechio, 2006, "Sovereign Borrowing Cost and the IMF's Data Standards Initiatives," IMF Working Paper 06/78).

government agencies. Improving data reporting is particularly important for series relevant for macroeconomic monitoring such as the breakdown of quarterly GDP, Government Finance Statistics, outward FDI flows and stocks, and portfolio equity flows and stocks. The authorities indicated that they prioritize the revision of national account statistics and the enhancement of foreign direct investment data.

# STAFF APPRAISAL

**24. The baseline outlook is favorable, with moderate risks.** Panama's economic growth started to moderate in 2013, but is expected to remain strong over the medium term as it continues to enhance its regional and global logistics role for the movement of goods, capital, and people. Inflation is moderating due to the deceleration of international food and oil prices, but remains higher than in major trading partners owing in part to strong domestic demand. The 2014 fiscal deficit is expected to remain within the revised SFRL ceilings, taking into account the expected upward revision to GDP. The current account deficit is expected to remain elevated, reflecting high public and private investment, but buoyant FDI inflows are projected to continue to finance most of the deficit.

**25. Near-term risks arise mainly from overheating pressures and shifts in global trade and financial conditions**. Strong domestic demand contributes to the risk of overheating: resilient inflationary pressures may feed into wage dynamics, possibly reducing competitiveness. With regard to external risks, the normalization—and the surrounding uncertainty—of U.S. monetary policy may expose vulnerabilities, including through higher interest rates and capital outflows. Other external risks relate to a protracted economic slowdown in trading partners and persistent payment difficulties in Venezuela. Additional significant delays in the Canal expansion would have an adverse impact on output and employment in the short term, and on exports and fiscal revenues in the medium term. Strong fundamentals and the ability to implement countercyclical fiscal policies would, however, help mitigate the impact of these external shocks.

**26. Keeping the fiscal deficits below the SFRL ceilings would help contain overheating pressures and build fiscal policy buffers**. Tighter fiscal policy than envisaged will help rein in domestic inflationary pressures (and prevent them from becoming entrenched in wage dynamics), leave room for policy maneuver to cope with shocks, and build public savings that could help finance the liquidity facility. Furthermore, targeting a fiscal deficit below the ceiling would reduce the risk of exceeding or revising the ceiling. Indeed, authorities should avoid further revision to the ceilings, which erode the credibility of the SFRL and investors' confidence. The significant revision of nominal GDP offers an opportunity to remain well below the ceiling in 2014, by maintaining the moderate fiscal tightening imbedded in the nominal deficit path that would have otherwise been targeted.

**27. The fiscal reform agenda should continue to strengthen the capacity in budgeting and public financial management**. Completing the Single Treasury Account and the Medium-Term Expenditure Framework would help in this area. A comprehensive strategy for public assets and liabilities management should jointly guide decisions related to public debt management, the role of the sovereign wealth fund, the path for fiscal tightening, the funding of the financial liquidity facility, the management of public enterprises' liabilities, and the use of contingent instruments (such as catastrophic insurance).

**28. The banking system remains generally healthy, but the remaining recommendations of the 2011 FSAP should be swiftly implemented.** Bank performance indicators are sound. The authorities have moved proactively to contain risks related to exposures to Venezuela, but they should continue to monitor closely credit growth, leverage, and external positions, and take additional measures if needed. Creating an adequately financed and well designed liquidity facility would help absorb liquidity shocks. The authorities should continue to improve their capacity for (i) monitoring systemic risks (including through collecting necessary data and frequently updating stress tests), (ii) conducting macroprudential policies, and (iii) supervising both banks and nonbank financial institutions.

**29. Intensifying efforts towards enhancing financial transparency is imperative.** The law providing for custody of bearer shares and the publication of the IMF AML/CFT reports are important steps toward increased transparency of the corporate and financial sectors, but the authorities should accelerate the implementation of the recommendations in the AML/CFT assessment.

**30. Medium-term reforms and policies should focus on maintaining external stability, promoting inclusiveness and fairness, and enhancing human capital and productivity.** In order to maintain external sustainability and competitiveness, it is important to contain inflationary pressures, prevent further appreciation of the real exchange rate, and monitor the buildup of external liabilities. The authorities should continue to undertake social and institutional reforms, in order to enhance poverty reduction and improve the distribution of income and of economic opportunities. Emphasis should be placed on further improving the quality of public education, stimulating female labor force participation and enhancing the availability of vocational training. An important priority will be the implementation of measures to support the rapid reallocation of labor from construction to other economic sectors (such as logistics services), once the large infrastructure projects, including the Canal expansion, are completed. These measures should also include skills upgrading as well as the deployment of social safety nets to accommodate the transition.

**31. The authorities should resume efforts towards the subscription to the Special Data Dissemination Standard (SDDS) and close gaps in data that are critical for conducting sound macroeconomic policy.**

**32. Staff recommends that the next Article IV consultation takes place on the standard 12-month cycle.**

## Box 1. Panama: 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 2012 Article IV consultation, Directors encouraged the authorities to build up fiscal space and enhance crisis prevention tools. In particular, the Directors saw merit in a tighter fiscal stance, further improvements in tax administration and expenditure management, and avoiding further revision of the SFRL ceilings. Directors also emphasized the importance of further strengthening the financial safety net. Directors underscored the importance of continued efforts to reduce poverty and inequality, and to tackle youth unemployment.*

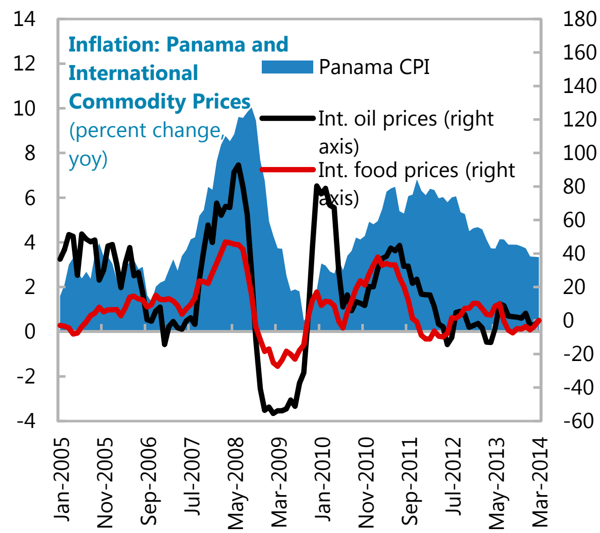
**Fiscal policy.** The 2013 deficit (at 3 percent of GDP) was within the ceiling, when accounting for the supplementary budget to cover the costs of reconstruction associated with the October 2012 floods. The fiscal deficit ceilings under the Social and Fiscal Responsibility Law remain on a declining path. Revenue collection has been improved, including via the recent creation of the independent revenue agency and the Large Tax Payers' Unit. Efforts have also been made to smooth the medium-term amortization profile, and the authorities plan to publish a Medium-Term Debt Management Strategy in 2014. Progress is being made in the implementation of the Single Treasury Account and the establishment of a Medium-Term Expenditure Framework.

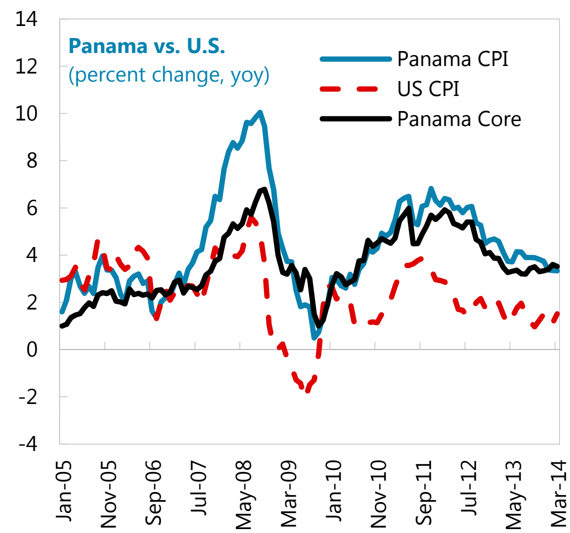
**Financial sector reforms.** Further progress has been made in implementing the 2011 FSAP recommendations since 2012. The plan to establish a liquidity facility (PALET) is being finalized. Progress has also been made in improving the transparency of the financial and corporate sector (Law 47 of August 6, 2013 adopted a custody regime applicable to bearer shares). The IMF Detailed Assessment Report on Anti-Money Laundering and Combating Financing of Terrorism was published in February 2014. The Financial Coordination Committee has been established and has taken measures against emerging risks. The regulation on credit risks issued in May 2013 incorporated a dynamic provisioning mechanism. Laws on Trust Funds, Cooperatives, and on Certified Public Accountants have been drafted.

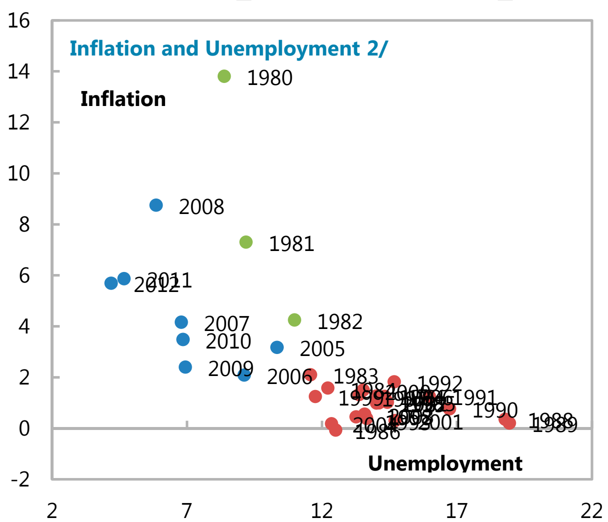
**More inclusive growth.** The authorities are enhancing social protection programs and evaluating how to better target them. Cash transfers to the elderly have been increased. Reforms to the education system include modernizing the curriculum, enhancing the training of teachers, and involving the private sector in the reforms to address skill mismatches and youth unemployment.

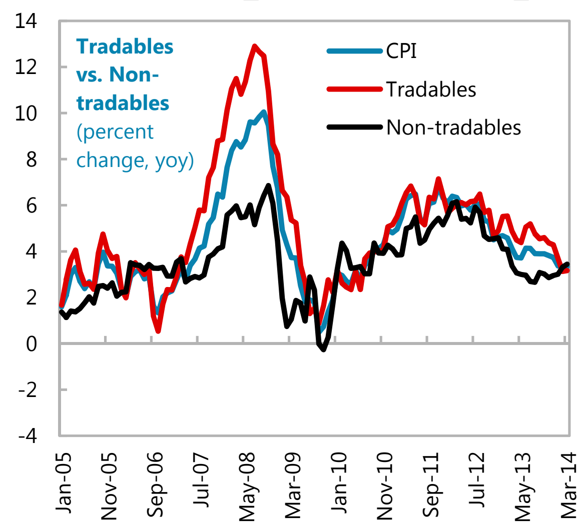
## Box 2. Panama: Inflation Is Not Just An Imported Phenomenon

**The resilience of inflation is likely to reflect exuberant growth**. Inflation has traditionally been low in Panama (about 1 percent from 1990 to mid-2000s), even lower than in the U.S. In the mid-2000s, a significant increase in inflation (up to about 10 percent, yoy) was mainly associated with the large increase in the international prices of energy and food. However, the role of international prices in the resurgence of inflation since 2009 is less clear-cut; it seems that the economic boom may be contributing to the resilience of inflation. First, international prices moderated towards end-2011, while inflation remains substantially higher (see charts below). Second, core inflation has been very close to overall inflation (more than in the past). Third, a typical Phillips curve relation between output growth (or unemployment) and inflation seems to have emerged in mid-2000s (see also text Chart 6); and over the past three decades the relation between inflation and unemployment has been evident when unemployment has been below 10 percent, which has been the case since mid-2000s.[1/] The effect of a booming economy on inflation seems to result more from the demand than the supply side, given that tradable and non-tradable inflation are very similar (if a Balassa-Samuelson effect were at work, we would observe lower tradable than non-tradable inflation). Indeed, wage inflation recently picked up along with inflation (Figure 1). Overall, strong demand seems to be contributing to inflation resilience.




Sources: Panama National Authorities; EMED and International Financial Statistics (IFS) Databases

1/ Overall, regression analysis shows a significant relation between Panama's CPI inflation rate, U.S. inflation, international food and oil price inflation, and Panama's GDP growth (the latter only after mid-2000s).

2/ Green dots correspond to 1980–82; red to 1983–2004; and blue to 2005–12.

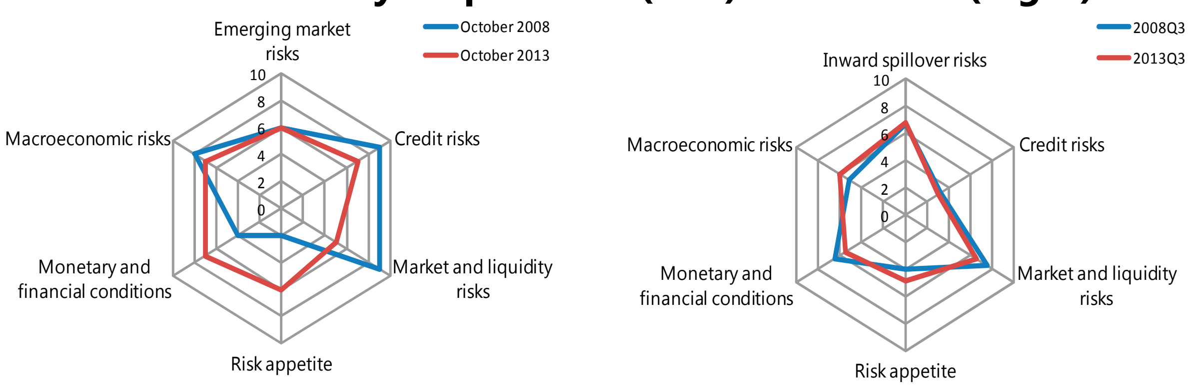
## Box 3. Panama: Financial Stability Map[1]

**The high reliance of the Panamanian economy on international trade, as well as its role as a financial center, potentially makes the country vulnerable to turbulence in international trade and global financial markets**. This box applies the Country Financial Stability Map methodology to Panama and compares six aggregate indicators of risks and macroeconomic conditions in the third quarter of either 2013 or 2008, with the 2003–08 average for these indicators. It also compares changes in financial stability for Panama versus other emerging markets.

**Panama macro-financial risks are close to their pre-crisis level.** As of the third quarter of 2013, credit risks are low in Panama (as they were in 2008) compared to mid-2000s, owing in part to the effect of the decline in unemployment on bank portfolio risk. Market and liquidity risks declined moderately since 2008, but remain high with respect to mid-2000s, mainly due to movements in large foreign exposures of the banking sector. Macroeconomic risks have slightly increased since 2008 mainly due to a slowdown in investment and trade growth. Notably, both credit risk and market and liquidity risk in Panama experienced a very different pattern than in other emerging markets, where these risks were very high at the onset of the crisis compared to mid-2000s (not surprisingly, the economic and financial impact of the recent global crisis was smaller in Panama than in numerous emerging markets).

**Panama now faces somewhat tighter monetary and financial conditions in the domestic market (in contrast to the global environment), but foreign investors show improved risk appetite towards Panamanian assets**. The tighter monetary and financial conditions are mainly attributable to declining inflationary pressures which contributed to the increase in domestic short-term real interest rates. Encouragingly, the strong FDI inflows point to Panama's attractiveness as an investment destination for foreign investors, supported by the improving stability of its domestic financial environment; the reliance on stable FDI flows makes the risk appetite for Panamanian assets quite stable compared to other emerging markets.

### Financial Stability Map: Global (Left) vs. Panama (Right)




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

[1] The methodology is detailed in Cervantes, Ricardo, Phakawa Jeasakul, Joseph F. Maloney and Li Lian Ong, 2014, "Mapping Country to Global Financial Stability," IMF Working Paper, forthcoming.

## Box 4. Panama: External Financial Linkages of the Banking System[1]

**Being a regional financial center, the Panamanian banks are relatively more exposed to international financial risks, both downstream and upstream, than banks from other major countries in the region.** Downstream exposure highlights the potential credit risk, i.e. the possibility of losing money on foreign assets if a financial crisis occurs in borrowing countries. Panamanian banks' lending to foreigners (excluding subsidiaries' claims, except for the parent bank's equity and any non-equity intra-group claims) is about 40 percent of GDP as of 2013 Q3, significantly greater than in LA5 (see Box table). The upstream exposure helps gauge the potential rollover risk that Panama faces as it borrows from foreign banks. BIS-reporting banks' foreign claims on Panama (to the public, corporate, and financial sectors, both via direct cross-border claims and claims of foreign affiliates in Panama that are not financed by local consumer deposits) were about 95 percent of GDP as of 2013 Q3, much higher than in the LA5 countries.

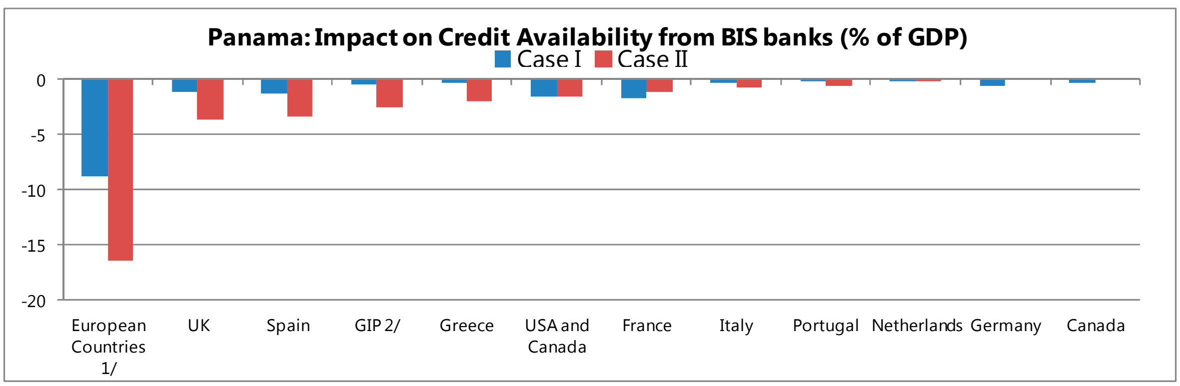
**Foreign Exposure: Panama vs. LA5 (2013Q3)**

| Downstream | Panama | Brazil | Chile | Colombia | Mexico | Peru |
|---|---|---|---|---|---|---|
| *Exposure as % of GDP* | 38.9 | 5.0 | 3.8 | n.a. | 0.3 | n.a. |
| *Expected Loss (% of GDP)* | 4.4 | 0.5 | 0.5 | n.a. | 0.0 | n.a. |
| **Upstream** | Panama | Brazil | Chile | Colombia | Mexico | Peru |
| *Exposure as % of GDP* | 95.2 | 11.8 | 21.1 | 5.6 | 6.4 | 7.0 |

Source: Staff Calculations using BIS, bank-level data

**Potential downstream losses can exceed 4 percent of GDP.** This figure is estimated using inputs from the IMF's Vulnerabilities Exercises for Advanced and Emerging Economies and assuming standard loss-given default ratios (75 percent for the sovereign and 60 percent for the private sector). This potential loss for Panama is seven times larger than the highest level among LA5 countries with available data.

**Negative shocks to foreign banks' balance sheets could cause a severe credit crunch in Panama, if a malicious deleveraging cycle is triggered.** The experiment was done assuming that a shock forced banks in a specified region to default on a given percent of their domestic on-sheet claims, and banks would restore the capital adequacy ratio (e.g. 9 percent of Core Tier 1 capital in the case of European banks) by uniform deleveraging across domestic and external claims. Two shocks were considered: (case I) a 3 percent default rate; and (case II) default rates varying across countries.[2] Several rounds of deleveraging process were considered until no further deleveraging occurred in the simulation.[3] When European countries get hit by the shock, Panama's credit contraction would be large (about 9 and 16 percent of GDP in case I and II respectively; see chart below). It is however possible that part of the inflows may be more immune to global financing conditions, as a large part of domestic borrowing from BIS-reporting foreign banks was undertaken by the nonbank sector, and these flows have been fairly stable during the global crisis (especially compared to bank borrowing).




Source: IMF Staff calculations based on BIS, ECB, and IFS data.
1/ Greece, Ireland, Portugal, Italy, Spain, France, Germany, Netherlands, and UK
2/ Greece, Ireland, and Portugal

[1] Based on Cerutti E., 2013 "Banks' Foreign Credit Exposures and Borrowers' Rollover Risks", IMF working paper No. 13/09.
[2] Case I: default on 3 percent of on-balance sheet claims (all borrowing sectors/all countries). Case II: default of 2.5, 5, and 10 percent, respectively, for: countries whose change in the non-performing-loans indicator from 2007 to 2012 was between 0 and 2.5 percent (Canada, Germany, France, Japan, The Netherlands); countries whose change was between 2.5 and 5 percent (U.S., UK); and countries whose change was above 5 percent (Greece, Ireland, Italy, Portugal, Spain). (The UK exposure has been reduced by US$2bn to capture the sale of HSBC Panama in late 2013.)
[3] To capture the effect on the domestic economy, the results are adjusted by the exposure of BIS banks to Panama's off-shore banks and corporations with limited domestic activity (about half).,The analysis does not take into account the effect of bank recapitalizations and other remedial policy actions—ring fencing, monetary policy, etc.—in the host and/or home country.

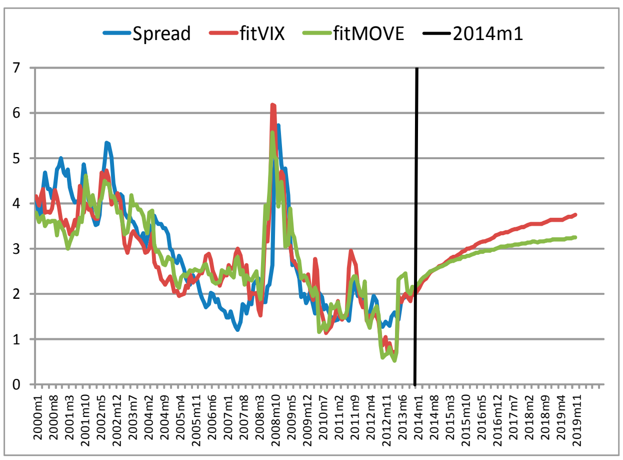
## Box 5. Forecasting Panama's EMBI Spread and Interest Rates[1]

**Panama's EMBI spread can be explained by country-specific financial and political risks, as well as the U.S. 10-year nominal yield and the volatility of U.S. market.** As illustrated by the panel to the right, a simple OLS regression delivers a reasonable fit. In Case I, the Merrill Option Volatility Expectations index (MOVE) is utilized as the measure of volatility, while Case II makes use of the Chicago Board Option Market VIX index. Quantitatively, a 100 basis points (bps) increase in U.S. nominal rates is associated with a rise in Panama' spread of about 24 bps in Case I, and 45 bps in Case II. As expected, higher volatility tends to increase Panama' spread (an one-standard-deviation increase of the volatility index—30 points for MOVE or 9 points for VIX—would raise the spread by 60 or 70 bps, in Case I or II, respectively), while lower financial and political risks (higher values indicate lower risks) are associated with a reduction of the spread (a decline in financial or political risk by one standard deviation is associated with a spread reduction of 69 or 45 bps respectively in case I, and with a reduction of 52 or 43 bps respectively in case II).

**EMBI Spread**

| | Case I | Case II |
|---|---|---|
| ***Financial Condition*** | -0.20** | -0.15** |
| ***Political Condition*** | -0.23** | -0.22** |
| ***Volatility*** | 0.02** | 0.08** |
| ***US 10Y Nominal*** | 0.24** | 0.45** |
| ***Constant*** | 31.26** | 25.94** |
| ***R square*** | 0.70 | 0.72 |
| ***N*** | 168 | 171 |

**Source: ICRG; Bloomberg, and IMF Staff calculation.**
**Case I (II) uses MOVE (VIX) as measure of volatility.**




**Source: ICRG, Bloomberg, and IMF Staff calculation.**

**In the medium term, the model predicts an increase in the spread, consistently with the general expectation for emerging market, as a result of the normalization of the U.S. monetary policy and the uncertainty related to its pace.** In the medium term, Panama' spread is expected to increase by about 125 to 175 bps to around 325 or 375 bps (in case I or II, respectively). In the projection, both domestic financial risks and political risks are assumed to remain at their current level. The projection for the U.S. 10-year nominal yield is based on the IMF WEO database and increases by about 250 bps from end December 2013 to Q4 2019. Both MOVE and VIX are assumed to gradually increase, converging to their respective long run mean according to an estimated mean-reverting process, thus contributing to an increase in spread.

**Domestic banks deposit and lending rates are less responsive than sovereign rates to changes in U.S. rates.** As shown in the panel to the right (which relates domestic rates to U.S. rates of the same maturity), a 100 bps increase in U.S. one-month nominal treasury bill rate is associated with less than 50 bps increase in the corresponding deposit rate (which applies to the majority of Panamanian deposits). Similar patterns emerge for the various lending rates with one year maturity, which tend to rise by 26 to 40 bps if the U.S. one-year nominal treasury bill rate increases by 100 bps. These effects are much smaller than the ones implicitly identified above for sovereign rates, given that: (i) these effects are estimated for nominal rates rather than for spreads; and (ii) the domestic bank rates are also in U.S. dollars (i.e. there is no exchange rate adjustment). Domestic bank rates also increase with global financial market volatility (for which VIX serves as a proxy).

**Panama: Domestic General License Bank Rates**

| | Deposit Rate | Lending Rates (One Year) | | |
|---|---|---|---|---|
| | One Month | Commercial | Industrial | Personal |
| ***VIX*** | 0.05** | 0.03** | 0.03** | 0.07** |
| ***US rates*** | 0.47** | 0.27** | 0.40** | 0.26** |
| ***Constant*** | 0.77** | 6.96** | 6.85** | 8.65** |
| ***R Square*** | 0.52 | 0.50 | 0.52 | 0.42 |
| ***N*** | 149 | 142 | 142 | 142 |

**Source: ICRG; Bloomberg, EMED and IMF Staff calculation.**

[1] The model is based on the analysis in the Global Financial Stability Report (GFSR), April 2014, and uses monthly data from January 2000 to December 2013. Both the financial and the political risks are measured by index numbers from the International Country Risk Guide (ICRG).

## Box 6. Panama: External Balance Assessment

*A number of methodologies suggest that there are moderate signs of an excessive current account deficit, but no indication of a real exchange rate misalignment (see Box table). Further real appreciation would undermine competitiveness, thus macroeconomic policies should aim at containing demand.*

**Panama: External Assessment Results (in percent) 1/**

| | CA/Y Norm | Underlying CA/Y | NFA/Y | NFA/Y-stabilising CA/Y | CA/Y gap | REER gap |
|---|---|---|---|---|---|---|
| **MB Approach** | -5.6 | -11.5 | | | -5.9 | |
| **ES Approach** | | -11.5 | -71 | -7.8 | -3.7 | |
| **REER Approach** | | | | | | |
| **REER (INS measure)** | | | | | | -2 |
| **REER (relative to EBA countries)** | | | | | | 2 |

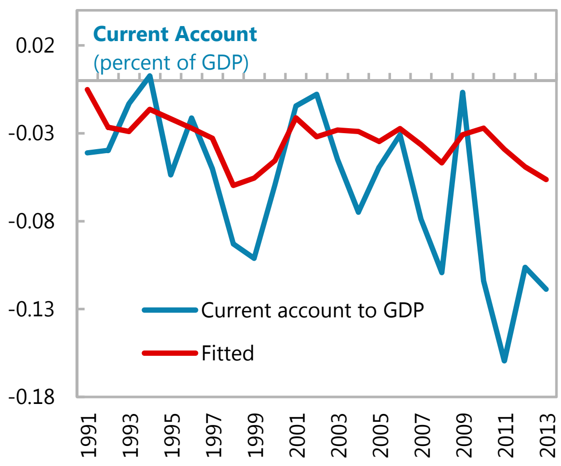
1/ The MB approach calculates the norm in the current account to GDP ratio (CA/Y), based on an approach similar to the IMF External Balance Assessment methodology (EBA), adding Panama to the EBA sample. The ES approach calculates the difference between the underlying CA to GDP ratio (2013, adjusted for output gap) and the CA to GDP ratio stabilizing the 2012 NFA to GDP ratio. The first REER approach uses EBA-like regressions to explain the INS REER; the second REER approach explains an REER index whose set of trading partners is based on the EBA set of countries, hence it excludes Venezuela. CA/Y and NFA/Y are measured in percent of GDP. REER is measured in percent.

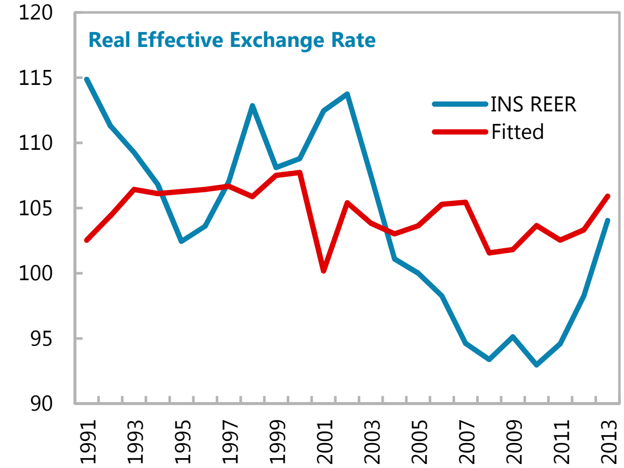
**Panama's current account deficit has been worsening significantly in recent years, from about 4 percent in 2000–06 to about 10 percent in 2007–13.** Indeed the CA deficit has been larger than the value explained by fundamentals and current policies since mid-2000s—apart from the sharp adjustment during the global crisis—and the gap is now about 6 percent (see the Box table and charts, which report results based on an approach similar to EBA, adding Panama to the EBA sample). However, the MB gap is overestimated as the EBA-like regressions cannot adequately capture the impact on the current account of temporarily high investment, which is expected to increase productivity capacity. Indeed, if one were to base the underlying current account on the medium-term projections (as in CGER) the gap would be much smaller (less than 2 percent of GDP). The ES methodology also points to a smaller CA imbalance. Moreover, a large component of the current account deficit comes from the income payment associated with reinvested earnings from direct investment, strong and fairly stable FDI inflows are expected to continue to finance the bulk of external CA deficits in the coming years (Table 6), external debt is deemed sustainable and fairly resilient to shocks (see Annex II), and the net international investment position has remained fairly stable and mainly financed by inward FDI (Table 10).

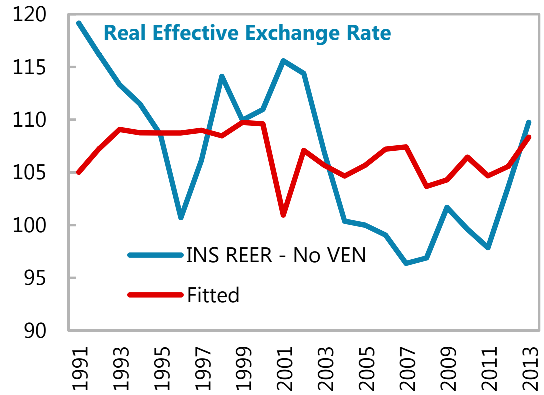
**The REER does not appear misaligned.** The REER (as measured by the INS) depreciated substantially in the early 2000s and has only recently started appreciating with the surge in inflation. When using a methodology similar to EBA, the misalignment appears very small (see the Box table and charts). However, the INS REER index may underestimate the extent of the appreciation in Panama, by assigning an excessive trade weight to Venezuela (10 percent), which has high inflation. When we calculate the REER relative to the set of EBA countries as trading partners (thus excluding Venezuela) and apply a similar methodology, the misalignment remains very small. While a misalignment is not obvious at present, going forward, further real appreciation driven by inflation above trading partners could erode competitiveness.

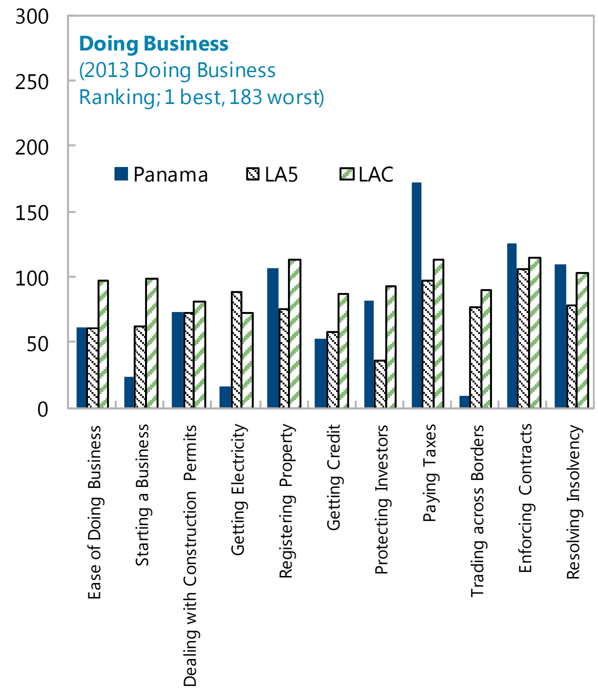
**Survey-based competitiveness rankings improved in recent years, owing in part to ongoing reforms** (see the Box charts**).** Overall, Panama ranks better than most of its peers in South America, except Chile. In terms of competitiveness areas, Panama ranks well on market efficiency, financial development, technological readiness, and infrastructure. However, its rankings in terms of labor market efficiency, access to health care, primary education, and governance are less competitive.

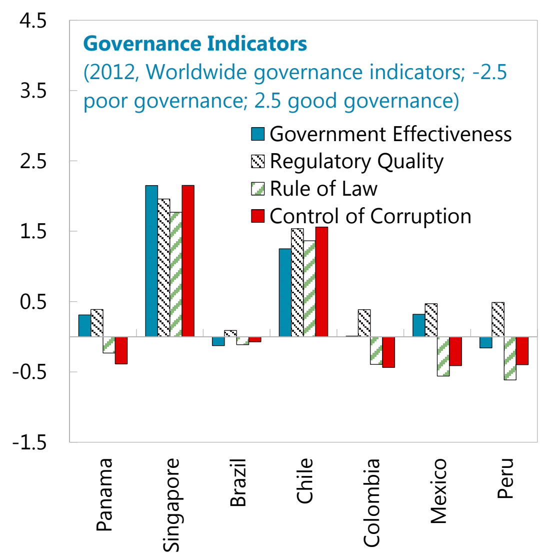
## Box 6. Panama: External Balance Assessment (concluded)




**Global Competitiveness Rankings: Panama, Singapore and LA5 countries (2013)**

| | Panama | Singapore | LA5 | Brazil | Chile | Colombia | Mexico | Peru |
|---|---|---|---|---|---|---|---|---|
| Overall GCI Ranking (2013) | 40 | 2 | 55 | 56 | 34 | 69 | 55 | 61 |
| 2012 Ranking | 40 | 2 | 53 | 48 | 33 | 69 | 53 | 51 |
| *Ranking on Pillars* | | | | | | | | |
| Health and Primary Education | 68 | 2 | 86 | 89 | 74 | 98 | 73 | 95 |
| Higher Education and Training | 68 | 2 | 68 | 72 | 38 | 60 | 85 | 86 |
| Labor Market Efficiency | 75 | 1 | 77 | 92 | 45 | 87 | 113 | 48 |
| Financial Market Developments | 16 | 2 | 46 | 50 | 20 | 63 | 59 | 40 |

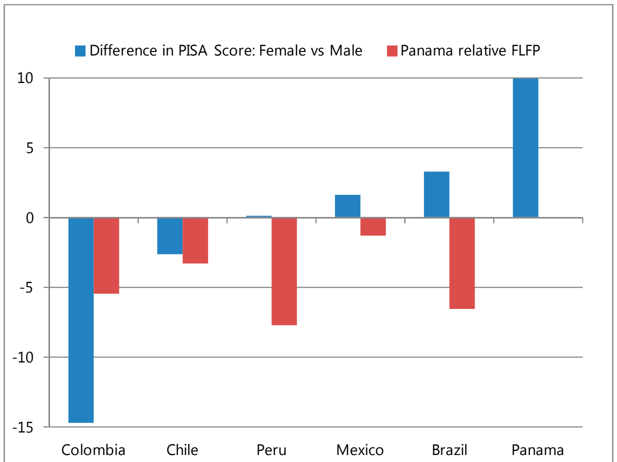
Sources: World Economic Forum, World Bank Doing Business data, Worldwide Governance Indicators, and IMF staff calculations. As pointed out in an independent evaluation of the Doing Business survey (see www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants, which tend to overstate the indicators' coverage and explanatory power.

## Box 7. Panama: Female Labor Force Participation (FLFP)

**Panamanian women make up a little more than half of the population and are relatively better educated, but seem to be under-represented in the labor market.** Only around one-third of labor market participants are women. Furthermore, the probability of longer-than-one-year unemployment is 30 percent for females versus 19 percent for males. However, over 40 percent of the working females have university degrees, while the corresponding ratio for male is only 24 percent. Moreover, the most recent internationally standard PISA test scores, averaged among math, reading, and science tests, indicate that compared to peer countries Panamanian girls enjoy higher test scores than boys, largely in contrast to the fact that Panama is the country that has the fewest women in the labor market. Overall, these numbers suggest that women's limited participation in the labor market is not a reflection of weaker qualifications and lack of education.

| | Female | Male |
|---|---|---|
| **Demographic Characteristics** | | |
| *Share in the population (*)* | **51.5** | **48.5** |
| **Labor Market Statistics** | | |
| *Share of economically active persons (*)* | **39.7** | **60.3** |
| *of which (share relative to own sex):* | | |
| *Government (*)* | 27.8 | 17.3 |
| *Private sector (*)* | 56.4 | 79.7 |
| *Others (*)* | 15.8 | 2.9 |
| *Share of inactive population, relative to own sex* | | |
| *Student (*)* | 21.1 | 45.9 |
| *Retired or pensioned (*)* | 11.6 | 30.4 |
| *Household worker (*)* | 58.4 | 4.1 |
| *Others (*)* | 7.7 | 19.3 |
| *Share of unemployed persons, relative to own sex (**)* | 4.9 | 4.2 |
| *Of which, less than 1 year (**)* | 70.4 | 81.5 |
| *Of which, more than 1 year (**)* | 29.6 | 18.5 |
| **Education Indicators** | | |
| *Share of economically active persons with university degree, relative to own sex (**)* | 40.5 | 23.8 |

Source: (*) National Authorities 2013 August survey and IMF staff calculation. (**) National Authorities 2011 survey. Numbers in bold are relative to the total population.



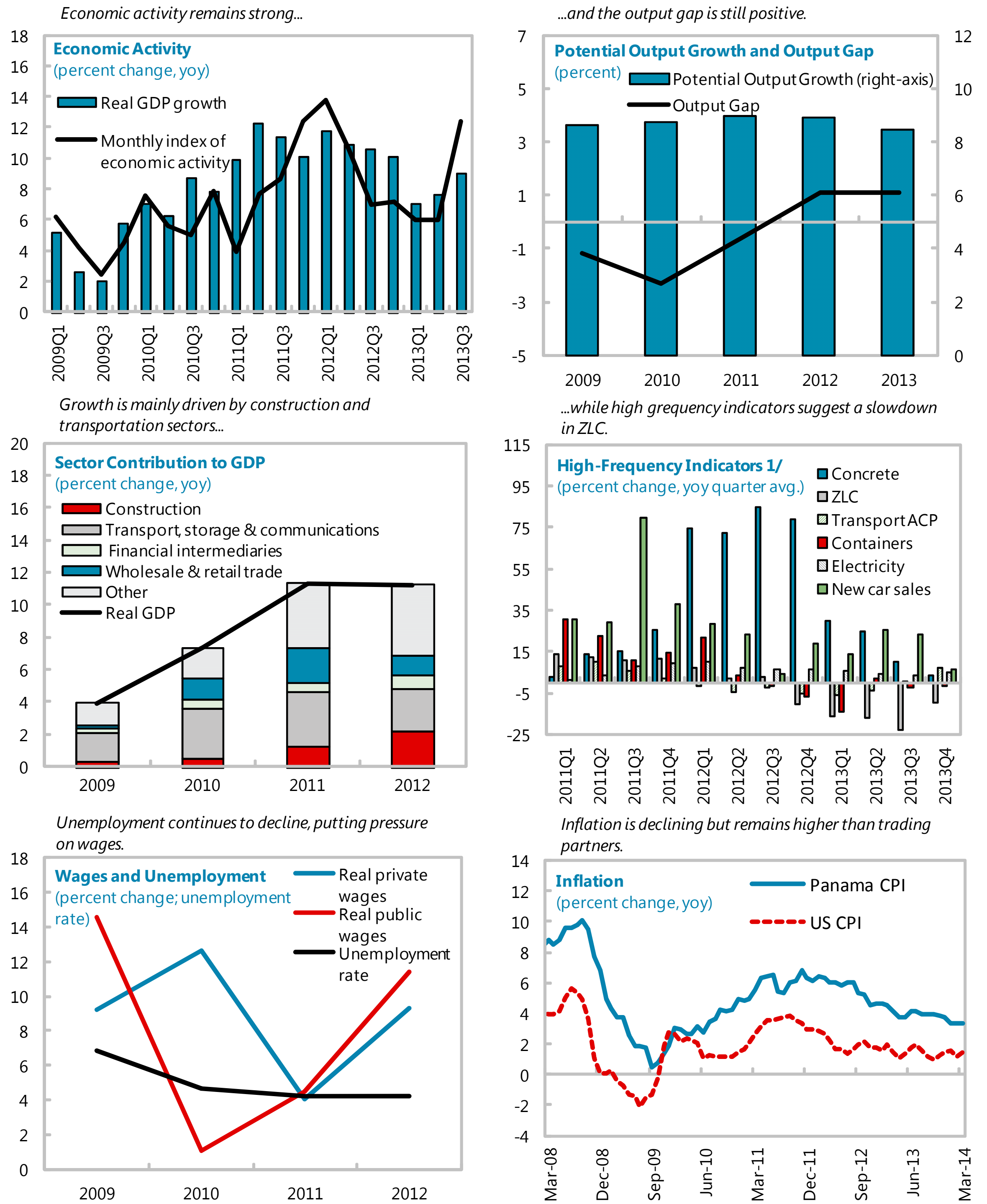

Source: World Development Indicators, 2012. The FLFP rate is shown as the difference between Panama's value (37.2 in 2012) and the one for each country.

**That said, female labor force participation (FLFP) has been rising, and further increases would yield economic and social benefits.** FLFP rose from 35.4 in 2001 to 39.7 in 2013. Going forward, more working females could help relieve the capacity constraint of the Panamanian economy (with unemployment at historically low levels) by enlarging the total labor force. In addition, in light of the discussion above, introducing relatively well educated women into the existing pool of workers may also raise the average labor productivity, which is one of the key factors for sustainable long run growth. Regional studies done by the World Bank also find evidence that higher FLFP significantly helps reducing poverty in Latin America and the Caribbean.[1]

**There are no legal barriers to FLFP, but obstacles common to other countries seem to present.**[2] Child and elderly care tends to keep women from seeking formal employment; indeed female employment in Panama is relatively higher in the public sector which provides more access to child care. Also, over half of the economically inactive females are classified as housewives or working for the household, compared to only 4 percent for inactive males. Other countries' experience also shows that policies aiming at increasing the flexibility of the working arrangement (like flexible hours), and removing labor market distortions in general, often end up boosting female labor market participation.

[1] See World Bank (2012) "The Effect of Women's Economic Power in Latin America and the Caribbean", August.
[2] See Elborgh-Woytek, et al., (2013) "Women, Work and the Economy: Macroeconomic Gains from Gender Equality", IMF staff discussion note, September.

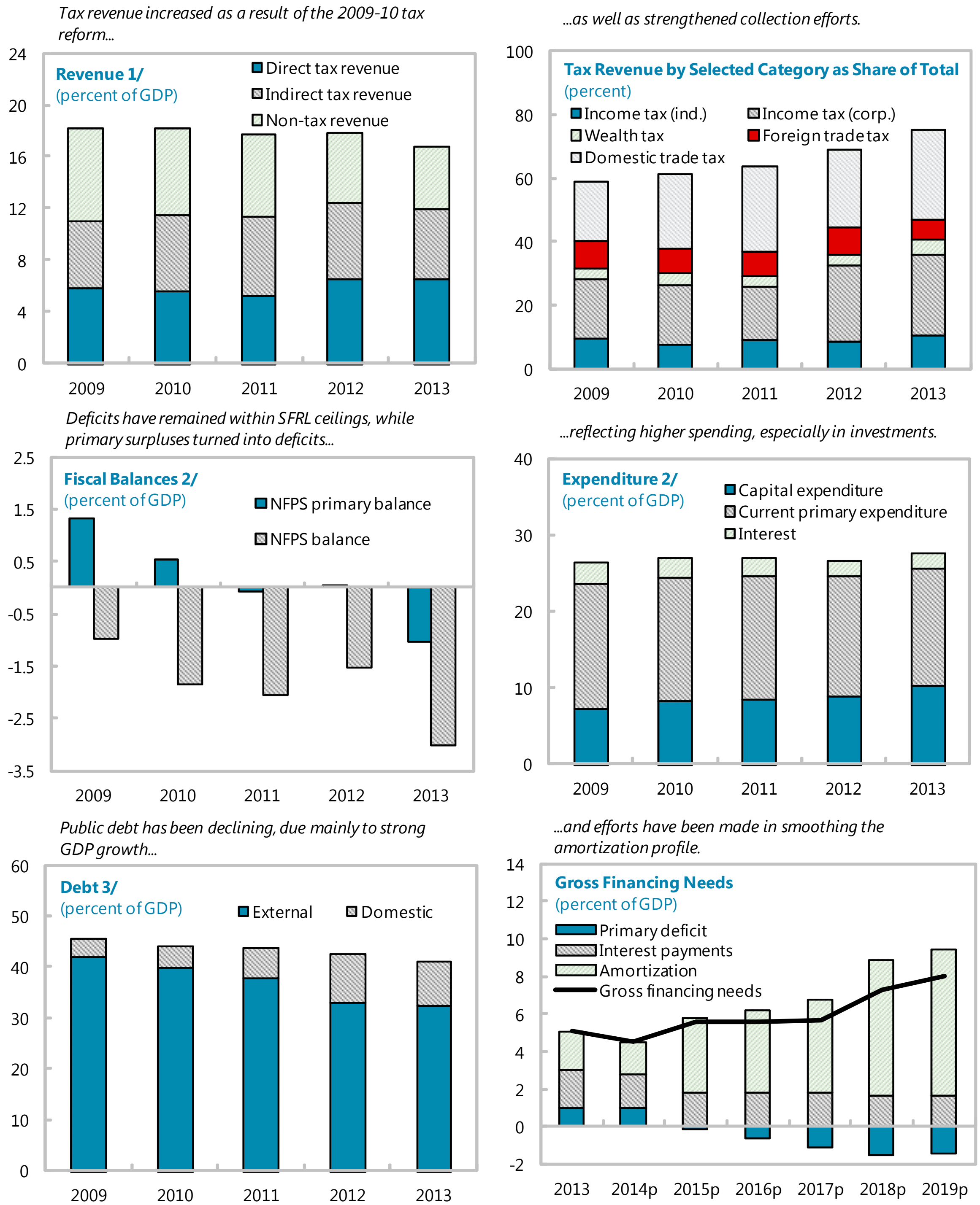
## Figure 1. Panama: Real Sector Developments, 2008–13




Source: National Authorities; and IMF staff calculations.

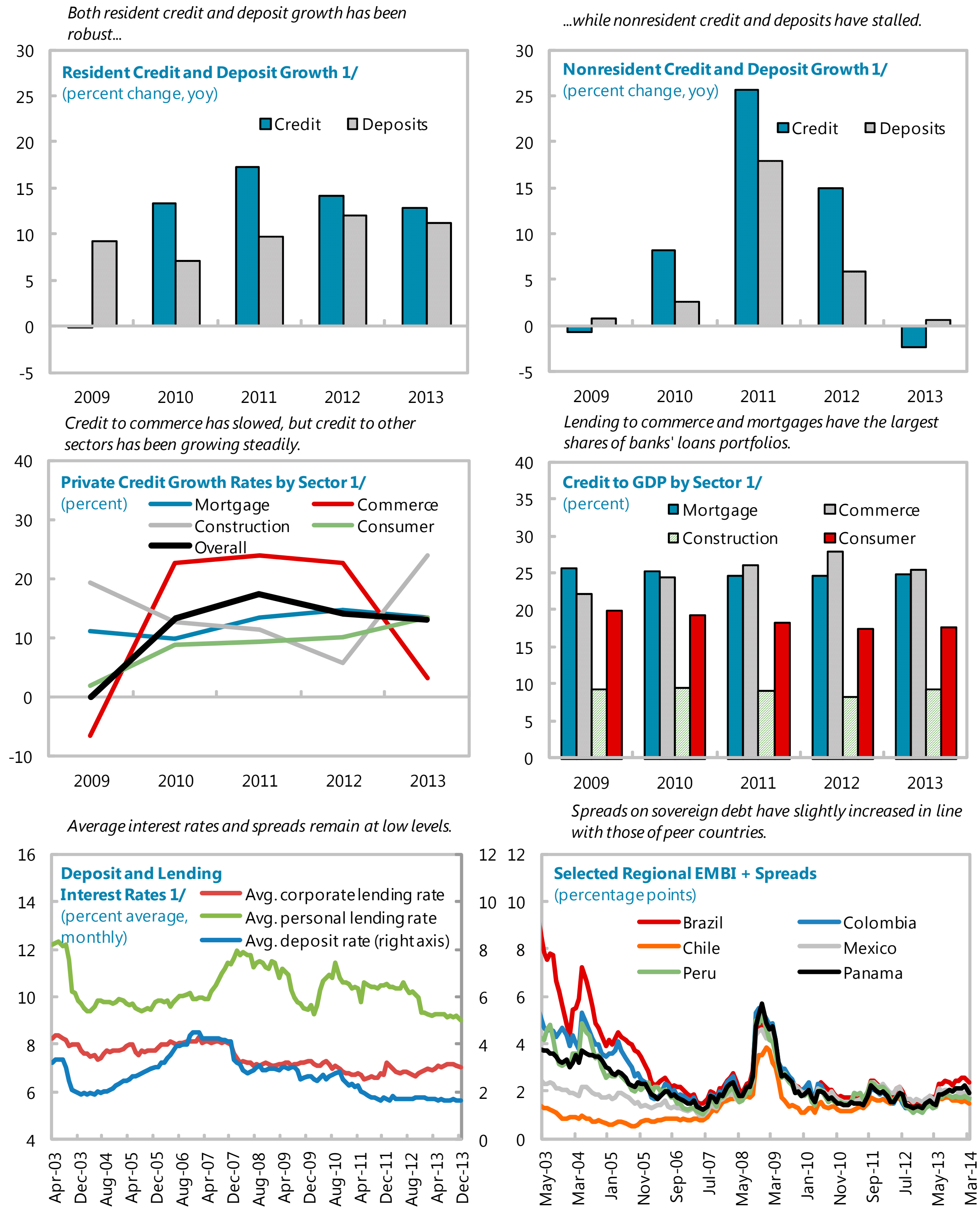
1/ Concrete measured in cubic meters; ZLC in gross metric tons; and electricity consumption in kWh.

## Figure 2. Panama: Fiscal Developments and Projections, 2009–19




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.

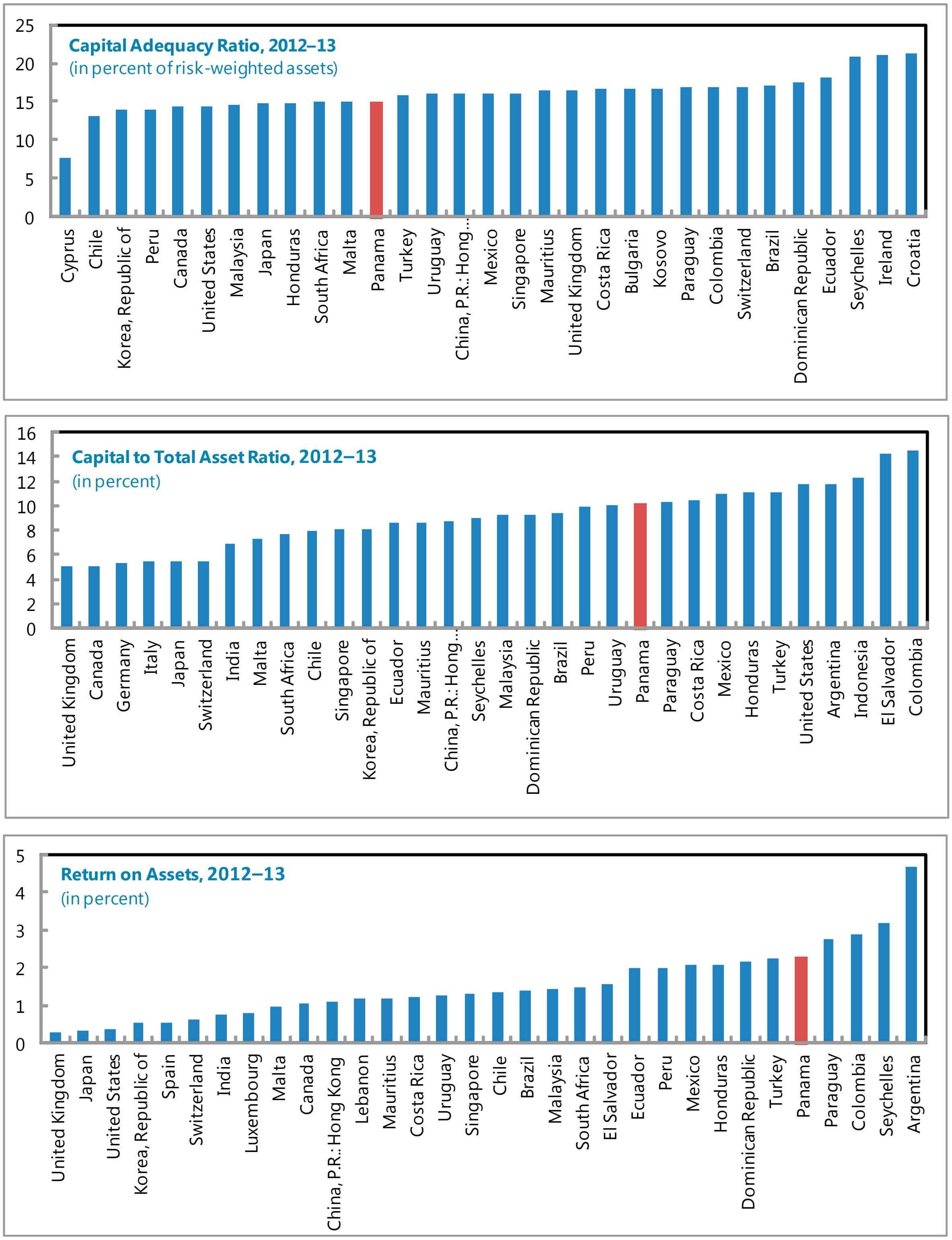
## Figure 3. Panama: Financial Sector Developments, 2003–13




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

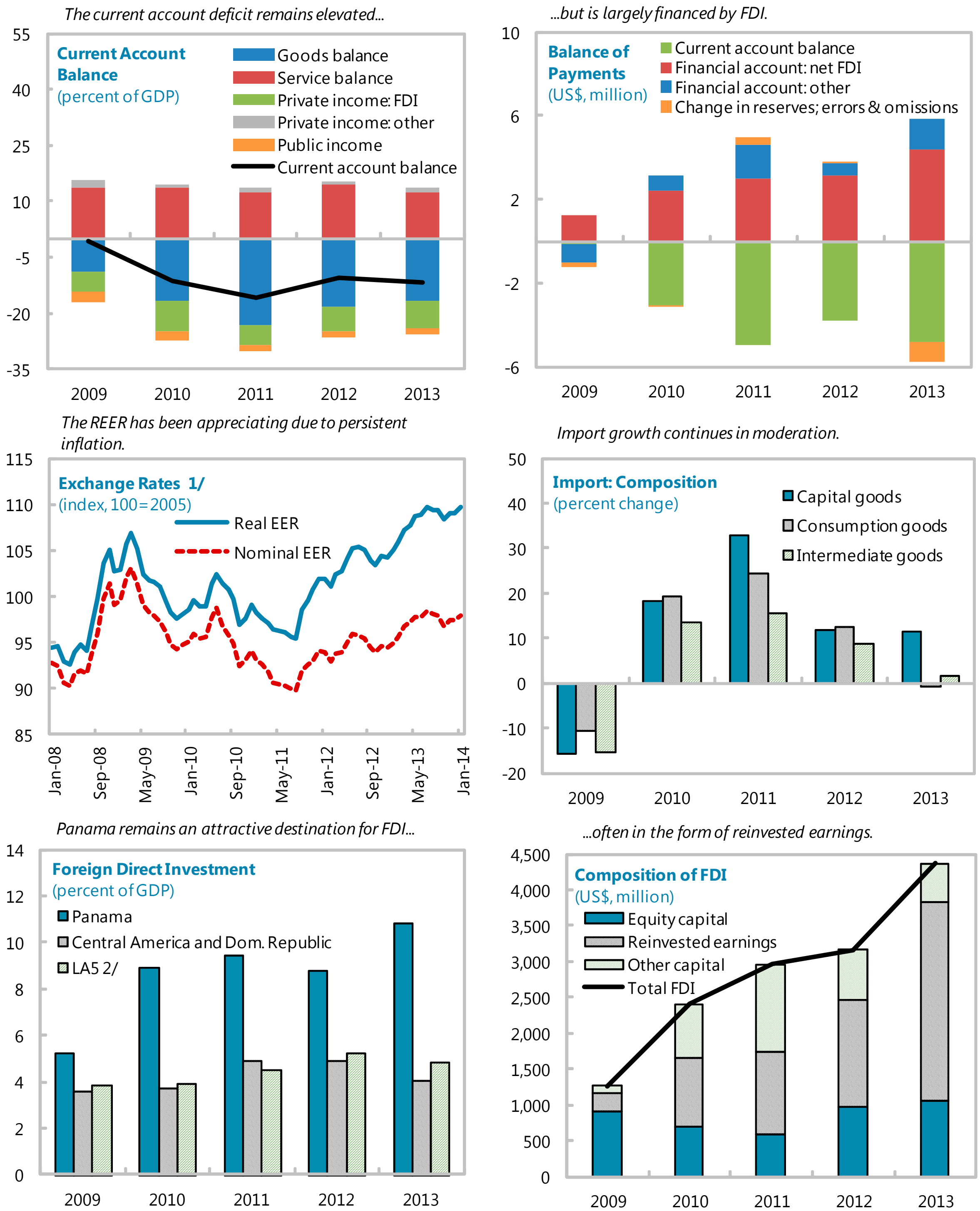
**Figure 3: Panama: Financial Sector Developments, 2003–13 (Concluded)**

*Most banks are well capitalized and profitable.*




Source: IMF *Financial Soundness Indicators* Database.

## Figure 4. Panama: External Sector Developments, 2008–13

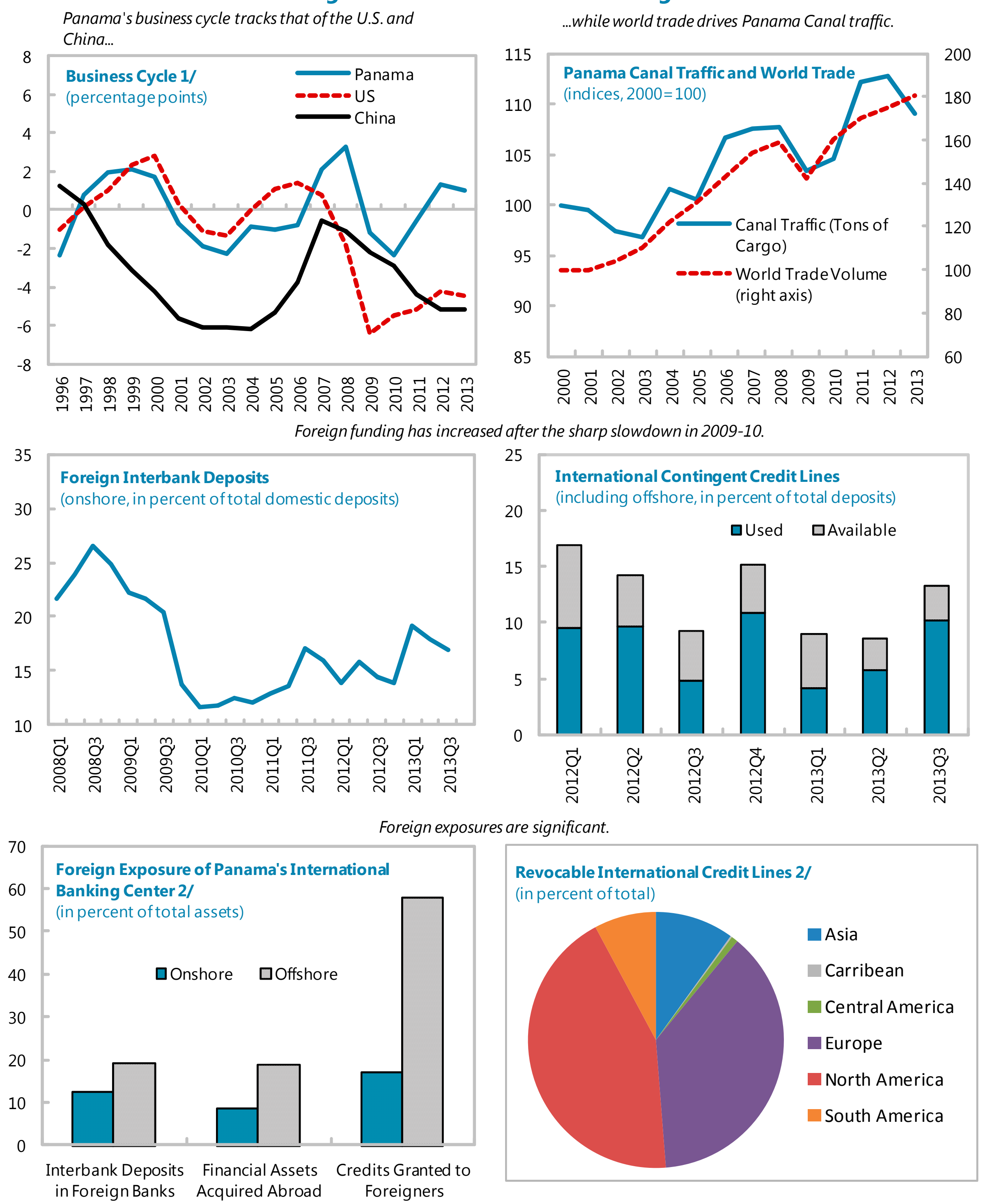



Source: National Authorities; WEO; and IMF staff calculations.

1/ Excluding Venezuela.

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

## Figure 5. Panama: External Linkages



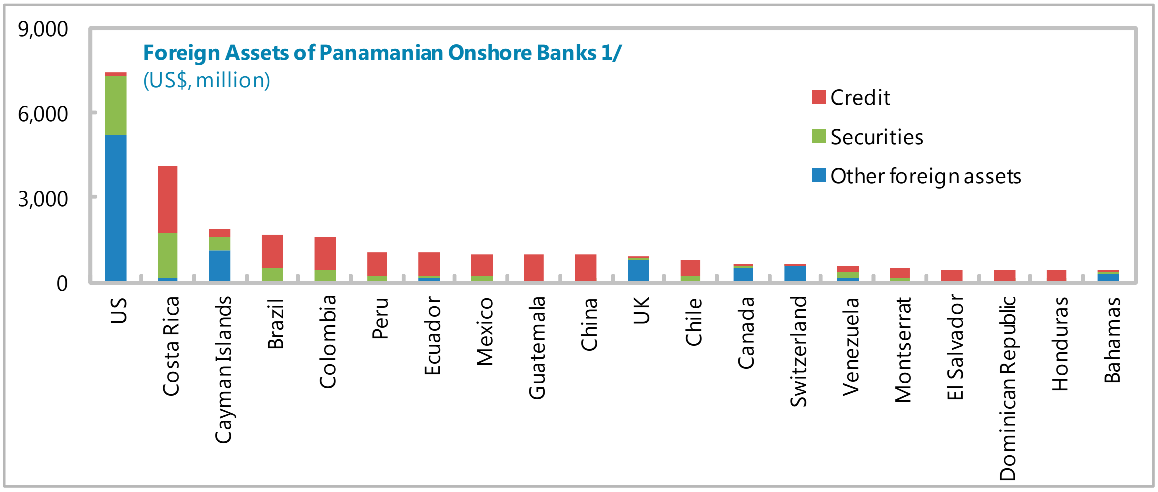

Source: National Authorities; and IMF staff calculations.

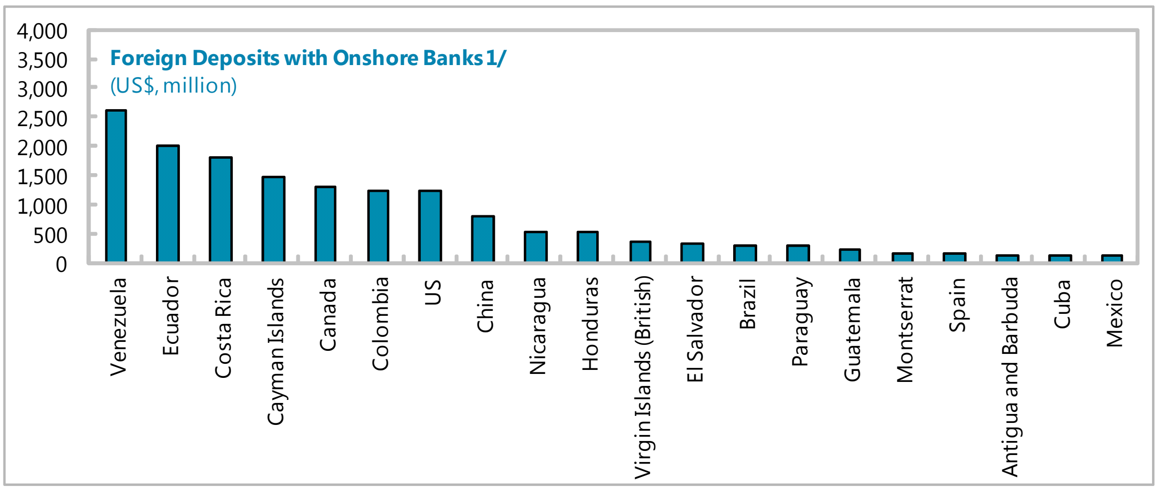
1/ Percentage deviation of real GDP from potential GDP.

2/ As of December 2013.

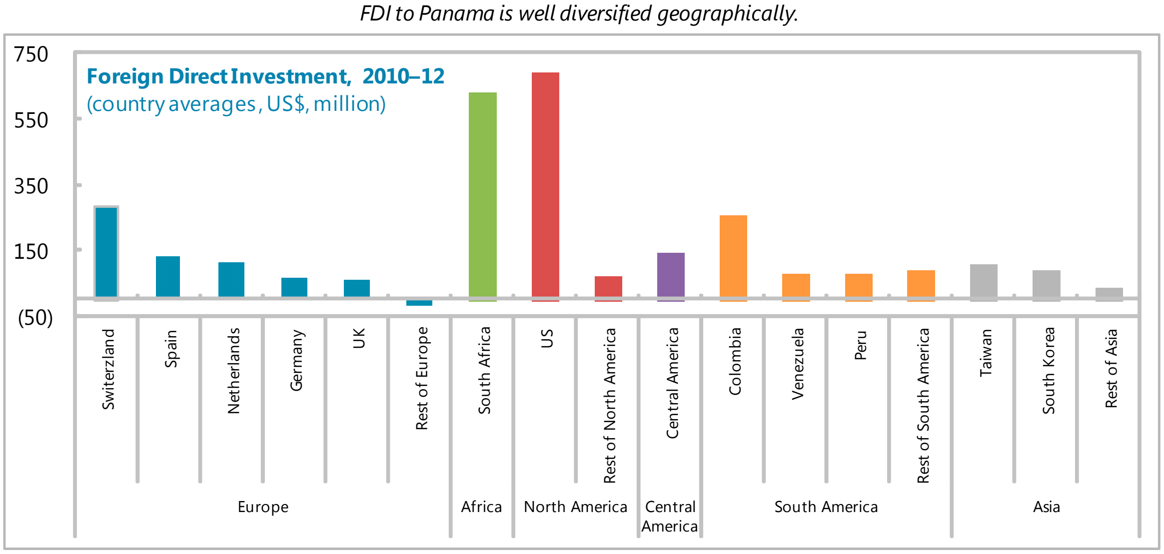
## Figure 5. Panama: External Linkages (Concluded)

*Banking sector exposures reflect Panama's role as a regional banking hub.*



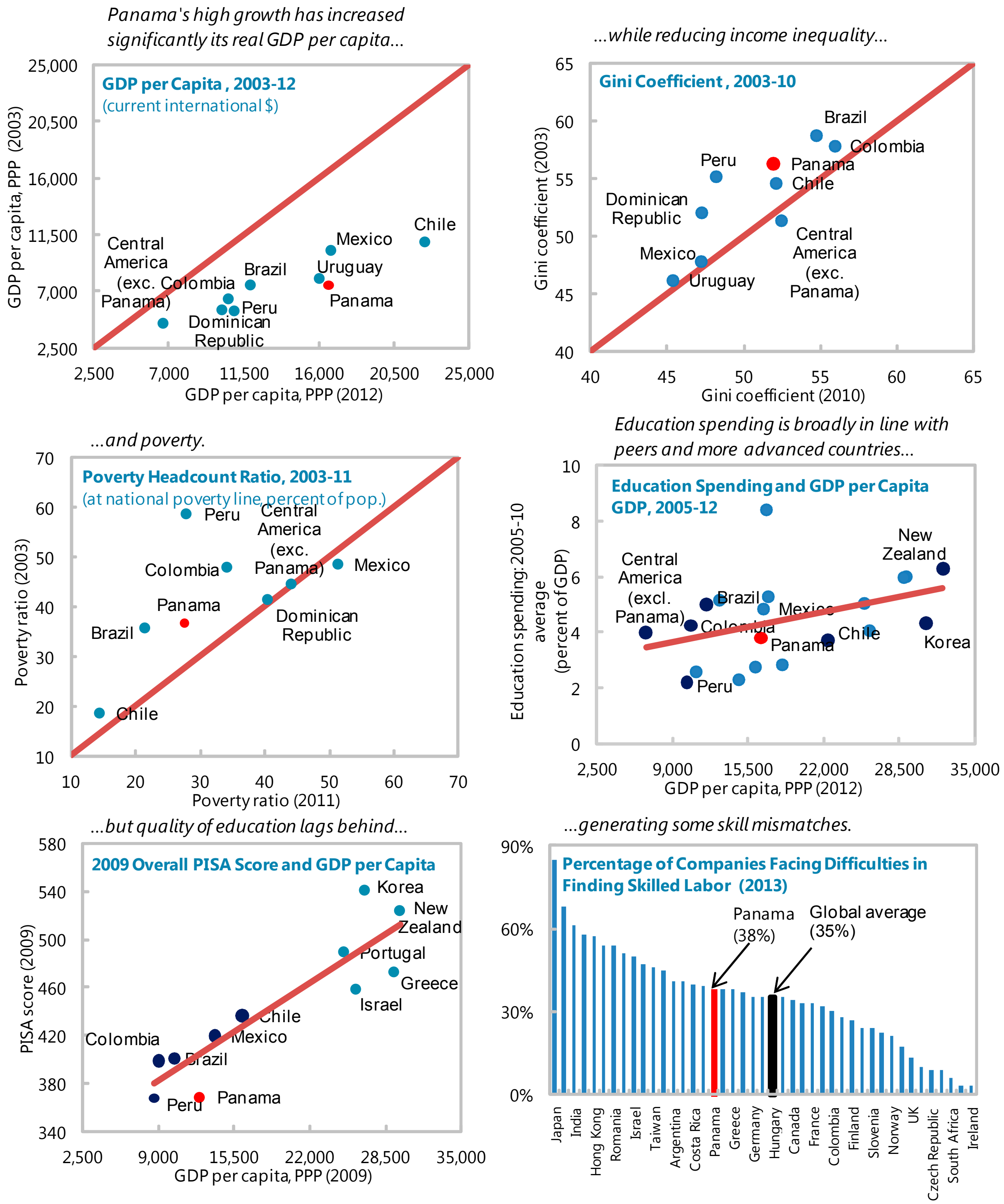




*FDI to Panama is well diversified geographically.*




Source: Panama National Authorities; and IMF staff calculations.
1/ November 2013 data.

## Figure 6. Panama: Social and Labor Market Indicators




Sources: National Authorities; Manpower; World Development Indicators; and IMF staff estimates and calculations.

## Table 1. Panama: Selected Economic and Social Indicators

| | | | |
|---|---|---|---|
| Population (millions, 2012) | 3.8 | Poverty line (percent, 2011) | 27.6 |
| Population growth rate (percent, 2012) | 1.6 | Adult literacy rate (percent, 2010) | 94.0 |
| Life expectancy at birth (years, 2011) | 76.0 | GDP per capita (USD, 2012) | 9,452 |
| Total unemployment (2013) | 4.3 | IMF Quota (SDR, million) | 206.6 |

| | | | | | Est. | Proj. |
|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| | (Percent change) | | | | | |
| Production and prices | | | | | | |
| Real GDP (1996 prices) | 3.9 | 7.5 | 10.9 | 10.8 | 8.4 | 7.2 |
| Consumer price index (average) | 2.4 | 3.5 | 5.9 | 5.7 | 4.0 | 3.8 |
| Consumer price index (end-of-year) | 1.9 | 4.9 | 6.3 | 4.6 | 3.7 | 3.6 |
| Domestic demand (at constant prices) | | | | | | |
| Public consumption | 4.1 | 15.3 | 4.4 | 3.0 | 4.9 | 12.9 |
| Private consumption | -2.8 | 27.4 | 7.1 | 7.3 | 11.8 | 7.9 |
| Public investment 1/ | 4.8 | 23.3 | 34.9 | 26.4 | 14.0 | 0.3 |
| Private investment | -9.7 | 5.9 | 11.8 | 9.7 | 11.9 | 11.0 |
| Financial sector | | | | | | |
| Private sector credit | 1.3 | 13.6 | 16.8 | 14.1 | 12.6 | 11.3 |
| Broad money | 9.4 | 11.6 | 7.8 | 10.4 | 8.8 | 11.1 |
| Average deposit rate (1-year) | 2.8 | 2.9 | 2.1 | 2.2 | 2.1 | … |
| Average lending rate (1-year) | 7.5 | 7.5 | 6.9 | 7.2 | 7.2 | … |
| External trade | | | | | | |
| Merchandise exports | -37.1 | 12.8 | 29.4 | 36.2 | -8.3 | 5.2 |
| Merchandise imports | -16.1 | 18.9 | 42.3 | 6.8 | 6.2 | 7.4 |
| | (In percent of GDP) | | | | | |
| Saving-investment balance | | | | | | |
| Gross domestic investment | 25.6 | 25.5 | 27.2 | 28.6 | 30.0 | 29.8 |
| Public sector | 7.9 | 12.0 | 12.8 | 12.9 | 13.6 | 12.8 |
| Private sector | 17.7 | 13.5 | 14.4 | 15.7 | 16.4 | 17.0 |
| Gross national saving | 24.9 | 14.2 | 11.3 | 18.0 | 18.1 | 19.0 |
| Public sector | 8.4 | 8.0 | 8.1 | 7.8 | 7.5 | 6.9 |
| Private sector | 16.5 | 6.2 | 3.2 | 10.2 | 10.6 | 12.2 |
| Public finances 1/ | | | | | | |
| Revenue and grants | 30.3 | 29.5 | 29.0 | 28.9 | 28.0 | 27.8 |
| Expenditure | 29.2 | 33.0 | 33.4 | 32.2 | 33.0 | 32.7 |
| Current, including interest | 21.3 | 21.0 | 20.6 | 20.1 | 19.4 | 19.9 |
| Capital | 7.9 | 12.0 | 12.8 | 12.1 | 13.6 | 12.8 |
| Overall balance, including ACP | 1.0 | -3.5 | -4.4 | -3.3 | -5.0 | -4.8 |
| Overall balance, excluding ACP | -1.0 | -1.8 | -2.1 | -1.5 | -3.0 | -3.0 |
| External sector | | | | | | |
| Current account | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 |
| Net exports from Colon Free Zone | 8.0 | 1.8 | 0.8 | 1.5 | 3.4 | 2.1 |
| Net oil imports | 0.8 | 1.0 | 1.4 | 0.2 | 0.3 | 0.6 |
| Foreign direct investment | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 |
| Total public debt | | | | | | |
| Total debt 1/ | 45.4 | 44.1 | 43.8 | 42.6 | 41.1 | 41.3 |
| External 1/ | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 |
| Domestic | 3.4 | 4.4 | 6.1 | 9.7 | 8.9 | 8.9 |
| Memorandum items: | | | | | | |
| GDP (in millions of US$) | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 |

Sources: Comptroller General, Superintendency of Banks and IMF staff estimates.
1/ Includes Panama Canal Authority (ACP).

## Table 2. Panama: Summary Operations of the Non-Financial Public Sector 1/
(In percent of GDP)

| | 2009 | 2010 | 2011 | 2012 | 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| Revenues | 25.4 | 25.2 | 24.8 | 25.1 | 24.5 | 24.5 |
| Current revenue | 25.7 | 25.4 | 25.2 | 25.0 | 24.0 | 24.0 |
| Tax revenue | 10.9 | 11.4 | 11.3 | 12.4 | 12.0 | 12.0 |
| Nontax revenue of central government | 7.2 | 6.7 | 6.4 | 5.5 | 4.8 | 5.1 |
| *o/w:* Panama Canal fees and dividends | 3.2 | 3.0 | 3.3 | 2.7 | 2.4 | 2.5 |
| Social security agency | 5.7 | 6.1 | 6.5 | 6.1 | 6.6 | 6.3 |
| Public enterprises' operating balance | 0.9 | 0.7 | 0.5 | 0.4 | 0.3 | 0.3 |
| Other 2/ | 1.0 | 0.5 | 0.5 | 0.6 | 0.4 | 0.4 |
| Capital revenue | 0.3 | 0.5 | 0.1 | 0.1 | 0.4 | 0.4 |
| Expenditure | 26.4 | 27.0 | 26.9 | 26.6 | 27.5 | 27.5 |
| Current primary expenditure | 16.2 | 16.1 | 16.1 | 15.8 | 15.3 | 15.9 |
| Central government 3/ | 8.5 | 8.8 | 9.2 | 9.4 | 8.8 | 9.3 |
| Rest of the general government | 7.7 | 7.3 | 6.8 | 6.4 | 6.5 | 6.6 |
| Social security agency | 6.9 | 6.7 | 6.2 | 5.8 | 6.0 | 6.1 |
| Decentralized agencies | 0.8 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 |
| Interest | 2.9 | 2.6 | 2.4 | 2.1 | 2.0 | 2.0 |
| Capital | 7.3 | 8.3 | 8.4 | 8.7 | 10.1 | 9.5 |
| Overall balance, excluding ACP | -1.0 | -1.8 | -2.1 | -1.5 | -3.0 | -3.0 |
| Panama Canal Authority (ACP) | | | | | | |
| Revenue | 8.1 | 7.3 | 7.4 | 6.7 | 6.0 | 5.9 |
| Current expenditure | 2.2 | 2.2 | 2.0 | 2.0 | 1.7 | 1.7 |
| Transfers to the government | 3.2 | 3.0 | 3.2 | 2.8 | 2.4 | 2.5 |
| Interest payments | 0.0 | 0.0 | 0.1 | 0.2 | 0.3 | 0.3 |
| Capital expenditure | 0.6 | 3.7 | 4.3 | 3.4 | 3.5 | 3.2 |
| Overall balance | 2.0 | -1.7 | -2.3 | -1.7 | -2.0 | -1.8 |
| Overall balance, including ACP | 1.0 | -3.5 | -4.4 | -3.3 | -5.0 | -4.8 |
| Net financing, excluding ACP | 1.0 | 2.1 | 2.3 | 1.4 | 3.0 | 3.0 |
| External | 8.9 | 1.7 | 1.3 | 0.2 | 2.8 | 2.1 |
| Domestic | -7.9 | 0.4 | 0.9 | 1.1 | 0.3 | 0.9 |
| Memorandum items: | | | | | | |
| Primary balance (including ACP) | 2.3 | -2.5 | -3.1 | -2.5 | -3.1 | -2.9 |
| Primary balance (excluding ACP) | 1.3 | 0.5 | -0.1 | 0.0 | -1.0 | -1.2 |
| Structural primary balance (excluding ACP) 4/ | 1.6 | 1.1 | 0.1 | -0.3 | -1.3 | -1.3 |

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/ Structural primary balance adjusted for output gap.

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

| | 2009 | 2010 | 2011 | 2012 | 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| Revenues and grants | 18.5 | 18.6 | 17.8 | 17.9 | 17.1 | 17.4 |
| Current revenue | 18.1 | 18.1 | 17.7 | 17.9 | 16.8 | 17.0 |
| Taxes | 10.9 | 11.4 | 11.3 | 12.4 | 12.0 | 12.0 |
| Direct taxes | 5.8 | 5.6 | 5.3 | 6.5 | 6.5 | 6.5 |
| Income tax | 5.2 | 4.9 | 4.6 | 5.8 | 5.8 | 5.8 |
| Tax on wealth | 0.6 | 0.7 | 0.6 | 0.7 | 0.7 | 0.7 |
| Indirect taxes | 5.1 | 5.8 | 6.1 | 5.9 | 5.5 | 5.5 |
| Import tax | 1.6 | 1.4 | 1.3 | 1.5 | 1.0 | 1.0 |
| ITBMS | 2.3 | 3.1 | 3.3 | 3.0 | 3.1 | 3.1 |
| Petroleum products | 0.5 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 |
| Other tax on domestic transactions | 0.7 | 1.0 | 1.2 | 1.1 | 1.1 | 1.1 |
| Nontax revenue | 7.2 | 6.7 | 6.4 | 5.5 | 4.8 | 5.1 |
| Dividends | 2.7 | 2.7 | 3.0 | 2.5 | 2.2 | 2.5 |
| *Of which*: Panama Canal Authority | 1.8 | 1.7 | 2.2 | 1.8 | 1.5 | 1.7 |
| Panama Canal Authority: fees per ton 1/ | 1.4 | 1.3 | 1.2 | 0.9 | 0.9 | 0.8 |
| Transfers from decentralized agencies | 1.6 | 1.6 | 1.0 | 0.7 | 0.6 | 0.6 |
| Other | 1.4 | 1.2 | 1.2 | 1.4 | 1.0 | 1.2 |
| Capital revenue | 0.3 | 0.4 | 0.0 | 0.0 | 0.3 | 0.3 |
| Grants | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| Total expenditure | 19.9 | 20.5 | 21.4 | 21.6 | 21.5 | 21.3 |
| Current | 13.6 | 13.2 | 13.3 | 12.6 | 12.0 | 12.4 |
| Wages and salaries | 3.7 | 4.1 | 4.5 | 4.4 | 4.4 | 4.8 |
| Goods and services | 1.7 | 1.7 | 3.6 | 1.8 | 1.7 | 1.7 |
| Current expenditure of CSS | 1.6 | 1.0 | 1.0 | 0.6 | 0.6 | 0.5 |
| Transfers to public and private entities | 3.1 | 3.3 | 1.8 | 3.7 | 3.3 | 3.3 |
| Interest | 2.9 | 2.6 | 2.3 | 2.1 | 2.0 | 2.0 |
| Domestic | 0.4 | 0.1 | 0.2 | 0.3 | 0.4 | 0.5 |
| External | 2.6 | 2.5 | 2.2 | 1.8 | 1.7 | 1.5 |
| Capital | 6.3 | 7.3 | 8.0 | 9.0 | 9.5 | 9.0 |
| Savings 2/ | 4.6 | 5.0 | 4.4 | 5.3 | 4.8 | 4.7 |
| Overall balance | -1.4 | -1.9 | -3.6 | -3.7 | -4.4 | -4.0 |
| Financing (net) | 1.4 | 1.9 | 3.6 | 3.6 | 4.4 | 4.0 |
| External | 6.5 | 1.1 | 1.3 | 0.2 | 2.8 | 2.1 |
| Domestic | -5.1 | 0.8 | 2.2 | 3.3 | 1.6 | 1.9 |
| Memorandum items: | | | | | | |
| Primary balance | 1.5 | 0.7 | -1.2 | -1.7 | -2.4 | -1.9 |
| GDP (in millions of US$) | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 |

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes public service fees.
2/ Revenues and grants less current expenditure.

## Table 4. Panama: Monetary Accounts 1/

| | 2009 | 2010 | 2011 | 2012 | Est. 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| | (In millions of U.S. dollars at end-period) | | | | | |
| Net foreign assets | 8,632 | 8,529 | 7,259 | 5,847 | 5,829 | 6,534 |
| Short-term foreign assets, net | 8,637 | 8,532 | 7,261 | 5,849 | 5,831 | 6,536 |
| National Bank of Panama | 3,406 | 2,945 | 2,665 | 2,307 | 3,038 | 3,388 |
| Rest of banking system | 5,231 | 5,586 | 4,597 | 3,542 | 2,793 | 3,148 |
| Long-term foreign liabilities | 5 | 2 | 2 | 2 | 2 | 2 |
| National Bank of Panama | 5 | 2 | 2 | 2 | 2 | 2 |
| Rest of banking system | 0 | 0 | 0 | 0 | 0 | 0 |
| Net domestic assets | 13,735 | 16,334 | 19,115 | 23,306 | 26,284 | 29,144 |
| Public sector (net credit) | -3,265 | -2,745 | -3,636 | -3,575 | -5,366 | -6,103 |
| Central government (net credit) | -672 | -707 | -550 | 311 | -781 | -695 |
| Rest of the public sector (net credit) | -2,593 | -2,038 | -3,086 | -3,886 | -4,585 | -5,408 |
| Private sector credit | 21,514 | 24,448 | 28,553 | 32,590 | 36,685 | 40,840 |
| Private capital and surplus | -5,573 | -6,438 | -6,931 | -6,856 | -7,129 | -7,921 |
| Other assets (net) | 1,058 | 1,068 | 1,129 | 1,147 | 2,095 | 2,329 |
| Domestic liabilities to private sector | 22,240 | 24,813 | 26,755 | 29,542 | 32,149 | 35,719 |
| Total deposits | 22,073 | 24,699 | 26,666 | 29,501 | 32,113 | 35,679 |
| Demand deposits | 4,366 | 5,188 | 6,227 | 7,067 | 7,693 | 8,547 |
| Time deposits | 13,145 | 14,034 | 13,864 | 15,174 | 16,485 | 18,315 |
| Savings deposits | 4,562 | 5,477 | 6,574 | 7,260 | 7,936 | 8,817 |
| Bonds | 167 | 114 | 89 | 41 | 36 | 40 |
| | (12-month change in relation to liabilities to the private sector at the beginning of the period) | | | | | |
| Net foreign assets | 12.7 | -0.5 | -5.1 | -5.3 | -0.1 | 2.2 |
| Net domestic assets | -3.2 | 11.7 | 11.2 | 15.7 | 10.1 | 8.9 |
| Public sector credit (net) | -3.9 | 2.3 | -3.6 | 0.2 | -6.1 | -2.3 |
| Private sector credit | 1.3 | 13.2 | 16.5 | 15.1 | 13.9 | 12.9 |
| Private capital and surplus | -4.2 | 3.9 | 2.0 | -0.3 | 0.9 | 2.5 |
| Other assets (net) | -4.7 | 0.0 | 0.2 | 0.1 | 3.2 | 0.7 |
| Liabilities to the private sector | 9.4 | 11.6 | 7.8 | 10.4 | 8.8 | 11.1 |
| Memorandum items: | | | | | | |
| | (12-month percent change) | | | | | |
| M2 2/ | 9.4 | 11.6 | 7.8 | 10.4 | 8.8 | 11.1 |
| Private sector credit | 1.3 | 13.6 | 16.8 | 14.1 | 12.6 | 11.3 |
| | (In percent of GDP) | | | | | |
| Onshore banks | | | | | | |
| Domestic private sector credits | 89.0 | 90.4 | 91.2 | 90.7 | 90.6 | 90.8 |
| Foreign credits | 36.7 | 35.4 | 38.4 | 38.5 | 33.0 | … |
| Domestic private sector deposits | 91.4 | 91.3 | 85.1 | 82.1 | 79.3 | 79.3 |
| Government deposits | 16.3 | 11.8 | 14.0 | 14.2 | 15.4 | … |
| *Of which* , central government | 5.0 | 4.0 | 3.9 | 3.4 | 4.0 | … |
| Foreign deposits | 54.6 | 49.9 | 50.9 | 46.9 | 42.1 | … |
| Offshore banks | | | | | | |
| Credits | 27.6 | 34.9 | 32.3 | 26.9 | 26.7 | … |
| Deposits | 34.0 | 26.5 | 26.5 | 26.4 | 26.2 | … |

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 resident 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)

| | 2009 | 2010 | 2011 | 2012 | 2013 | | | | LA5 6/ |
|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Dec. | Dec. | Mar. | June | Sept. | Dec. | Dec. 2012 |
| Asset quality | | | | | | | | | |
| Nonperforming loans as percent of total loans 2/ | | | | | | | | | |
| Banking system | 1.4 | 1.9 | 1.6 | 1.1 | 1.1 | 1.1 | 1.2 | 1.4 | 2.8 |
| Domestic banks | 1.3 | 1.9 | 1.7 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 | |
| Foreign banks | 1.5 | 1.9 | 1.5 | 1.0 | 0.9 | 0.9 | 1.0 | 1.0 | |
| Ratio of provisions to nonperforming loans | | | | | | | | | |
| Banking system | 120.0 | 139.6 | 160.7 | 178.2 | 194.5 | 172.6 | 168.7 | 171.5 | n.a. |
| Domestic banks | 150.3 | 160.2 | 157.7 | 183.2 | 173.4 | 152.1 | 140.3 | 158.7 | |
| Foreign banks | 99.6 | 124.1 | 152.8 | 160.2 | 197.7 | 186.1 | 185.7 | 173.1 | |
| Profitability | | | | | | | | | |
| Net income on average assets | | | | | | | | | |
| Banking system 3/ | 1.4 | 1.0 | 1.7 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 | 2.0 |
| Domestic banks | 1.4 | 0.0 | 1.5 | 1.6 | 1.6 | 1.6 | 1.4 | 1.4 | |
| Foreign banks | 1.4 | 2.0 | 1.9 | 1.5 | 1.4 | 1.4 | 1.4 | 1.4 | |
| Liquidity 4/ | | | | | | | | | |
| Ratio of liquid assets to total deposits | | | | | | | | | |
| Banking system | 28.4 | 25.2 | 23.5 | 22.6 | 20.4 | 21.2 | 21.6 | 23.9 | 20.2 |
| Domestic banks | 27.6 | 27.4 | 23.5 | 22.8 | 20.5 | 23.1 | 21.6 | 22.6 | |
| Foreign banks | 29.3 | 23.1 | 23.5 | 22.4 | 20.2 | 19.2 | 21.5 | 25.5 | |
| Ratio of liquid assets plus marketable securities to total deposits 5/ | | | | | | | | | |
| Banking system | 42.9 | 40.0 | 37.9 | 34.4 | 32.5 | 33.2 | 33.1 | 34.2 | n.a. |
| Domestic banks | 39.9 | 38.3 | 34.4 | 31.9 | 30.3 | 32.6 | 31.1 | 31.9 | |
| Foreign banks | 45.7 | 41.7 | 41.4 | 37.1 | 34.7 | 33.8 | 35.2 | 39.5 | |
| Capital adequacy ratios | | | | | | | | | |
| Ratio of capital to risk-weighted assets | | | | | | | | | |
| Banking system | 16.4 | 16.3 | 15.5 | 15.7 | 15.8 | 15.3 | 15.4 | 14.8 | 15.6 |
| Domestic banks | 18.4 | 19.1 | 17.6 | 16.9 | 16.7 | 16.6 | 16.4 | 15.9 | |
| Foreign banks | 15.3 | 14.7 | 14.3 | 14.7 | 14.9 | 14.3 | 14.6 | 13.7 | |
| Ratio of capital to total assets | | | | | | | | | |
| Banking system | 11.7 | 12.2 | 11.7 | 10.6 | 10.4 | 10.2 | … | … | 10.6 |
| Ownership | | | | | | | | | |
| Foreign banks' share of domestic banking system assets | 53.9 | 53.1 | 53.3 | 51.7 | 53.0 | 52.0 | 51.7 | 49.7 | n.a. |

Sources: Superintendency of Banks; and IMF staff calculations.

1/ Domestic banking system only, comprises general license banks; does not include offshore banks.
2/ For Panama, NPLs are calculated as the sum of the following category loans: substandard, doubtful and loss.
3/ For Panama, a simple average of domestic private banks and state-owned banks.
4/ Liquid assets to total assets.
5/ For Panama, liquid assets, as defined in Article 75 of the 2008 Banking Law, also include marketable short-term securities (*Indice de Liquidez Financiera - Metodología del Cálculo)* .
6/ LA5 includes Brazil, Chile, Colombia, Mexico and Peru. The source is IMF FSI database (may not be fully comparable with Panama figures).

## Table 6. Panama: Medium-Term Balance of Payments

| | 2009 | 2010 | 2011 | 2012 | 2013 | Proj. 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | (In millions of U.S. dollars) | | | | | | | | | | |
| Current account | -163 | -3,076 | -4,993 | -3,816 | -4,805 | -4,837 | -5,349 | -4,966 | -5,329 | -5,129 | -5,094 |
| Trade balance excluding Colón Free Zone | -4,123 | -5,035 | -7,480 | -7,066 | -8,124 | -8,808 | -9,473 | -10,167 | -10,894 | -11,455 | -12,225 |
| Exports, f.o.b. | 2,154 | 2,430 | 3,145 | 4,284 | 3,928 | 4,131 | 4,396 | 4,730 | 5,123 | 5,545 | 5,989 |
| Imports, f.o.b. | -6,277 | -7,465 | -10,624 | -11,350 | -12,052 | -12,940 | -13,870 | -14,897 | -16,018 | -17,000 | -18,213 |
| Net exports from Colón Free Zone | 1,940 | 492 | 263 | 526 | 1,372 | 931 | 840 | 898 | 965 | 1,039 | 1,117 |
| Re-exports, f.o.b. | 9,883 | 10,245 | 13,782 | 14,588 | 13,577 | 14,441 | 15,394 | 16,513 | 17,766 | 19,136 | 20,588 |
| Imports, f.o.b. | -7,943 | -9,753 | -13,519 | -14,063 | -12,204 | -13,510 | -14,553 | -15,615 | -16,801 | -18,096 | -19,471 |
| Services, net | 3,330 | 3,549 | 3,933 | 5,164 | 5,052 | 5,849 | 6,442 | 7,704 | 8,531 | 9,363 | 10,149 |
| Travel, net | 1,146 | 1,279 | 2,144 | 2,562 | 2,487 | 2,697 | 2,970 | 3,311 | 3,712 | 4,156 | 4,630 |
| Transportation, net | 1,928 | 1,890 | 1,738 | 2,448 | 2,614 | 3,205 | 3,530 | 4,455 | 4,887 | 5,281 | 5,600 |
| Other services | 256 | 381 | 51 | 154 | -49 | -53 | -57 | -62 | -68 | -74 | -81 |
| Income, net | -1,463 | -2,548 | -1,979 | -2,565 | -3,119 | -2,780 | -3,128 | -3,366 | -3,892 | -4,035 | -4,091 |
| Private sector | -858 | -1,913 | -1,377 | -1,968 | -2,486 | -2,019 | -2,275 | -2,531 | -2,791 | -3,048 | -3,321 |
| *Of which: Direct Investment* | -1,301 | -2,166 | -1,695 | -2,354 | -2,998 | -2,524 | -2,776 | -3,033 | -3,301 | -3,573 | -3,864 |
| Public sector | -605 | -635 | -603 | -598 | -634 | -761 | -853 | -835 | -1,102 | -987 | -770 |
| *Of which: NFPS interest* | -647 | -711 | -644 | -929 | -799 | -768 | -860 | -842 | -1,109 | -995 | -778 |
| Current transfers, net | 126 | 138 | 202 | 94 | -25 | -28 | -31 | -34 | -37 | -40 | -44 |
| Capital and financial account | 357 | 3,154 | 4,568 | 3,752 | 5,807 | 5,187 | 5,716 | 5,339 | 5,715 | 5,521 | 5,515 |
| Financial account | 357 | 3,154 | 4,568 | 3,752 | 5,807 | 5,187 | 5,716 | 5,339 | 5,715 | 5,521 | 5,515 |
| Public sector, medium and long-term | 1,729 | 342 | 455 | -258 | 1,685 | 1,512 | 772 | 641 | 574 | 561 | 562 |
| Nonfinancial public sector 1/ | 1,676 | 270 | 423 | -45 | 1,577 | 1,404 | 664 | 533 | 466 | 453 | 454 |
| Other net flows | 59 | 79 | 39 | -206 | 115 | 115 | 115 | 115 | 115 | 115 | 115 |
| Private sector, medium and long-term | -9 | 5,155 | 3,907 | 5,077 | 3,003 | 3,878 | 4,189 | 4,477 | 4,797 | 4,102 | 4,487 |
| Direct investment (net) | 1,259 | 2,407 | 2,956 | 3,162 | 4,371 | 4,108 | 4,417 | 4,735 | 5,065 | 4,403 | 4,763 |
| Portfolio investment | -972 | 735 | 800 | 1,369 | -676 | 201 | 148 | 94 | 38 | -20 | -81 |
| Loans | -297 | 2,013 | 151 | 547 | -691 | -431 | -376 | -352 | -306 | -281 | -195 |
| Short-term flows | -1,362 | -2,342 | 206 | -1,067 | 1,118 | -203 | 755 | 221 | 344 | 858 | 465 |
| Public sector | 238 | 25 | 29 | -116 | 313 | 349 | 371 | 373 | 374 | 374 | 374 |
| Private sector | -1,600 | -2,367 | 177 | -951 | 805 | -553 | 384 | -152 | -29 | 485 | 92 |
| Errors and omissions | 517 | -538 | 145 | -293 | -271 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 711 | -460 | -281 | -357 | 731 | 350 | 367 | 373 | 386 | 392 | 420 |
| Financing | -711 | 460 | 281 | 357 | -731 | -350 | -367 | -373 | -386 | -392 | -420 |
| Net foreign assets of the BNP | -711 | 460 | 281 | 357 | -731 | -350 | -367 | -373 | -386 | -392 | -420 |
| Net use of Fund credit | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Exceptional financing | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Memorandum items: | (In percent of GDP) | | | | | | | | | | |
| Merchandise exports | 8.9 | 9.0 | 10.0 | 11.9 | 9.7 | 9.2 | 8.8 | 8.7 | 8.6 | 8.6 | 8.6 |
| Merchandise imports | -26.0 | -27.6 | -33.9 | -31.6 | -29.8 | -28.8 | -27.9 | -27.3 | -26.9 | -26.4 | -26.1 |
| Net exports from Colón Free Zone | 8.0 | 1.8 | 0.8 | 1.5 | 3.4 | 2.1 | 1.7 | 1.6 | 1.6 | 1.6 | 1.6 |
| Current account | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 | -10.8 | -9.1 | -9.0 | -8.0 | -7.3 |
| *Of which* : related to Canal Expansion | -0.4 | -2.8 | -3.4 | -2.8 | -2.9 | -2.7 | -2.3 | -1.2 | -0.3 | -0.3 | -0.3 |
| Direct foreign investment | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 | 8.9 | 8.7 | 8.5 | 6.8 | 6.8 |
| External public debt | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 | 31.1 | 28.5 | 26.2 | 24.1 | 22.3 |

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

1/ Includes disbursements to ACP.

## Table 7. Panama: Medium-Term Macroeconomic Framework

| | 2009 | 2010 | 2011 | 2012 | Est. 2013 | Proj. 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (Percent change) | | | | | | |
| Economic growth and prices | | | | | | | | | | | |
| Real GDP at market prices | 3.9 | 7.5 | 10.9 | 10.8 | 8.4 | 7.2 | 6.9 | 6.4 | 6.2 | 5.9 | 5.8 |
| CPI (period average) | 2.4 | 3.5 | 5.9 | 5.7 | 4.0 | 3.8 | 3.5 | 3.2 | 2.9 | 2.5 | 2.5 |
| CPI (end of period) | 1.9 | 4.9 | 6.3 | 4.6 | 3.7 | 3.6 | 3.3 | 3.0 | 2.8 | 2.5 | 2.5 |
| | | | | | (Percent of GDP) | | | | | | |
| Savings and investment | | | | | | | | | | | |
| National savings | 24.9 | 14.2 | 11.3 | 18.0 | 18.1 | 19.0 | 18.5 | 20.0 | 19.9 | 20.0 | 20.6 |
| Public sector | 8.4 | 8.0 | 8.1 | 7.8 | 7.5 | 6.9 | 6.5 | 7.6 | 7.9 | 7.7 | 7.9 |
| Private sector | 16.5 | 6.2 | 3.2 | 10.2 | 10.6 | 12.2 | 12.0 | 12.3 | 12.0 | 12.4 | 12.8 |
| Gross domestic investment | 25.6 | 25.5 | 27.2 | 28.6 | 30.0 | 29.8 | 29.3 | 29.1 | 28.9 | 28.0 | 27.9 |
| Public sector | 7.9 | 12.0 | 12.8 | 12.9 | 13.6 | 12.8 | 11.0 | 9.6 | 8.0 | 7.1 | 7.2 |
| Private sector | 17.7 | 13.5 | 14.4 | 15.7 | 16.4 | 17.0 | 18.3 | 19.5 | 20.9 | 20.9 | 20.7 |
| External savings | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 | -10.8 | -9.1 | -9.0 | -8.0 | -7.3 |
| **Nonfinancial public sector, excluding ACP** | | | | | | | | | | | |
| Revenue | 25.4 | 25.2 | 24.8 | 25.1 | 24.5 | 24.5 | 24.5 | 25.0 | 25.1 | 25.0 | 25.0 |
| Revenue, excluding ACP transfers | 22.5 | 22.4 | 21.5 | 22.3 | 21.6 | 21.5 | 21.6 | 21.5 | 21.6 | 21.5 | 21.5 |
| Expenditure | 26.4 | 27.0 | 26.9 | 26.6 | 27.5 | 27.5 | 26.4 | 26.5 | 26.1 | 25.5 | 25.5 |
| Primary balance | 1.3 | 0.5 | -0.1 | 0.0 | -1.0 | -1.2 | -0.1 | 0.4 | 0.9 | 1.4 | 1.3 |
| Overall balance | -1.0 | -1.8 | -2.1 | -1.5 | -3.0 | -3.0 | -2.0 | -1.5 | -1.0 | -0.5 | -0.5 |
| Net external financing | 8.9 | 1.7 | 1.3 | 0.2 | 2.8 | 2.1 | 0.4 | 0.1 | 0.0 | 0.0 | 0.0 |
| Net domestic financing | -7.9 | 0.4 | 0.9 | 1.1 | 0.3 | 0.9 | 1.6 | 1.4 | 1.0 | 0.5 | 0.5 |
| **Panama Canal Authority (ACP)** | | | | | | | | | | | |
| Revenue | 8.1 | 7.3 | 7.4 | 6.7 | 6.0 | 5.9 | 5.8 | 7.0 | 7.1 | 7.1 | 6.9 |
| Current expenditure | 2.2 | 2.2 | 2.0 | 2.0 | 1.7 | 1.7 | 1.9 | 1.9 | 1.8 | 1.7 | 1.6 |
| Transfers to the government | 3.2 | 3.0 | 3.2 | 2.8 | 2.4 | 2.5 | 2.5 | 3.0 | 3.0 | 3.1 | 3.1 |
| Interest payments | 0.0 | 0.0 | 0.1 | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Capital expenditure | 0.6 | 3.7 | 4.3 | 3.4 | 3.5 | 3.2 | 2.7 | 1.3 | 0.2 | 0.2 | 0.2 |
| Overall balance | 2.0 | -1.7 | -2.3 | -1.7 | -2.0 | -1.8 | -1.5 | 0.5 | 1.9 | 1.9 | 1.8 |
| **Nonfinancial public sector, including ACP** | | | | | | | | | | | |
| Overall balance | 1.0 | -3.5 | -4.4 | -3.3 | -5.0 | -4.8 | -3.5 | -1.0 | 0.9 | 1.4 | 1.3 |
| Total public debt 1/ | 45.4 | 44.1 | 43.8 | 42.6 | 41.1 | 41.3 | 40.8 | 38.7 | 36.5 | 34.2 | 32.0 |
| *o/w*: ACP | 0.0 | 1.1 | 2.9 | 2.9 | 2.8 | 3.8 | 4.8 | 4.4 | 3.5 | 2.8 | 2.2 |
| **External** | | | | | | | | | | | |
| Exports, f.o.b., excluding Colón Free Zone | 8.9 | 9.0 | 10.0 | 11.9 | 9.7 | 9.2 | 8.8 | 8.7 | 8.6 | 8.6 | 8.6 |
| Imports, f.o.b., excluding Colón Free Zone | -26.0 | -27.6 | -33.9 | -31.6 | -29.8 | -28.8 | -27.9 | -27.3 | -26.9 | -26.4 | -26.1 |
| Net exports of Colón Free Zone | 8.0 | 1.8 | 0.8 | 1.5 | 3.4 | 2.1 | 1.7 | 1.6 | 1.6 | 1.6 | 1.6 |
| Current account balance | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 | -10.8 | -9.1 | -9.0 | -8.0 | -7.3 |
| Foreign Direct Investment | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 | 8.9 | 8.7 | 8.5 | 6.8 | 6.8 |
| | | | | | (In millions of U.S. dollars) | | | | | | |
| Memorandum items: | | | | | | | | | | | |
| Nominal GDP | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 | 49,696 | 54,483 | 59,443 | 64,485 | 69,885 |
| External debt (public, percent of total non-bank external debt) | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 | 31.1 | 28.5 | 26.2 | 24.1 | 22.3 |
| External Debt (excluding banks, percent of GDP) | 59.4 | 70.9 | 70.3 | 66.2 | 61.8 | 58.7 | 54.6 | 50.9 | 47.7 | 44.9 | 42.4 |
| External Debt (excluding offshore banks, percent of GDP) | 139.7 | 134.8 | 142.3 | 134.4 | 132.2 | 132.3 | 130.9 | 129.4 | 128.0 | 126.9 | 125.7 |
| External Debt (including banks, percent of GDP) 2/ | 163.3 | 164.4 | 162.4 | 151.6 | 145.0 | 137.6 | 129.9 | 123.8 | 118.3 | 113.5 | 108.9 |

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes external debt for Panama Canal expansion.
2/ Includes offshore banks.

## Table 8. Panama: Debt of the Non-Financial Public Sector 1/

| | 2009 | 2010 | 2011 | 2012 | 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| | (In millions of U.S. dollars) | | | | | |
| External debt | 10,158 | 10,738 | 11,810 | 11,832 | 13,059 | 14,560 |
| Multilaterals | 1,646 | 1,825 | 2,039 | 2,403 | 2,770 | 3,227 |
| IBRD | 435 | 420 | 399 | 489 | 578 | 651 |
| IDB | 1,073 | 1,284 | 1,361 | 1,426 | 1,473 | 1,804 |
| Others | 138 | 121 | 280 | 488 | 719 | 773 |
| Bilateral and guaranteed suppliers | 223 | 325 | 381 | 352 | 336 | 313 |
| Commercial banks | 219 | 217 | 216 | 302 | 409 | 706 |
| Global bonds | 8,071 | 8,071 | 8,274 | 7,726 | 8,392 | 8,613 |
| ACP | 0 | 300 | 900 | 1,050 | 1,152 | 1,702 |
| Domestic debt | 821 | 1,190 | 1,904 | 3,483 | 3,589 | 4,003 |
| Private creditors | 519 | 894 | 1,422 | 2,933 | 3,038 | 3,453 |
| Public financial institutions | 302 | 296 | 482 | 550 | 550 | 550 |
| Total Public debt | 10,980 | 11,928 | 13,714 | 15,315 | 16,648 | 18,564 |
| | (In percent of GDP) | | | | | |
| Total | 45.4 | 44.1 | 43.8 | 42.6 | 41.1 | 41.3 |
| External | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 |
| Domestic | 3.4 | 4.4 | 6.1 | 9.7 | 8.9 | 8.9 |
| Memorandum items: | | | | | | |
| External assets of FFD/FAP, net of government debt holdings | 2.0 | 4.5 | 4.0 | 3.5 | 3.1 | 2.8 |
| GDP (in millions of U.S. dollars) | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 |

Sources: Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes external debt for Panama Canal expansion.

## Table 9. Panama: Vulnerability Indicators

| | 2009 | 2010 | 2011 | 2012 | Est. 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| Financial indicators | | | | | | |
| Broad money (12-month percent change) | 9.4 | 11.6 | 7.8 | 10.4 | 8.8 | 11.1 |
| Private sector credit (12-month percent change) | 1.3 | 13.6 | 16.8 | 14.1 | 12.6 | 11.3 |
| Deposit rate (6-month; in percent) 1/ | 3.0 | 2.6 | 1.9 | 1.9 | 1.8 | ... |
| External indicators | | | | | | |
| Merchandise exports (12-month percent change) | -37.1 | 12.8 | 29.4 | 36.2 | -8.3 | 5.2 |
| Merchandise imports (12-month percent change) | -16.1 | 18.9 | 42.3 | 6.8 | 6.2 | 7.4 |
| Current account balance (in percent of GDP) | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 |
| Capital and financial account balance | 1.5 | 11.7 | 14.6 | 10.4 | 14.3 | 11.5 |
| *Of which*: direct investment | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 |
| Public sector external debt (in percent of GDP) | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 |
| In percent of exports of goods and services 2/ | 105.6 | 117.5 | 102.9 | 83.6 | 86.7 | 90.9 |
| External interest payments | | | | | | |
| In percent of exports of goods and services 2/ | 6.7 | 7.8 | 5.6 | 6.6 | 5.3 | 4.8 |
| External amortization payments | | | | | | |
| In percent of exports of goods and services 2/ | 2.2 | 1.9 | 4.5 | 6.5 | 5.1 | 1.6 |
| REER, percent change (average, depreciation -) | 1.9 | -2.3 | 1.7 | 3.9 | 5.3 | ... |
| Gross international reserves at end of period | | | | | | |
| In millions of U.S. dollars 3/ | 3,424 | 2,975 | 2,733 | 2,413 | 3,144 | 3,494 |
| In months of imports of goods and services | 3.8 | 2.4 | 2.0 | 1.6 | 2.0 | 2.1 |
| In percent of broad money 4/ | 15 | 12 | 10 | 8 | 10 | 10 |
| In percent of short-term external debt 5/ | 50 | 40 | 32 | 28 | 31 | 34 |
| | (In millions of U.S. dollars) | | | | | |
| Memorandum items: | | | | | | |
| Nominal GDP | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 |
| Exports of goods and services 2/ | 9,619 | 9,142 | 11,483 | 14,158 | 15,067 | 16,011 |
| Imports of goods and services 2/ | 10,418 | 10,756 | 15,029 | 16,059 | 18,139 | 18,971 |

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 10. Panama: Net International Investment Position (NIIP)**

| | 2009 | 2010 | 2011 | 2012 | Est. 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| | (In percent of GDP) | | | | | |
| Net international investment position | **-61.4** | **-61.1** | **-68.3** | **-70.8** | **-75.5** | **-76.4** |
| Assets | **176.5** | **180.0** | **170.3** | **155.2** | **147.1** | **138.5** |
| Direct investment abroad | 12.7 | 12.5 | 11.3 | 9.1 | 8.8 | 8.2 |
| Portfolio investment abroad | 25.5 | 28.3 | 26.8 | 24.6 | 23.5 | 20.7 |
| *of which:* debt securities | 24.7 | 27.5 | 26.0 | 23.4 | 22.5 | 19.8 |
| Other investment | 123.5 | 124.8 | 120.4 | 114.2 | 106.6 | 101.1 |
| Trade credits | 13.6 | 13.2 | 12.7 | 12.1 | 12.9 | 11.7 |
| Loans (short term, to banks) | 64.6 | 70.7 | 71.0 | 65.7 | 60.0 | 57.7 |
| Currency and deposits | 42.0 | 37.6 | 33.4 | 33.6 | 31.7 | 30.5 |
| Other assets | 3.3 | 3.3 | 3.3 | 2.9 | 1.9 | 1.2 |
| Reserve assets | 14.8 | 14.4 | 11.7 | 7.3 | 8.3 | 8.2 |
| Liabilities | **237.9** | **241.1** | **238.6** | **226.0** | **222.6** | **214.9** |
| Direct investment inward | 74.6 | 76.7 | 76.2 | 74.5 | 77.6 | 77.0 |
| Portfolio investment | 32.6 | 38.4 | 38.8 | 35.4 | 35.4 | 35.1 |
| *of which* debt securities | 32.6 | 38.4 | 38.8 | 35.2 | 35.2 | 34.9 |
| Financial derivatives | 0.0 | 0.0 | 0.0 | 0.2 | 0.2 | 0.2 |
| Other investment | 130.8 | 126.0 | 123.5 | 116.1 | 109.6 | 102.6 |
| Trade credits | 4.2 | 4.7 | 5.2 | 5.4 | 5.3 | 5.3 |
| Loans | 32.9 | 41.5 | 38.1 | 35.6 | 34.3 | 31.6 |
| Monetary authorities | 0.3 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 |
| General government | 8.4 | 8.6 | 8.2 | 8.4 | 8.3 | 8.2 |
| Banks | 19.3 | 25.3 | 21.5 | 19.9 | 19.6 | 17.5 |
| Long-term | 9.1 | 11.6 | 9.6 | 9.7 | 6.4 | 4.2 |
| Short-term | 10.2 | 13.7 | 11.9 | 10.2 | 13.2 | 13.2 |
| Other sectors | 4.9 | 7.4 | 8.1 | 7.0 | 6.3 | 5.8 |
| Currency and deposits | 88.8 | 76.8 | 77.8 | 73.5 | 68.7 | 64.9 |
| Other liabilities | 4.9 | 3.0 | 2.5 | 1.7 | 1.3 | 0.9 |

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

# Annex I. Implementation of 2011 FSAP Recommendations

| Recommendation | Status/Expected Completion Date |
|---|---|
| **Banking Oversight** | |
| Finalize and implement regulations on operational and interest rate risks. | Implemented/ongoing.<br>A regulation on operational risks was adopted 2011. The SBP staff was trained.<br>A draft regulation on interest rate risks will be submitted to the SBP Board after the Basel Committee publishes its guidance on this topic. |
| Enhance systemic risk monitoring and the capacity to implement macro-prudential policies | A regulation on dynamic provisioning was issued on May 18, 2013.<br>The Financial Coordination Council was established and has taken measures against emerging risks.<br>Draft law on Trust Funds is being prepared.<br>Draft law of Certified Public Accountants is being prepared. |
| Develop capital adequacy and regulatory reporting standards for holding companies. | Ongoing. A draft regulation is being prepared with technical assistance from CAPTAC-DR, to be adopted by April 2014. |
| Develop concentration limits and risk management requirements for interbank deposits. | No plans to develop such requirements. The authorities noted that the law allows them to introduce such limits and requirements for individual banks as needed, and they have used this clause in practice. |
| Enhance offsite supervision to develop a view on macroprudential and systemic risk trends. | Ongoing. The SBP has identified systemically important banks and initiated a Financial Stability Report series. |
| Regulate and effectively supervise cooperatives that provide credit and savings products. | Legislation pending. A draft law on cooperatives, which would upgrade regulation and strengthen supervision in that sector, is being prepared. |
| **Insurance Sector Oversight** | |
| Approve draft Insurance Law with strengthened prudential requirements. | Implemented. The law was adopted in 2012. |
| Strengthen disclosure of performance indicators and brokers' commissions. | No initiatives so far. |
| **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. The SMV is seeking to further strengthen its enforcement capacity. |
| **Payments and Securities Systems Oversight** | |
| Create a comprehensive payments system law guaranteeing payment finality. | No initiatives so far. |
| Adopt a Real Time Gross Settlement or Hybrid Payments System | Medium-term recommendation. No initiatives so far. The authorities are considering to increase the number of netting operations per day, in line with the FSAP recommendation. |
| **Financial Safety Nets** | |
| Conclude studies and introduce a banks' liquidity facility. | Ongoing. The authorities are getting TA from the CAPTAC-DR. |
| Establish a deposit insurance scheme. | No policy 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. The authorities have been making efforts to extend market making to global bonds. |
| Review and restructure or close public development banks and guarantee funds. | Medium-term recommendation. No initiatives so far. |

# Annex II. Debt Sustainability Analysis (DSA)

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

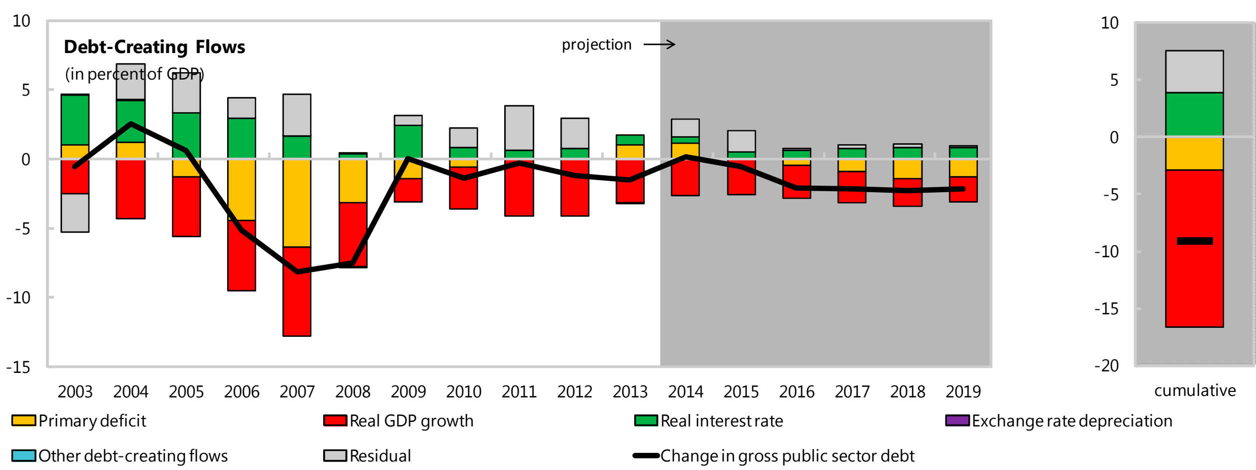
(In percent of GDP unless otherwise indicated)

### Debt, Economic, and Market Indicators [1/]

| | Actual | | | Projections | | | | | | As of February 28, 2014 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2003-2011 [2/] | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Sovereign Spreads | | |
| Nominal gross public debt | 54.1 | 42.6 | 41.1 | 41.3 | 40.8 | 38.7 | 36.5 | 34.2 | 32.0 | EMBIG (bp) 3/ | | 215 |
| Public gross financing needs | 7.4 | 5.4 | 5.1 | 6.0 | 7.3 | 5.9 | 6.1 | 7.8 | 8.3 | 5Y CDS (bp) | | 104 |
| Real GDP growth (in percent) | 8.0 | 10.8 | 8.4 | 7.2 | 6.9 | 6.4 | 6.2 | 5.9 | 5.8 | Ratings | Foreign | Local |
| Inflation (GDP deflator, in percent) | 2.8 | 3.6 | 3.9 | 3.6 | 3.3 | 3.0 | 2.7 | 2.4 | 2.4 | Moody's | Baa2 | Baa2 |
| Nominal GDP growth (in percent) | 11.0 | 14.7 | 12.7 | 11.1 | 10.5 | 9.6 | 9.1 | 8.5 | 8.4 | S&Ps | BBB | BBB |
| Effective interest rate (in percent) [4/] | 6.9 | 5.4 | 5.4 | 5.0 | 4.8 | 4.9 | 4.9 | 4.9 | 5.2 | Fitch | BBB | BBB |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2003-2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | cumulative | debt-stabilizing primary balance [9/] |
| Change in gross public sector debt | -2.2 | -1.2 | -1.5 | 0.2 | -0.6 | -2.1 | -2.2 | -2.3 | -2.2 | -9.1 | |
| Identified debt-creating flows | -3.6 | -3.3 | -1.5 | -1.1 | -2.1 | -2.2 | -2.4 | -2.6 | -2.3 | -12.7 | |
| Primary deficit | -1.7 | 0.0 | 1.0 | 1.2 | 0.0 | -0.5 | -0.9 | -1.4 | -1.3 | -2.9 | -1.0 |
| Primary (noninterest) revenue and grants | 24.0 | 24.6 | 24.4 | 24.2 | 24.3 | 24.8 | 24.9 | 24.8 | 24.9 | 147.9 | |
| Primary (noninterest) expenditure | 22.3 | 24.5 | 25.4 | 25.4 | 24.3 | 24.3 | 24.0 | 23.4 | 23.6 | 145.0 | |
| Automatic debt dynamics [5/] | -1.9 | -3.3 | -2.5 | -2.3 | -2.1 | -1.8 | -1.5 | -1.2 | -1.0 | -9.8 | |
| Interest rate/growth differential [6/] | -1.9 | -3.3 | -2.5 | -2.3 | -2.1 | -1.8 | -1.5 | -1.2 | -1.0 | -9.8 | |
| Of which: real interest rate | 2.1 | 0.8 | 0.7 | 0.4 | 0.5 | 0.6 | 0.7 | 0.8 | 0.8 | 3.9 | |
| Of which: real GDP growth | -4.0 | -4.1 | -3.2 | -2.7 | -2.6 | -2.4 | -2.2 | -2.0 | -1.8 | -13.7 | |
| 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 | |
| PS: Privatization proceeds and sales of assets (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 | |
| CG: Privatization Proceeds | 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/] | 1.4 | 2.2 | 0.0 | 1.3 | 1.5 | 0.2 | 0.3 | 0.3 | 0.1 | 3.7 | |




Source: IMF staff.

1/ Public sector debt and financing needs includes those of the Non-Financial Public Sector and the external finacing needs of the Panama Canal expansion. .

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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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).

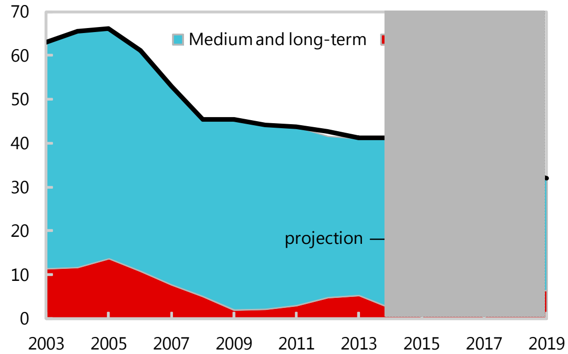
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

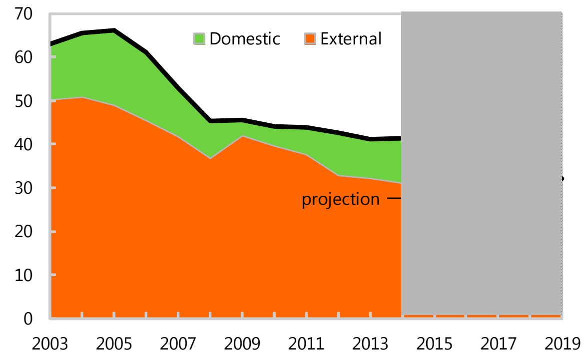
## Panama: Public DSA – Composition of Public Debt and Alternative Scenarios 1/

### Composition of Public Debt

**By Maturity**
(in percent of GDP)



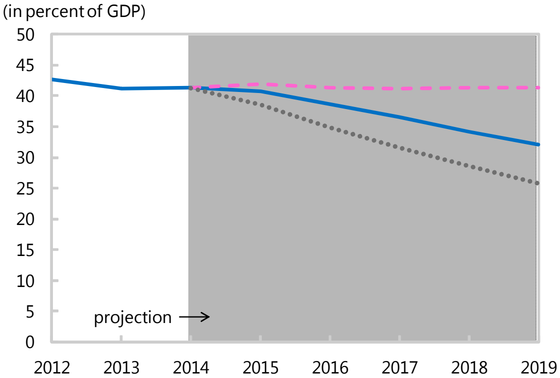

**By Market**
(in percent of GDP)



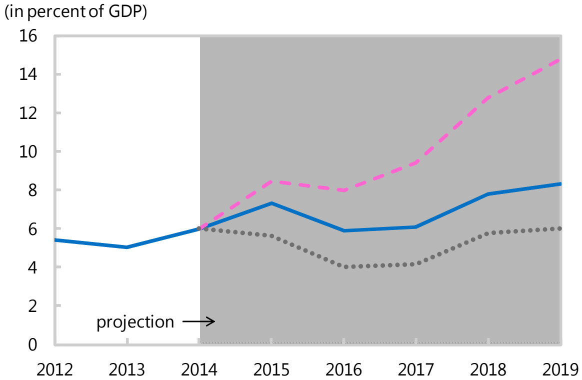

### Alternative Scenarios

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** | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GDP growth | 7.2 | 6.9 | 6.4 | 6.2 | 5.9 | 5.8 |
| Inflation | 3.6 | 3.3 | 3.0 | 2.7 | 2.4 | 2.4 |
| Primary Balance | -1.2 | 0.0 | 0.5 | 0.9 | 1.4 | 1.3 |
| Effective interest rate | 5.0 | 4.8 | 4.9 | 4.9 | 4.9 | 5.2 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 7.2 | 6.9 | 6.4 | 6.2 | 5.9 | 5.8 |
| Inflation | 3.6 | 3.3 | 3.0 | 2.7 | 2.4 | 2.4 |
| Primary Balance | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 |
| Effective interest rate | 5.0 | 4.8 | 4.8 | 4.9 | 4.8 | 5.0 |

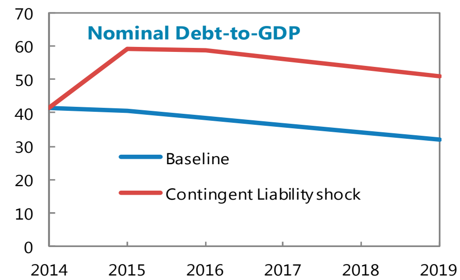
| **Historical Scenario** | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GDP growth | 7.2 | 8.7 | 8.7 | 8.7 | 8.7 | 8.7 |
| Inflation | 3.6 | 3.3 | 3.0 | 2.7 | 2.4 | 2.4 |
| Primary Balance | -1.2 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Effective interest rate | 5.0 | 4.8 | 5.1 | 5.3 | 5.3 | 5.7 |

1/ Historical scenario assumes real GDP growth and primary balance convert to 10 year (2004-2013) historical average from 2015 onwards.
Source: IMF staff. Gross financing needs in 2018 includes an expected amortization on existing debt in the amount of US$1.3 billion.

## Panama Public DSA Stress Test

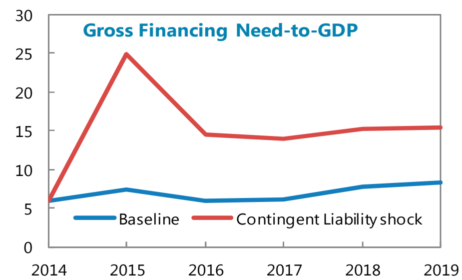
Two additional stress tests are conducted—a near-term financial contingent liability shock and a medium-term output and financial shock.

The near-term financial contingent liability shock assumes a one-standard-deviation shock to GDP growth in 2015–16 and a public expenditures shock in the amount of 10 percent of banking system's assets in 2015; at the same time, for every 1 percentage of GDP increase in primary deficits, financing costs increase by 25 basis points. Public debt increases to 65 percent of GDP in 2016 in this scenario but does not enter an explosive path.




| Financial Contingent Liability Shock | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GDP growth | 7.2% | 4.6% | 4.0% | 6.2% | 5.9% | 5.8% |
| Inflation (GDP Deflator change) | 3.6% | 2.7% | 2.4% | 2.7% | 2.4% | 2.4% |
| Non-interest revenue-to-GDP ratio | 24.2% | 24.3% | 24.8% | 24.9% | 24.8% | 24.9% |
| Non-interest expenditure-to-GDP ratio | 25.4% | 41.3% | 24.3% | 24.0% | 23.4% | 23.6% |
| Primary Balance | -1.2% | -17.1% | 0.5% | 0.9% | 1.4% | 1.3% |
| Nominal Exchange Rate -- average | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Nominal Exchange Rate -- end of period | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Interest rate shock (bpts) compared to baseline | 0 | 426 | 0 | 0 | 0 | 0 |

Sources: Panama authorities; and IMF staff calculations.




The medium-term output and financial shock assumes GDP growth slows down to 4 percent from 2015 onward and financing cost increases by 400 basis points compared to baseline (this is similar to what happened in the recent global crisis, but more persistent). The impact on public debt is limited.

| Combined Real GDP and Financial Condition Shock | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GDP growth | 7.2% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% |
| Inflation (GDP Deflator change) | 3.6% | 3.3% | 3.0% | 2.7% | 2.4% | 2.4% |
| Non-interest revenue-to-GDP ratio | 24.2% | 24.3% | 24.8% | 24.9% | 24.8% | 24.9% |
| Non-interest expenditure-to-GDP ratio | 25.4% | 24.3% | 24.3% | 24.0% | 23.4% | 23.6% |
| Primary Balance | -1.2% | 0.0% | 0.5% | 0.9% | 1.4% | 1.3% |
| Nominal Exchange Rate -- average | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 100.0% |
| Nominal Exchange Rate -- end of period | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 100.0% |
| Interest rate shock (bpts) compared to baseline | 0 | 400 | 400 | 400 | 400 | 400 |

Sources: Panama authorities; and IMF staff calculations.

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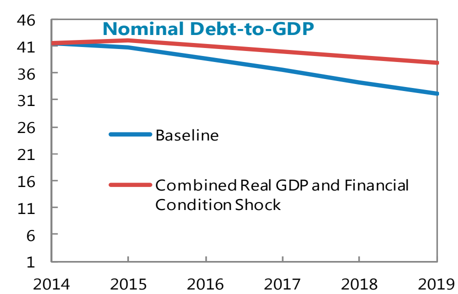
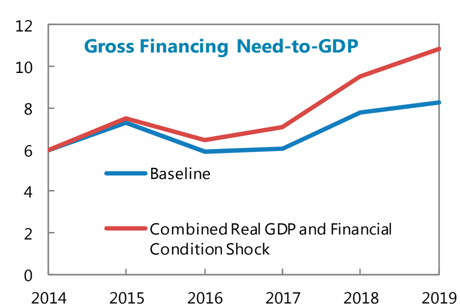


## Panama: External Debt Sustainability Framework, 2008–19

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | 142.8 | 139.7 | 134.8 | 142.3 | 134.4 | 132.2 | **132.3** | **130.9** | **129.4** | **128.0** | **126.9** | **125.7** | **-12.0** |
| Change in external debt | -2.5 | -3.1 | -4.9 | 7.5 | -7.9 | -2.2 | 0.2 | -1.5 | -1.4 | -1.4 | -1.2 | -1.2 | |
| Identified external debt-creating flows (4+8+9) | -18.7 | -11.4 | -12.5 | -11.9 | -16.5 | -14.0 | -7.0 | -6.4 | -7.3 | -7.0 | -5.9 | -6.4 | |
| Current account deficit, excluding interest payments | 3.5 | -5.9 | 5.6 | 10.6 | 5.8 | 7.3 | 6.2 | 6.2 | 4.5 | 4.4 | 3.4 | 2.7 | |
| Deficit in balance of goods and services | 6.7 | -4.7 | 3.9 | 10.5 | 3.8 | 4.2 | 4.5 | 4.4 | 2.9 | 2.4 | 1.6 | 1.4 | |
| Exports | 37.5 | 39.8 | 33.8 | 36.7 | 39.4 | 37.2 | 35.6 | 34.6 | 35.3 | 35.3 | 35.3 | 35.2 | |
| Imports | 44.2 | 35.1 | 37.7 | 47.1 | 43.2 | 41.4 | 40.1 | 39.0 | 38.2 | 37.7 | 37.0 | 36.6 | |
| Net non-debt creating capital inflows (negative) | -9.3 | -5.2 | -8.9 | -9.4 | -8.8 | -10.8 | -9.1 | -8.9 | -8.7 | -8.5 | -6.8 | -6.8 | |
| Automatic debt dynamics 1/ | -12.8 | -0.3 | -9.1 | -13.0 | -13.5 | -10.5 | -4.0 | -3.7 | -3.1 | -2.8 | -2.4 | -2.3 | |
| Contribution from nominal interest rate | 7.5 | 6.6 | 5.8 | 5.4 | 4.8 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | |
| Contribution from real GDP growth | -12.7 | -5.2 | -9.3 | -12.6 | -13.4 | -10.1 | -8.6 | -8.3 | -7.7 | -7.4 | -7.0 | -6.8 | |
| Contribution from price and exchange rate changes 2/ | -7.6 | -1.6 | -5.6 | -5.7 | -4.9 | -5.0 | -4.6 | -4.2 | -3.8 | -3.4 | -3.0 | -3.0 | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 16.1 | 8.3 | 7.5 | 19.4 | 8.5 | 11.8 | 11.7 | 9.2 | 9.6 | 9.0 | 7.7 | 8.2 | |
| External debt-to-exports ratio (in percent) | 380.7 | 351.0 | 398.9 | 388.3 | 341.2 | 355.2 | 371.8 | 378.6 | 366.2 | 362.6 | 358.9 | 357.1 | |
| **Gross external financing need (in billions of US dollars) 4/** | 9.4 | 7.9 | 10.1 | 13.0 | 12.8 | 14.1 | 15.2 | 16.2 | 16.5 | 17.1 | 17.9 | 18.7 | |
| in percent of GDP | 40.8 | 32.6 | 37.3 | 41.6 | 35.7 | 34.9 | 33.7 | 32.6 | 30.3 | 28.7 | 27.7 | 26.8 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | | | | | | |
| **External debt** | | | | | | **132.2** | **129.0** | **123.5** | **118.5** | **113.0** | **106.3** | **100.3** | **-14.5** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 10.1 | 3.9 | 7.5 | 10.9 | 10.8 | 8.4 | 7.2 | 6.9 | 6.4 | 6.2 | 5.9 | 5.8 | |
| GDP deflator in US dollars (change in percent) | 5.5 | 1.1 | 4.2 | 4.4 | 3.6 | 3.9 | 3.6 | 3.3 | 3.0 | 2.7 | 2.4 | 2.4 | |
| Nominal external interest rate (in percent) | 6.0 | 4.9 | 4.7 | 4.6 | 3.9 | 3.8 | 3.8 | 3.8 | 3.8 | 3.9 | 3.9 | 3.9 | |
| Growth of exports (US dollar terms, in percent) | 26.6 | 11.5 | -5.0 | 25.6 | 23.3 | 6.4 | 6.3 | 7.3 | 12.1 | 9.0 | 8.6 | 7.9 | |
| Growth of imports (US dollar terms, in percent) | 31.0 | -16.6 | 20.3 | 44.8 | 5.2 | 7.9 | 7.6 | 7.4 | 7.5 | 7.5 | 6.5 | 7.2 | |
| Current account balance, excluding interest payments | -3.5 | 5.9 | -5.6 | -10.6 | -5.8 | -7.3 | -6.2 | -6.2 | -4.5 | -4.4 | -3.4 | -2.7 | |
| Net non-debt creating capital inflows | 9.3 | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 | 8.9 | 8.7 | 8.5 | 6.8 | 6.8 | |

1/ 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; $\rho$ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, $\varepsilon$ = nominal appreciation (increase in dollar value of domestic currency, equal to zero for Panama), and $\alpha$ = share of domestic-currency denominated debt in total external debt.

2/ 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. $\rho$ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator). Given $\varepsilon = 0$ for Panama, this term becomes $-\rho(1+g)/(1+g+\rho+g\rho)$.

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

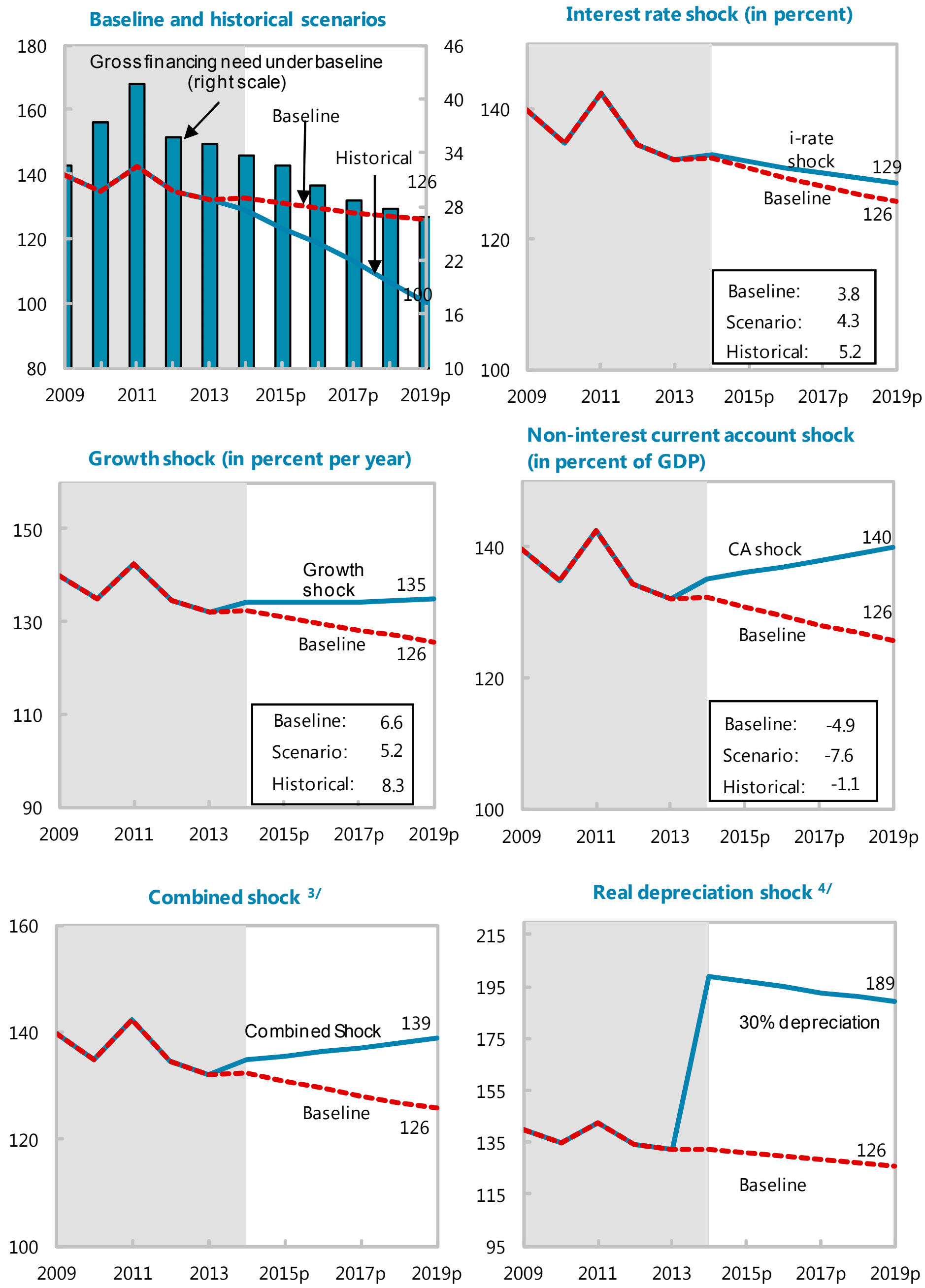
4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

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

6/ 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 2014.

# Annex III. Investment and Growth

**A growth decomposition exercise suggests that the recent growth spur was due to capital accumulation and improvements in productivity.** [1] While until early 2000s Panama's growth performance was mainly driven by labor and private investment, the last decade witnessed a surge in public investment and various structural reforms aimed at improving efficiency and competitiveness.

Table Panama: Real Growth and Input Contributions (%)

| | 1980-2013 | 1980-1990 | 1991-2013 | 1991-2001 | 2002-2013 | 2007-2013 |
|---|---|---|---|---|---|---|
| GDP | 5.0 | 2.3 | 6.3 | 4.7 | 7.7 | 9.0 |
| Capital | 1.9 | 0.6 | 2.6 | 2.7 | 2.6 | 3.4 |
| Public | 0.5 | 0.2 | 0.7 | 0.4 | 1.0 | 1.5 |
| Private | 1.3 | 0.1 | 1.9 | 2.2 | 1.6 | 2.0 |
| Labor | 3.2 | 3.2 | 3.2 | 3.0 | 3.4 | 2.8 |
| TFP | -0.2 | -1.5 | 0.4 | -1.0 | 1.7 | 2.8 |
| Investment as % of GDP | 18.9 | 11.2 | 22.7 | 21.9 | 23.4 | 26.8 |

**Labor contribution to output growth has been relatively stable.** [2] Employment increased steadily over the past decades. At the same time, education indicators improved substantially, and enrollment rates now compare favorably with peers in the region. Average years of schooling of the population of 15 years and older increased from 7.6 in 1990 to 9.6 years in 2010. Also, enrollment in tertiary education accelerated from the 1990s and doubled from 22.7 percent in 1991 to 45.7 percent in 2010. As unemployment reduction reached its limits, labor contribution slowed down in recent years.

**Total factor productivity (TFP) did not contribute to growth until 2004.** TFP registered negative contribution in 1980 and 1990s. Beginning in the 1990s, and especially in the 2000s, the authorities adopted an economic strategy aiming at reducing public sector indebtedness, removing impediments to productivity growth, stimulating private sector investment, and enhancing public sector capacity. These reforms include significant efforts in privatization, trade and market liberalization, and financial regulation and supervision, and they helped improve the competitiveness of the economy.[3] As a consequence, in the last decade, TFP's contribution accounted for almost one quarter of growth.

**Capital contribution to growth increased over time**. The evolution of capital stock reflected the lack of investor confidence in the 1980s, its recovery in the 1990s, and the acceleration of investment growth

[1] Assuming a Cobb-Douglas production function: $Y_t \;=\; A_t\, K_t^{\alpha} L_t^{(1-\alpha)}$, where *Yt* is the level of output, *Kt* is capital input; *Lt* is labor input, *At* is the technology or total factor productivity (TFP), and $\alpha$ denotes the capital output ratio and is estimated at 0.37 (via an OLS regression over the 1991-2012 period). See also C. Johnson, *Potential Output and Output Gap in Central America, Panama and Dominican Republic*, IMF working paper 13/145.

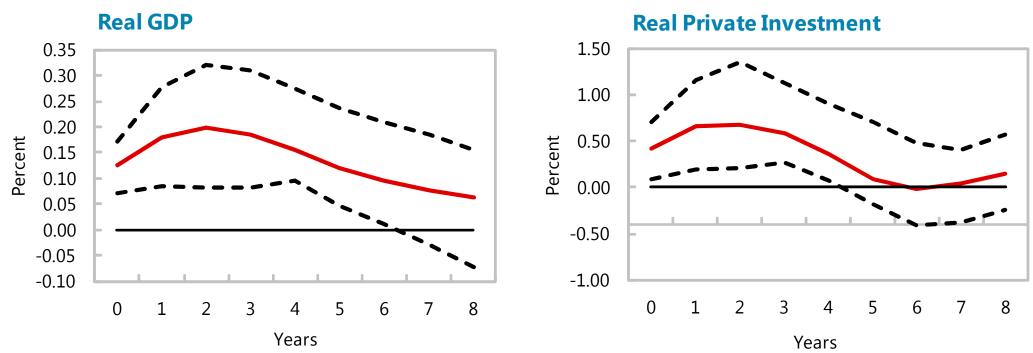
[2] When calculating labor input, the number of employees in the economy is adjusted by the education attainment represented by the average years of schooling obtained from Barro and Lee Education Attainment Dataset.

[3] Panama ranked 40 out of 144 countries in the 2012/13 World Economic Forum Global Competitive Index, and ranked second in Latin America (after Chile). It also improved its ranking in the Ease of Doing Business index from 65 in 2008 to 61 in 2013.

since mid-2000s. The corresponding share of contribution to growth was about 40 percent in 1980–2013. Public investment increased from an average of 2.4 percent of GDP in the 1980s to 3.4 percent in the 1990s, and to more than 9 percent in 2007–13. Indeed, public investment plans for 2009–14 include new highways, airports, roads, ports, urban infrastructure, sewage systems, healthcare facilities and new subway system. In addition, a third set of locks are being built to enable the transit of post-Panamax containerships through the Canal, which would double the transit capacity, boosting growth also in logistics and other trade-related activities. Contribution to growth from private sector investment also rose in recent years: private sector confidence was encouraged by the improvements in economic efficiency and business climate, better public finances, privatizations, and the repossession of the Canal.

**Public investment had a significant impact on output as well as on private investments.** Staff estimated a structural VAR model with real GDP as well as real private and public investments over the 1992–2012 period. The results indicate that an increase in public investment by 1 percent would raise GDP by 0.1 percent on impact and by about 0.2 percent after two years.[4]

**Dynamic Responses of GDP and Private Investment to a Shock in Public Investment**




Responses to a one-percent shock in real public investment. Dashed lines correspond to 95 percent confidence intervals.

**There is evidence of complementarities between public investment and private investment**. Public investment in large transportation projects has improved connectivity between logistics centers, and fostered private investment in tourism and in higher value-added agricultural exports. Public investment was also aimed at developing new industries and services around the logistics hubs, such as light manufacturing and value-added warehousing. Investment in education and hospitals should help improve social condition and human capital over the medium term. The structural VAR model confirms the complementarity of public and private investment: a 1 percent increase of public investment raises private investment by about 0.4 percent on impact and by about 0.6 percent after one to two years (thus "crowding-in" private investment).

[4] Our results are consistent with the average output elasticity of public capital reported by Bom and Lighart (2013) based on 578 estimates collected from 68 studies: 0.1 for public investment and 0.2 for core public investment, which includes roads, railways, airports, and utilities (*What Have We Learned from Three Decades of Research on the Productivity of Public Capital?* Journal of Economic Surveys, forthcoming).

INTERNATIONAL MONETARY FUND

# PANAMA

April 24, 2014

## STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Western Hemisphere Department

## CONTENTS

# FUND RELATIONS

(As of February 28, 2014)

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

| **General Resources Account:** | **SDR Million** | **%Quota** |
|---|---|---|
| Quota | 206.60 | 100.00 |
| Fund holdings of currency | 194.75 | 94.27 |
| Reserve Tranche Position | 11.86 | 5.74 |

| **SDR Department:** | **SDR Million** | **%Allocation** |
|---|---|---|
| Net cumulative allocation | 197.01 | 100.00 |
| Holdings | 170.84 | 86.72 |

**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** | | | |
|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 |
| Principal | | | | |
| Charges/Interest | 0.02 | 0.03 | 0.03 | 0.03 |
| **Total** | 0.02 | 0.03 | 0.03 | 0.03 |

**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 2012 Article IV consultation was concluded on January 25, 2013. 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 CAPTACDR. Latest assistance concentrated in the area of the national accounts, both on output compilation and producer price and export and import prices. 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 customs and tax administration consistent with its operational plans and requests by country authorities. Assistance was also provided in improving the external sector statistics. In the financial area, TA concentrated mostly on improving macroprudential policies, the design of liquidity facility and on IFRS adoption.

**Resident Representative:** None.

# RELATIONS WITH THE WORLD BANK-UNDER JMAP

(As of February 28, 2014)

| Title | Products | Provisional Timing of Missions | Expected Delivery Date |
|---|---|---|---|
| Bank Work Program | Panama Transitions and Strategy Program | March 2014 | September 2014 |
| | Implementation of Panama Maritime and Logistics Strategy – Phase 2 – Air Cargo | January 2014 | December 2014 |
| | Panama Public Expenditure and Financial Accountability | TBD | June 2014 |
| | Strengthening Panama's Agricultural Extension System | TBD | May 2014 |
| | Panama Skills and Productive Inclusion | February 2014 | May 2015 |
| | Apoyo al Fondo de Ahorro Panamá (FAP) | January 2014 | March 2015 |
| | Rural Productivity Project | February 2014 | July 2014 |
| | Rural Productivity Project (GEF) | February 2014 | July 2014 |
| | Water Supply and Sanitation in Low-Income Communities | January 2014 | November 2014 |
| | Social Protection Project | February 2014 | May 2014 |
| | Health Equity and Performance Improvement | March 2014 | December 2014 |

| Title | Products | Provisional Timing of Missions | Expected Delivery Date |
|---|---|---|---|
| | Panama Metro Water and Sanitation Improvement | March 2014 | September 2015 |
| | Panama Enhanced Public Sector Efficiency Technical Assistance Loan (TAL) | December 2013 | September 2016 |
| | Sustainable Production Systems and Conservation of Biodiversity | February 2014 | TBD |

# RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of February 28, 2014)

In 2013, the IDB disbursed a total US$305.1 million in 2013. The Bank approved two loans for a total of U$254 million during 2013: A loan for water supply in rural and peri-urban areas (US$54 million) and another for Strengthening Macrofinancial and Fiscal Management (US$200 million).

In 2014, the preliminary projection of disbursements for 2014 is around US$377 million. The IDB has approved a loan for the Stability and Fiscal and Financial Transparency for a total of US$300 million, and expects to approve a Program for Sustainable Rural Electrification for US$20 million.

**Panama: Relations with the Inter-American Development Bank**

(In millions of U.S. Dollars)

| **Operations** | | | |
|---|---|---|---|
| Sector | Approved | Disbursed | Undisbursed Amounts |
| Agriculture and rural development | 44.4 | 44.3 | 0.1 |
| Education | 100 | 22.7 | 77.3 |
| Health | 50 | 6 | 44 |
| Private Firms and SME Development | 38.3 | 31.3 | 7 |
| Reform/Modernization of the State | 94.3 | 46.6 | 47.7 |
| Science and Technology | 19.7 | 13.1 | 6.6 |
| Social Investment | 20.2 | 20 | 0.2 |
| Transport | 140 | 74.3 | 65.7 |
| Water and Sanitation | 288 | 129.3 | 158.7 |
| Total | 794.9 | 387.6 | 407.3 |

| **Loan Transactions** | | | | | | |
|---|---|---|---|---|---|---|
| | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** [1] |
| a. Disbursements | 216.8 | 302.2 | 181.1 | 170.8 | 305.1 | 377.0 |
| b. Repayment | 91.4 | 92.9 | 100.5 | 105.5 | 109.3 | 106.4 |
| **c. Net lending** | **125.5** | **209.3** | **80.6** | **65.3** | **195.8** | **270.6** |
| d. Interest and charges | 45.4 | 49.7 | 49.0 | 45.6 | 55.3 | 53.6 |
| e. Subscriptions and contributions | 3.0 | 0.7 | 1.9 | 3.6 | 0.0 | 0.0 |
| **f. Net transfer** | **77.1** | **158.9** | **29.6** | **16.1** | **140.5** | **217.0** |

Source: Inter-American Development Bank.

[1] Estimated.

# STATISTICAL ISSUES

(As of February 28, 2014)

| ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE (continued) |
|---|
| **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 authorities plan to change the base year of the national accounts to 2007. Preparation started in the second half of 2010 and rebased data should be published in the first quarter of 2014. The IMF national accounts technical assistance mission conducted in 2010-11 noted slow progress in expanding coverage of financial activity as well as the overestimation of the deflator used to calculate the financial services output at constant prices. During 2011-2012, progress was made in compiling financial intermediation services indirectly measured (FISIM) on a monthly basis following the *2008 System of National Accounts (2008 SNA)*, as well as in broadening the coverage of household output, employment, compensation of employees, and mixed income in informal activities for 2007-2008 due to the progress 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 proportional Denton method for aligning quarterly data to annual data (reducing further revisions) and ARIMA X-12 for seasonally-adjusting the quarterly series. In addition, IMF technical assistance has been provided to develop updated producer, export, and import price indices. |
| **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; and the coverage of the public enterprises should be made universal. 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 in its website (www.pancanal.com) on a fiscal year basis. There is a need to ensure a consistent and timely flow of ACP statistics on a calendar year basis. 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 (Fundo Ahorro de Panama, or FAP) mandated reporting of deferred payment schemes (e.g. turnkey projects) in budget documentation.<br><br>The authorities are receiving 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 increase 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 accounting reforms and the practical application of the accounting policies established in the International Public Sector Accounting |

| ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE (concluded) |
|---|
| Standards (IPSAS), an important step toward improving fiscal transparency. The financial accouting system is not prepared to support the recording of transactions and economic events under the accrual method. The authorities have taken important steps in improving these areas, further work would be needed to achieve compliance with international best practices. Panama does not report 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). The authorities have recently submitted test SRF data for the OFCs, which are being reviewed by STA. In February 2014, Panama started to report Financial Soundness Indicators (FSIs) to STA on a regular (quarterly) basis with data beginning on 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 corporate. |
| **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. 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 profit 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. A survey is being conducted to collect data on outward FDI of nonfinancial private sector. Quarterly IIP data have been compiled since 2002, and annual data are available since 1998. The definition of international reserves is currently being revised with TA support from STA, to ensure that the reserve assets reported by the National Bank of Panama are consistent with those published by the Contraloria, and that they meet the criteria defined in the international reserves template. STA also recommends that Contraloria should be the only agency in charge of compiling and disseminating international reserves data. The authorities are conducting Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS) with a view to improve external sector data quality in the context of CAPTAC Regional Harmonization Project of External Sector Statistics (RHPESS). |
| **DATA STANDARDS AND QUALITY** |
| Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000, but the metadata need to be updated. 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 CAPTAC missions. A data ROSC was published in October 2006. |

## Panama: Table of Common Indicators Required for Surveillance

(As of April 4, 2014)

| | 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 | No separate legal tender (U.S. dollar) | NA | NA | NA | NA | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities | NA | NA | NA | NA | NA | | |
| Reserve/Base Money | 12/2014 | 4/2014 | M | M | M | | |
| Broad Money | 1/2014 | 4/2014 | M | M | M | | |
| National Bank of Panama Balance Sheet | 1/2014 | 4/2014 | M | M | A | | |
| Consolidated Balance Sheet of the Banking System | 1/2014 | 4/2014 | M | M | M | | |
| Interest Rates[1] | 1/2014 | 3/2014 | M | M | M | | |
| Consumer Price Index | 2/2014 | 3/2014 | M | M | M | O, LNO, LO, LO | LO. LO. LO. O, LO |
| Revenue, Expenditure, Balance and Composition of Financing[2] – General Government[3] | 12/2013 | 2/2014 | Q | Q | Q | LO, LNO, LO, O | O, LO, LO, LO, LO |
| Revenue, Expenditure, Balance and Composition of Financing[2]–Central Government | 12/2013 | 2/2014 | Q | Q | Q | | |
| Stocks of Central Government and Central Government-Guaranteed Debt[4] | 1/2014 | 2/2014 | M | M | M | | |
| External Current Account Balance | 12/2013 | 2/2014 | Q | Q | Q | LO, LO, O, LO | LO, O LO, LO, LNO |
| Exports and Imports of Goods and Services | 12/2013 | 2/2014 | M | M | M | | |
| GDP/GNP | Q3/2013 | 1/2014 | Q | Q | Q | O, O, O, LO | LO, LO, LNO, LO, LNO |
| Gross External Debt | 12/2013 | 2/2014 | M | M | M | | |
| International Investment Position [5] | 2013 | 6/2013 | A | A | A | | |

[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.

INTERNATIONAL MONETARY FUND
COM
COMMUNICATIONS DEPARTMENT

Press Release No. 14/235
FOR IMMEDIATE RELEASE
May 19, 2014

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

**IMF Executive Board Concludes 2014 Article IV Consultation with Panama**

On May 9, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Panama.

Panama's economic performance remains buoyant. Real GDP growth averaged about 8.5 percent over the past decade, the highest in Latin America, supported by an ambitious public investment program, and accompanied by strong reduction in unemployment, poverty, and income inequality. After exceeding 10 percent in 2011–12, growth slowed to 8.4 percent in 2013 reflecting mainly a decline in Colon Free Zone activity and in Canal traffic. Growth is expected to remain strong over the medium term, as the economy continues to enhance its regional and global logistics role for the movement of goods, capital, and people. Inflation is moderating, due to the deceleration of international food and oil prices, but remains resilient and higher than in major trading partners, owing in part to strong domestic demand. The authorities are in the process of revising national accounts statistics (the Staff Report is based on the 1996-base national account statistics, the data available at the time of the staff mission).

The 2013 fiscal deficit was 3 percent of GDP, below the ceiling allowed under the Social and Fiscal Responsibility Law (SFRL) despite strong public investment. The 2014 fiscal deficit is expected to remain within the SFRL ceiling (2.7 percent of GDP), taking into account the expected upward revision to GDP. Strong growth and fiscal discipline contributed to a declining path of public debt. Efforts have been made to smooth the amortization profile and develop the domestic capital market. The banking system is generally healthy, with sound performance indicators, and the authorities have moved proactively to contain risks related to exposures to Venezuela. The current account deficit remains elevated, reflecting high public and private investment as well as temporarily weak exports, but is financed mainly by buoyant foreign direct investment.

[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.

The baseline outlook is favorable, with moderate risks. Panama's extensive external linkages bring strong economic and financial benefits, but also make the country sensitive to shifts in global economic and financial conditions. The normalization—and the surrounding uncertainty—of U.S. monetary policy may expose vulnerabilities, including through higher interest rates and capital outflows, while other external risks relate to a protracted economic slowdown in trading partners and persistent payment difficulties in Venezuela. Strong domestic demand contributes to the risk of overheating: resilient inflationary pressures may feed into wage dynamics, possibly reducing competitiveness. Additional significant delays in the Canal expansion would have an adverse impact on output and employment in the short term, and on exports and fiscal revenues in the medium term. However, strong fundamentals and the ability to implement countercyclical fiscal policies would help mitigate the impact of these shocks.

**Executive Board Assessment**[2]

Executive Directors commended Panama's continued robust macroeconomic performance, underpinned by sustained policy reforms, strong public investment, and private demand. Directors noted that although the outlook for growth is healthy, there are some signs of domestic overheating and the current account deficit is elevated. Changes in global economic and financial conditions could also pose risks. Directors emphasized that continued commitment to strong macroeconomic and financial policies and structural reforms will be important to safeguard against external and domestic shocks, and to support strong and sustainable growth.

Directors welcomed the prudent fiscal policy stance. However, they underscored that fiscal policy could be tightened to rein in inflationary pressures, and provide a cushion against external shocks. Furthermore, targeting a fiscal deficit below the Social and Fiscal Responsibility Law (SFRL) ceiling would help reduce the risk of exceeding or revising the deficit ceilings, thereby strengthening the credibility of the SFRL framework and investors' confidence. Directors encouraged the authorities to continue with fiscal reforms to strengthen capacity in budgeting and public financial management. Completing the implementation of the Single Treasury Account and establishing a Medium Term Expenditure Framework will be important going forward.

Directors noted that Panama's financial sector is generally healthy. Looking ahead, they advised close monitoring of external positions, credit growth, and the leverage and liquidity positions of banks. To safeguard financial stability, Directors encouraged swift implementation of the remaining 2011 Financial Sector Assessment Program recommendations. They called for further progress on a well designed liquidity facility for banks to help absorb liquidity shocks, and for building capacity to monitor systemic risks and to conduct macroprudential policies. Priority should also be given to further enhancing supervision of banks and non bank financial institutions.

[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.

Directors highlighted the importance of further enhancing corporate and financial transparency. They encouraged the authorities to step up their efforts to strengthen the anti money laundering and combating the financing of terrorism (AML/CFT) regime, including implementation of the recommendations of the AML/CFT assessment report.

Directors agreed that continued structural reforms are necessary to maintain external stability and competitiveness, reduce poverty, address income inequality, and enhance human capital and productivity. They encouraged the authorities to further enhance the quality of public education, increase the availability of vocational training, upgrade skills, and stimulate female labor force participation. Consideration should also be given to measures to support reallocation of labor from construction to other economic sectors, once the large infrastructure projects, including the canal expansion, are completed.

Directors encouraged the authorities to resume efforts toward subscription to the Special Data Dissemination Standard (SDDS), which would help close gaps in data that are critical for conducting sound macroeconomic policy.

## Panama: Selected Economic Indicators

| | 2009 | 2010 | 2011 | 2012 | Est. 2013 | Proj. 2014 |
|---|---|---|---|---|---|---|
| | (Annual percent change) | | | | | |
| **Real economy** | | | | | | |
| Nominal GDP | 5.0 | 12.0 | 15.8 | 14.7 | 12.7 | 11.1 |
| Real GDP (1996 prices) | 3.9 | 7.5 | 10.9 | 10.8 | 8.4 | 7.2 |
| Consumer price index (average) | 2.4 | 3.5 | 5.9 | 5.7 | 4.0 | 3.8 |
| Consumer price index (end-of-year) | 1.9 | 4.9 | 6.3 | 4.6 | 3.7 | 3.6 |
| **Money and credit** | | | | | | |
| Private sector credit | 1.3 | 13.6 | 16.8 | 14.1 | 12.6 | 11.3 |
| Broad money | 9.4 | 11.6 | 7.8 | 10.4 | 8.8 | 11.1 |
| Average deposit rate (1-year) | 2.8 | 2.9 | 2.1 | 2.2 | 2.1 | … |
| Average lending rate (1-year) | 7.5 | 7.5 | 6.9 | 7.2 | 7.2 | … |
| | (Percent of GDP) | | | | | |
| **Saving and investment** | | | | | | |
| Gross domestic investment | 25.6 | 25.5 | 27.2 | 28.6 | 30.0 | 29.8 |
| Gross national saving | 24.9 | 14.2 | 11.3 | 18.0 | 18.1 | 19.0 |
| **Nonfinancial public sector** 1/ | | | | | | |
| Revenue and grants | 30.3 | 29.5 | 29.0 | 28.9 | 28.0 | 27.8 |
| Expenditure | 29.2 | 33.0 | 33.4 | 32.2 | 33.0 | 32.7 |
| Current, including interest | 21.3 | 21.0 | 20.6 | 20.1 | 19.4 | 19.9 |
| Capital | 7.9 | 12.0 | 12.8 | 12.1 | 13.6 | 12.8 |
| Overall balance | 1.0 | -3.5 | -4.4 | -3.3 | -5.0 | -4.8 |
| Overall balance, excluding ACP | -1.0 | -1.8 | -2.1 | -1.5 | -3.0 | -3.0 |
| **External sector** | | | | | | |
| Current account | -0.7 | -11.4 | -15.9 | -10.6 | -11.9 | -10.8 |
| Foreign direct investment | 5.2 | 8.9 | 9.4 | 8.8 | 10.8 | 9.1 |
| Real effective exchange rate (depreciation -) | 1.9 | -2.3 | 1.7 | 3.9 | 5.3 | … |
| External public debt 2/ | 42.0 | 39.7 | 37.7 | 32.9 | 32.3 | 32.4 |
| **Memorandum items:** | | | | | | |
| GDP (in millions of US$) | 24,163 | 27,053 | 31,320 | 35,938 | 40,490 | 44,986 |

Sources: Comptroller General; Superintendency of Banks; and Fund staff estimates.
1/ Includes Panama Canal Authority (ACP).
2/ Including external debts of ACP.

**Statement by Paulo Nogueira Batista, Executive Director for Panama,**
**Ivan Luis Oliveira Lima, Alternate Executive Director,**
**and Alfredo Maciá, Advisor to Executive Director**
**May 7, 2014**

1. The Panamanian authorities thank the IMF staff for their assistance and advice. Panama's economic activity remained robust in 2013. Real GDP growth at 8.4 percent[1] continued to be one of the highest in Latin America, driven by the Panama Canal expansion works, large public infrastructure investments, high foreign direct investments (FDI), and strong domestic demand. Growth is projected to moderate somewhat in 2014, to around 7.0 percent of GDP, according to the national budget. Total unemployment remained low at 4.1 percent in August 2013, as estimated by the National Statistics Institute (*Instituto Nacional de Estadística y Censo* – INEC).

2. CPI inflation declined from 4.6 percent at end-2012 to 3.7 percent at end-2013, favored by lower import prices of fuel and commodities. The current account deficit reached almost 11.3 percent of GDP in 2013, over a percentage point higher than in 2012. This reflects mainly imports of capital goods associated to the execution of large public and private investment projects, as well as the ongoing expansion of the Panama Canal. Large FDI inflows continued to finance the bulk of the current account deficit.

3. Cautious fiscal policy management took centre stage in the implementation of the sizable 2013 public investments program. The end-2013 non-financial public sector (NFPS) fiscal deficit stood at 3 percent of GDP, below the 3.1 percent ceiling established in the fiscal responsibility law (*Ley de Responsabilidad Social Fiscal* – LRSF). In mid-2013 the fiscal deficit ceiling was changed from 2.8 percent to 3.1 percent of GDP, to create room for covering costs arising from the floods of end-2012, a natural disaster that led to the declaration of a state of national emergency. For 2014, the Ministry of Economy and Finance (MEF) projects a fiscal deficit of 2.7 percent of GDP, in line with the limit established in the LRSF. The downward trend of the public debt to GDP ratio results from Panama's prudent fiscal policies. The public debt to GDP ratio (excluding the external debt of the Panama Canal Authority) fell to 36.8 percent at end-2013, from 37.6 percent in 2012 and 42.3 percent in 2009. This trend also reflects Panama's strong fundamentals as an investment grade country and the authorities' commitment to sustained economic development.

4. The National Authority for Public Revenue (*Autoridad Nacional de Ingresos Públicos* – ANIP) was created in April 2013. Its setting up as an independent tax administration unit – replacing the General Revenue Office (*Dirección General de Ingresos* – DGI) that used to be under the MEF's structure – brought about strengthened

[1] GDP-related data used in this Buff statement take into account the change in the base year from 1996 to 2007, in accordance with the 2013 Report of the Comptroller General of the Republic released in March 27, 2014.

oversight, enhanced tax collection and a reduction in tax evasion. Based on MEF's year-end estimates, the NFPS total revenue increased 9.9 percent in 2013 compared to 2012.

5. Expenditures went up 16.4 percent within the same period, mostly to support large public infrastructure investments. This has led to a further improvement in the composition of the overall public expenditure, with the share of capital expenditure maintaining its upward trend from 31.8 percent in 2009 to 44.4 percent in 2013.

6. The banking system shows strong performance and stability, according to the indicators reported by the Superintendence of Banks (*Superintendencia de Bancos de Panamá* – SBP). It is well capitalized and liquid, with a capital adequacy ratio for the system as a whole at 14.8 percent. This is comparable to the 15.6 percent ratio recorded in the LA5 (Brazil, Chile Colombia, Mexico and Peru), and reflects solid fundamentals that will help mitigate possible external shocks to the banking system. Non-performing loans are minimal, slightly above one percent of total loans. Private credit continues to strongly support real estate, construction, consumption and mining activities.

7. The authorities have made steadfast progress on the implementation of the 2011 FSAP recommendations. The SBP is implementing risk-based supervision and strengthening offsite supervision. The Financial Coordination Council (FCC), comprised of Panama's financial regulators, is coordinating efforts with financial market institutions to monitor any potential systemic risks. The authorities have also given priority to the drafting of a new law on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), strengthening the Financial Intelligence Unit (FIU) and developing the framework for a liquidity facility. Technical assistance (TA) from the Fund and the Inter-American Development Bank (IDB) is underway to review the AML/CFT legislation. In addition, the US Treasury Department is assisting Panama in strengthening the FIU, with the aim of matching best practices of transparency for financial services. All legislation related to the above actions should be in place by end-2015.

8. The authorities are committed to improving corporate and financial transparency. There is significant support in the country to move forward with the amendments to law 47 of August, 2013 to accelerate implementation of bearer-shares registration. The network of double taxation agreements (DTA) has been expanded and now encompasses 18 countries with which Panama has signed a DTA to date. Negotiations are in progress with Taiwan and Vietnam and about to start with Hong Kong. Treaties for the exchange of fiscal information have been finalized with Germany and are in progress with Japan and Australia.

9. We are of the view that the staff report does not to fully recognize the progress that Panama has made and places undue emphasis on AML/CFT issues. This emphasis may not be in accordance with the Fund's policy on the treatment of AML/CFT in

surveillance. According to this year's review of the Fund's strategy, these issues "should be discussed in the context of surveillance when they undermine a member's balance of payments and domestic stability, or the effective operation of the international monetary system". The second does not apply, given the size of Panama's economy. There is also no evidence that AML/CFT issues undermine the country's balance of payments and domestic stability, as can be inferred from the rather convoluted discussion of risks in paragraph 19. In any case, what matters is that the authorities have reaffirmed and confirmed by actions their commitment to prevent money laundering and the financing of terrorism. Panama has undergone a comprehensive evaluation on AML/CFT and has authorized publication of the Detailed Assessment Report (DAR) and the Report on Observance of Standards and Codes (ROSC) in February.