INTERNATIONAL MONETARY FUND

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PANAMA

February 2021

REQUEST FOR AN ARRANGEMENT UNDER THE PRECAUTIONARY AND LIQUIDITY LINE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PANAMA

In the context of the Request for an Arrangement Under the Precautionary and Liquidity Line, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 19, 2021, following discussions that ended on December 16, 2020, with the officials of Panama on economic developments and policies underpinning the IMF arrangement under the Precautionary and Liquidity Line. Based on information available at the time of these discussions, the staff report was completed on January 5, 2021.
- A **Staff Supplement**: Assessment of the Risks to the Fund and the Fund's Liquidity Position.
- A **Statement by the Executive Director** for Panama.

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

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PRESS RELEASE

PR21/19

IMF Executive Board Approves US$2.7 billion Precautionary and Liquidity Line for Panama to Address COVID-19 Pandemic

FOR IMMEDIATE RELEASE

- The IMF Executive Board approved today a two-year arrangement for Panama under the Precautionary and Liquidity Line (PLL) in the amount equivalent to US$2.7 billion (SDR 1.884 billion). The PLL will serve as insurance against extreme external shocks stemming from the COVID-19 pandemic.

- The access under the PLL in the first year will be equivalent to about US$1.35 billion (0. 942 billion SDR). The authorities intend to treat the arrangement as precautionary.

- Panama qualifies for the PLL thanks to its sound economic fundamentals, strong institutional policy frameworks, long track record of good economic performance and policy implementation, and commitment to maintain such policies in the future. The arrangement should boost market confidence and provide protection against downside risks.

Washington, DC – January 19, 2021: The Executive Board of the International Monetary Fund (IMF) approved today Panama's request for a two-year arrangement under the Precautionary and Liquidity Line (PLL) for SDR 1.884 billion (500 percent of Panama's quota, equivalent to about US$2.7 billion), which the authorities intend to treat as precautionary. The PLL will serve as insurance against extreme external shocks stemming from the COVID-19 pandemic.

In 2020, Panama was severely affected by the global pandemic as containment measures significantly reduced economic activity, especially tourism. In addition, the country was hit by hurricane Eta and tropical storm Iota which curtailed a large part of the country's agricultural production. As a result, output is estimated to have dropped by 9 percent, with the fiscal position deteriorating significantly amid revenue shortfalls and expenditure pressures.

While Panama is able to cover its external financing needs under present conditions, the arrangement provides insurance against downside risks. Policy priorities under the PLL include supporting an adequate level of spending on health and the social sectors during the pandemic, continuing strengthening further institutional policy frameworks, including financial integrity and data adequacy, and preparing the economy for the post-pandemic recovery.

The PLL was introduced in 2011 to meet more flexibly the liquidity needs of member countries with sound economic fundamentals and strong records of policy implementation but with some remaining vulnerabilities.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Chair, made the following statement:

"Panama's sound macroeconomic policies have led to over three decades of dynamic growth. However, the impact of COVID-19 pandemic has caused a considerable deterioration in the country's macroeconomic situation and outlook. The two-year arrangement under the Precautionary and Liquidity Line (PLL) for 500 percent of quota (SDR 1.884 billion) will help the authorities' economic recovery efforts against the pandemic, address outstanding vulnerabilities, and boost market confidence.

“Panama qualifies under the PLL, as it performs strongly in three out of the five qualification areas (external, fiscal and monetary) and does not substantially underperform in the other two areas (financial and data). It also meets the criteria for exceptional access. The authorities intend to treat the PLL arrangement as precautionary.

“The authorities have resolutely implemented measures to contain the pandemic and mitigate its impact on the economy. These include a temporary relaxation of fiscal deficit limits under the Social and Fiscal Responsibility Law to support health and social-related expenditures, permitting banks to drawdown their accumulated dynamic provisioning to absorb credit losses, and loan restructurings for affected borrowers. They are committed to a gradual fiscal consolidation and recalibration of policy responses once the pandemic recedes.

The policy agenda during the PLL will focus on facilitating prompt exit from the FATF grey list, strengthening data adequacy and public financial management, as well as preparing the economy for the post-pandemic recovery.”

For information on COVID-related financing requests approved by the IMF Executive Board, please see a link to the IMF Financial Assistance Tracker:https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker

For the list of upcoming discussions, please see a link to the calendar of the IMF Executive Board meetings:

https://www.imf.org/external/NP/SEC/bc/eng/index.aspx

INTERNATIONAL MONETARY FUND

PANAMA

REQUEST FOR AN ARRANGEMENT UNDER THE PRECAUTIONARY AND LIQUIDITY LINE

January 5, 2021

EXECUTIVE SUMMARY

- **Context.** While Panama has been the most dynamic economy in Latin America over the last three decades (growing 6 percent on average), its strength is being tested by the COVID-19 global pandemic. Panama is a service-based economy that is highly integrated in the world economy and exposed to extreme shocks during the pandemic.

- **Outlook and Risks.** The economy is expected to have contracted by 9 percent in 2020 and to grow by 4 percent in 2021. Inflation has remained subdued. The outlook is subject to an unusually high level of uncertainty given the pandemic.

- **Precautionary and Liquidity Line.** The authorities are requesting a two-year arrangement under the PLL for 500 percent of quota (SDR 1.884 billion), which they intend to treat as precautionary and will serve as an insurance against extreme adverse risks related to the pandemic. Staff assesses that Panama qualifies under the PLL as it performs strongly in 3 out of the 5 qualification areas and does not substantially underperform in the other 2 areas. Staff also assesses that Panama meets the criteria for exceptional access and its capacity to repay the Fund is adequate.

- **Policy Agenda.** The main policy challenge is minimizing the loss of human lives in the wake of the pandemic and facilitating vaccination. The fiscal deficit is expected to have widened to 9 percent of GDP in 2020 to meet sanitary and social needs; gradually returning to the fiscal rule of 2 percent of GDP by 2024. The policy agenda during the PLL will focus on facilitating a prompt exit from the FATF grey list, strengthening data adequacy, and preparing the economy for the post-pandemic recovery.

- **Fund Liquidity.** Staff estimates that under an adverse scenario, potential additional financing needs for 2021–22 could amount to some US$2.6 billion or SDR 1.884 billion (500 percent of quota). The proposed commitment under the PLL would have a moderate impact on the Fund’s liquidity position.

- **Process.** An informal meeting to consult with the Executive Board on a possible PLL arrangement was held on October 9, 2020.

Approved By
Aasim M. Husain (WHD) and Martin Čihák (SPR)

Discussions were held virtually during October 12-December 16, 2020. The mission comprised Alejandro Santos (head), Olga Bespalova, Julian Chow, Marina Rousset (all WHD), Alberto Soler (FAD), Luiza Antoun de Almeida (SPR), and Torsten Wezel (MCM), with support from Paola Aliperti and Madina Toshmuhamedova (both WHD). Alfredo Macias (OED) also participated. The mission met with Minister of Economy and Finance Héctor Alexander, Superintendent of Banks Amauri Castillo, General Manager of the National Bank of Panama Javier Carrizo, and other senior officials.

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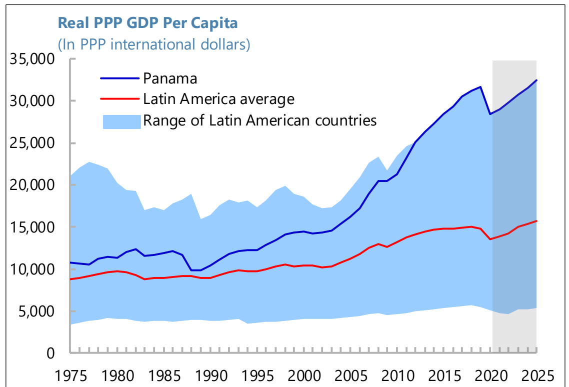
Acronyms

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BNP	Banco Nacional de Panama (National Bank of Panama)
CAPTAC-DR	Regional Technical Assistance Center for Central America, Panama and Dominican Republic (IMF)
CFZ	Colon Free Zone
CIT	Corporate Income Tax
DSBB	Dissemination Standards Bulletin Board
e-GDDS	Enhanced General Data Dissemination System
EMBIG	Emerging Markets Bond Index Global
FAD	Fiscal Affairs Department (IMF)
FATF	Financial Action Task Force
FCL	Flexible Credit Line
FES	Fund for Economic Stimulus
FSI	Financial Stress Index
GAFILAT	Latin America Anti-Money Laundering Group
GRA	General Resources Account
IFIs	International Financial Institutions
INEC	National Institute of Statistics and Census
LAC	Latin America and the Caribbean
LOLR	Lender of Last Resort
MCM	Monetary and Capital Markets Department (IMF)
MEF	Ministry of Economy and Finance
ML	Money Laundering
NBP	National Bank of Panama
NCS	National Statistical Council
NFPS	Non-Financial Public Sector
NPLs	Non-Performing Loans
PFM	Public Financial Management
PIT	Property Income Tax
PLL	Precautionary and Liquidity Line
RFI	Rapid Financing Instrument
ROSC	Report on the Observance of Standards and Codes
SBP	Superintendency of Banks of Panama
SDDS	IMF's Special Data Dissemination Standard
SDR	Special Drawings Rights
SFRL	Social and Fiscal Responsibility Law
SIP	Selected Issues Paper
SP	Stimulus Program
SPR	Strategy, Policy and Review Department (IMF)
SSNF	Superintendency of Non-Financial Entities
TA	Technical Assistance
VAT	Value-Added Tax
WEF	World Economic Forum
WEO	World Economic Outlook

CONTEXT

1. **After over two decades of record high growth, Panama's economy weakened in the two years prior to the pandemic and contracted sharply in 2020.** Panama experienced an unprecedented economic expansion with average annual growth of 6 percent in the last 25 years, the longest and fastest in Latin America (and one of the longest and fastest in the world). The high-growth episode was supported by an investment boom, which included the expansion of the Panama Canal and the construction of one of the largest copper mines in the world. Panama reached high-income status in 2017, according to the World Bank classification methodology, and enjoys the highest per capita income in Latin America.[1] Social outcomes also improved significantly over this period (Box 1). However, the economy is facing an unprecedented shock.



Source: World Economic Outlook and IMF staff calculations.

2. **Panama has had 20 Fund arrangements in its history, with about ⅔ being precautionary.** The authorities have used IMF-supported programs in the past to advance reform agendas that are responsible for the successful economic performance of the last quarter of a century. The most notable examples were the four most recent arrangements which covered a decade 1992–2002. The authorities consider that these arrangements supported a reform agenda that led to higher growth, provided insurance against external risks, helped strengthen fiscal and external buffers in a challenging external environment, and sent positive signals to market participants. Importantly, Fund-supported programs anchored Panama's reform agenda to reinforce expenditure controls and strengthen revenue collection, privatize enterprises and contract out services to the private sector, enhance financial supervision and measures to combat money laundering, as well as reduce poverty via targeted transfer programs. Following the global COVID-19 shock and the disruption it has created in the Panamanian economy,

Recent Fund Arrangements (1992-2002)[1]

Arrangement	Access/Duration	Reform Program
SBA [2] (Jun 2000)	SDR 64 million (31% of quota) 21 months	Broaden the tax base, improve expenditure control, expand social programs (on education, health, low-income housing, and potable water).
EFF (Dec 1997)	SDR 120 million (80% of quota) 31 months	Privatization (airports, casinos, public utilities, etc.), pension reform, import tariff reduction, and expanding public services in rural areas.
SBA [3] (Nov 1995)	SDR 84.3 million (56% of quota) 16 months	Public wage and employment reform, revamping the social security system, partial privatization of the telecommunications company, preparations for the reversion of the Canal Zone to Panama (from U.S. ownership).
SBA (Feb 1992)	SDR 74.2 million (73% of quota) 31 months	Reform of public enterprises, including reducing the public wage bill, implementing cost reduction measures and passing privatization legislature; reconciliation of private and bonded debt.

1/ Between 1965 and 1985, Panama had 16 Stand-By Arrangements (SBA) with the Fund with duration ranging between 8 and 21 months (averaging 13 months).
2/ Intended to be treated as precautionary and accompanied by EFF cancelation.
3/ Original SBA (69.8 million SDR) was augmented in March 1996 by 14.5 million SDR to finance debt and debt-service reduction (DDSR) operations.

[1] For an account of the growth episode in Panama see the IMF blog: Panama—Economic Quantum Leap (2019): https://blog-dialogoafondo.imf.org/?page_id=11156

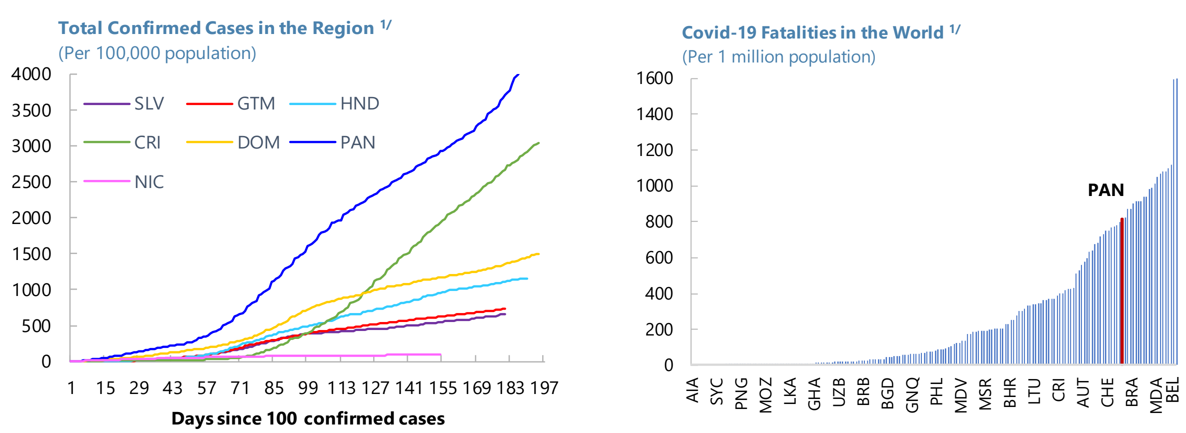
deteriorating the balance of payments and public finances, the authorities requested financial support under the Rapid Financing Instrument (RFI) in the amount of SDR 376.8 million, equivalent to 100 percent of quota, which was approved by the Executive Board on April 15, 2020.

3. Considering the still elevated external risks from the COVID-19 pandemic, the authorities are requesting a PLL arrangement following the RFI support. Given the significant downside risks in the external environment, including due to a second wave of the pandemic, the authorities believe now that an arrangement under the Precautionary Liquidity Line (PLL) would be useful in sending a strong signal to markets about their policies, providing important insurance against these risks as well as supporting their intention to strengthen the economy's resilience and foster higher and more inclusive growth.

RECENT DEVELOPMENTS

4. Despite strong containment measures, Panama has been severely affected by the COVID-19 pandemic. These measures significantly reduced mobility and negatively affected economic activity. High population density around Panama City (about ½ of the country's population) made the country very vulnerable to the virus contagion and fatality.[2] Panama has one of the highest COVID fatality rates in the world, despite a relatively robust healthcare system, a comparatively low share of informal employment, and decisive response measures. To contain the spread of the virus, the authorities declared a National State of Emergency in mid-March 2020, implemented a mandatory quarantine, border controls, introduced a curfew, closed schools, suspended commercial flights, cancelled events, and shut down all non-essential activities. The gradual reopening of the economy started in May-June 2020, but an acceleration of cases in the second phase prompted some tightening measures. In August-October 2020, the authorities gradually reactivated construction, free-trade zones, shopping and restaurants, air travel, and tourism sights. Mandatory quarantine ended in late October 2020, but the curfew remains active.

Impact of COVID-19 Shock in Panama: Contagion and Fatality

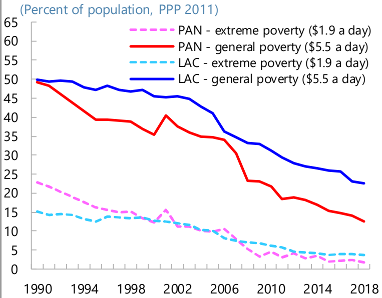


Sources: Johns Hopkins University CSSE, World Economic Outlook, and IMF staff calculations.
1/ Data as of December 17, 2020.

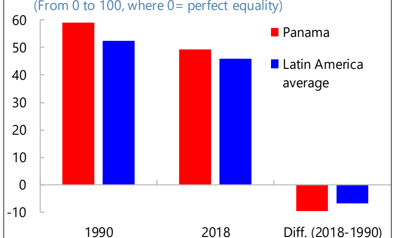
[2] The number of confirmed COVID-19 cases stood at 203,295 with 3,481 fatalities as of December 17, 2020.

Box 1. Progress on Social Outcomes

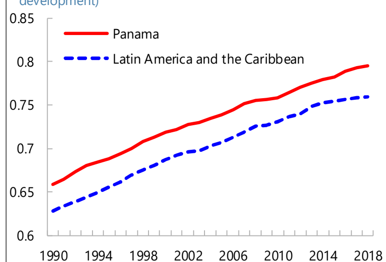
- **Progress on poverty and inequality reduction was significant before the pandemic.** Panama saw a remarkable reduction in poverty headcounts and a rise of the middle class. The extreme poverty rate (at US$1.9/day, PPP) dropped by over 85 percent (from 12.4 percent in 2000 to 1.7 percent in 2018), while the general poverty rate (at US$5.5/day, PPP) was slashed by about ⅔ (from 35.4 percent to 12.6 percent over the same period, and to 12.5 percent by 2019)—both at a much faster pace than elsewhere in the region. Income inequality was reduced substantially between 2000 and 2018, with the Gini coefficient declining from 56.8 to 49.2, also faster than in the region as a whole. Meanwhile, the United Nations Human Development Index, which measures average achievement in key dimensions of human development (namely a long and healthy life, being knowledgeable and having a decent standard of living), improved substantially and remains above regional norms. Moreover, average income growth of the bottom 40 percent of earners has been faster than that of an average citizen. However, as elsewhere, rural poverty is high and particularly elevated in the *comarcas*: territories inhabited by indigenous peoples, where it is difficult to provide services.



Poverty Headcount Ratio
(Percent of population, PPP 2011)
Source: World Development Indicators.

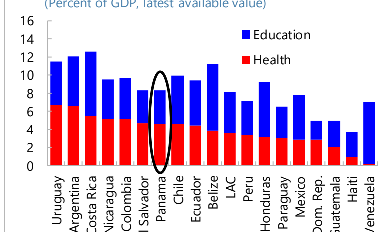


GINI Index [1/]
(From 0 to 100, where 0= perfect equality)
Source: World Development Indicators and IMF staff calculations.
1/ LAC average was calculated using available data in the World Bank database. Data for the closest available years was used when unavailable for the years 1990 and 2018.



Human Development Index, 1990-2018
(0-1, where higher value indicates higher human development)
Source: UN Human Development Report 2019 database.

- **Progress in other social areas has been mixed.** Panama's health spending exceeds the regional average and the efficiency and robustness of its healthcare system is ranked above the regional norm in the Global Health Security Index 2019. However, the country still has a yawning educational gap that needs to be tackled to improve social outcomes and secure long-term competitiveness. Government spending on education amounted to around 3¾ percent of GDP in 2019, below the LAC average, while enrollment rates remained low (mostly in secondary education). In addition, Panama's results in the 2018 Program for International Student Assessment (PISA) demonstrate significant deficiencies in reading, mathematics and science, which are unchanged since 2009.



Public Sector Social Spending
(Percent of GDP, latest available value)
Sources: National authorities, IMF FAD Expenditure Assessment Tool and IMF staff calculations.

- **Poverty rates are projected to rise due to the global pandemic, as elsewhere in the world, but policy measures are in place to protect the vulnerable population**. According to World Bank estimates, had the government not enacted fiscal stimulus, the general poverty rate would have risen from 12.5 to 15.9 percent of the population, an increase of 3.4 percentage points. Instead, the government's measures are expected to limit the increase in poverty headcount to just 1.7 percentage points. The government's fiscal stimulus package included: (i) delivery of food baskets and cash transfers to low-income individuals, affected workers and small business owners through the "Panama Solidarity Plan"; (ii) programs (such as Opportunity Banking, Guarantee Fund, and the Soft Loan program) jointly valued at US$235 million, aimed at supporting the micro, small and medium-sized companies in restarting operations and continuing to employ workers; (iii) a suspension of payments for public services (electricity, phone and internet); (iv) an electricity subsidy; and (v) an expansion of the Housing Solidarity Fund program which provides US$10,000 towards a house down payment to families in need. In addition, development partners such as the IDB and the World Bank mobilized loans aimed at supporting the Panamanian authorities in their effort to contain the COVID-19 pandemic and mitigate its impact on vulnerable households and short-term adverse effects on the economy.

5. The country was hit by hurricane Eta and tropical storm Iota in November 2020, resulting in loss of human lives and damage to agricultural production. Hurricane Eta landed in Panama on November 5 and Iota on November 17 causing floods and landslides that affected a large part of the country's agricultural production. The death toll stood at 21 while another 13 people went missing. Economic losses were estimated at US$15 million, mainly in the agricultural sector as the production of bananas, rice, legumes, and vegetables was severely curtailed. The authorities declared a state of "Environmental Emergency" and allocated US$100 million to alleviate natural disaster risks. Shelters and medical assistance were provided by the Ministry of Health and the Social Security Fund, with over 7 thousand tons of humanitarian aid (including water, food, and basic necessities) dispatched to the affected population.

6. Economic indicators point to significant weaknesses in 2020. This was mostly due to the measures to contain virus contagion which induced a widespread economic shutdown.

- ***The economy contracted***. Following a moderation of growth to 3 percent in 2019, the economy virtually stagnated in Q1-2020 (growing only at ½ percent, y/y), and contracted sharply in Q2-2020 (declining 38½ percent, y/y). The index of economic activity (IMAE) fell by 30 percent in July 2020 (y/y), and about 29 percent in August (y/y).

- ***Inflation remains subdued.*** There are no discernible price pressures. Following relative price stability in 2019, consumer prices have fallen by 1½ percent in June 2020 (y/y). Prices are expected to have remained soft in recent months.

- ***The fiscal position deteriorated markedly***. The fiscal deficit stood at 3 percent of GDP in 2019 and is estimated to have reached around 7 percent of GDP in the first 9 months of 2020 as tax revenues suffered due to tax deferrals and lower GDP growth while expenditure pressures emerged from the health and social areas due to the COVID-19 pandemic. In response to the difficult fiscal situation, and at the request of the government, the National Assembly approved in late October 2020 legislation relaxing the fiscal rule for 2020–23 (to a deficit between 9 and 10½ percent of GDP in 2020, between 7 and 7½ percent in 2021, 4 percent in 2022 and 3 percent in 2023), while strengthening the rule for 2025 and onwards (to a deficit of 1½ percent of GDP). The ranges in the deficits for 2020–21 reflect uncertainties on nominal GDP projections, as the deficit in dollar terms is fixed in the amended 2020 budget and the 2021 budget. The new path towards the medium-term anchor seems appropriate, as it avoids significant pro-cyclical pressures while ensuring a steadily declining public debt path.

Fiscal Rule
(In percent of GDP)

	Fiscal Deficit		
	Old SFRL	New SFRL	Δ (Mean)
2020	2¾	9-10½	7
2021	2	7-7½	5¼
2022	2	4	2
2023	2	3	1
2024	2	2	--
2025	2	1½	-½

SFRL=Social Fiscal Responsibility Law

- ***Financial conditions remain stable***. Despite generalized loan repayment deferments agreed between the government and the banking community for the second half of 2020 and mandated by the government for the first half of 2021, banks remain liquid. Deposits have increased modestly, and credit has contracted slightly by ¾ percent through August 2020 (y/y).

Non-performing loans have likely increased but it is difficult to assess their magnitude given the repayment deferments. The Superintendency of Banks (SBP) released dynamic provisioning amounting to US$1.3 billion (about 2 percent of GDP) to ease banks financial position.

- ***The external position improved.*** The external current account was broadly balanced in the first half of 2020, compared to a deficit of 3.5 percent of GDP over the same period in 2019. The sharp recession and lower oil prices have led to a stronger decline in imports compared to exports, which were supported by increased copper production.

7. High-frequency indicators corroborate that reduced mobility and containment measures caused a sharp economic contraction. Mobility indicators have partially recovered lately but remained significantly below the pre-pandemic levels. Reduced mobility, suspended activities, and other containment measures have significantly reduced demand, especially in construction, commerce, restaurants, and hotels. High-frequency indicators point to a significant decline in domestic demand for cars, fuel, toll road use, and electricity generation in March–October 2020. Canal activity deteriorated, with traffic falling by 7.4 percent in October 2020 (y/y), although revenues in the same period increased by almost 7 percent, supported by a new toll structure. Ports cargo movement posted a 14 percent increase (y/y) in October 2020.

Economic Indicators

(Year-on-year growth, percent)

	Area	2019 Dec	2020 Mar	Jun	Jul	Aug	Sep	Oct
1	Canal traffic	17.6	-5.2	-15.8	-9.7	-12.6	-9.6	-7.4
2	Canal revenue	8.0	1.9	-11.0	-2.3	-2.0	2.1	6.9
3	Ports cargo movement	4.1	38.7	-13.2	-3.4	5.5	-13.3	14.2
4	Road revenue	-7.2	-38.2	-63.9	...	...	...	...
5	Fuel sales	-4.3	-26.7	-48.5	-50.6	-48.6	-38.0	-29.7
6	New cars registered	-24.4	-41.2	-83.0	-71.9	-65.2	-29.5	-52.1
7	Electricity generation	6.1	0.0	-10.2	-7.7	-6.9	-5.1	-0.3
8	Electricity consumption	7.5	-3.2	-12.6	-18.5	-13.8	-10.5	-7.9
9	Water consumption	1.6	0.2	0.5	0.0	0.0	-0.6	0.3

Source: INEC and IMF staff calculations.

OUTLOOK AND RISKS

8. The COVID-19 pandemic has deteriorated the outlook significantly. Suppression of economic activity, exacerbated by the decline of global growth and trade, will widen the negative output gap in 2020–21, while the negative external outlook will affect Canal traffic and revenues. Staff projects that real GDP declined by 9 percent in 2020 (3 percent growth in 2019) and is expected to recover to 4 percent growth in 2021 as economic activities return to normality, which implies a sizable cumulative output loss compared to the pre-pandemic outlook.[3]

Macroeconomic Framework

(Percent of GDP unless otherwise indicated)

	2019	Est. 2020	Projection 2021	2022
GDP growth (%)	**3.0**	**-9.0**	**4.0**	**5.0**
Inflation (%)	-0.1	-0.5	0.5	2.0
Credit growth (%)	2.4	-2.0	2.0	6.2
Fiscal balance	**-3.1**	**-9.0**	**-7.4**	**-4.0**
Public debt (NFPS)	41.0	53.8	59.4	60.0
Current account	-5.4	-2.5	-6.0	-4.8

Source: Fund staff calculations.

[3] The economic cost of the pandemic in terms of foregone output will be substantial. Before the pandemic, real GDP was envisaged to grow at 4 percent in 2020 and 5 percent thereafter. However, the latest estimates suggest a decline of 9 percent in 2020, and a projected 4 percent growth in 2021 and 5 percent growth thereafter.

Prices will remain soft. Weaker economic activity will lower credit growth. Suspension of labor contracts (to allow renegotiation of wages) is unlikely to prevent an increase in unemployment, which may cause late payments on personal bank loans.

9. The external position improved temporarily in 2020 due to the economic downturn but is expected to return to its pre-pandemic level in 2021 as imports recover. The external current account deficit is estimated to have narrowed to 2.5 percent of GDP in 2020 (from 5.4 percent of GDP in 2019) on the back of a sharp contraction in imports, lower oil prices, and increased copper exports.[4] The current account is expected to weaken in 2021 and 2022, close to its historical level, as the anticipated recovery in the domestic economy will lead to stronger growth in imports. However, over the medium-term, the current account deficit will continue to narrow as tourism, trade, and Canal activity recover post-pandemic.

Balance of Payments
(In percent of GDP)

		Est.	Projection	
	2019	2020	2021	2022
Current Account	**-5.4**	**-2.5**	**-6.0**	**-4.8**
Non-oil balance	-10.7	-7.5	-8.7	-8.6
Oil balance	-3.8	-2.6	-2.8	-2.8
Colon Free Zone	2.7	2.7	2.1	2.2
Tourism	4.7	2.7	3.7	3.9
Canal receipts	4.8	4.2	4.5	4.5
Other current	-3.0	-2.1	-4.7	-4.0
Financial Account	**7.1**	**2.5**	**5.9**	**4.8**
Foreign direct investment	5.5	4.1	4.7	4.9
Portfolio Investment	4.8	3.7	3.0	4.0
Other financial	-3.2	-5.3	-1.8	-4.2

Source: INEC and Fund staff estimates.

10. The fiscal outlook has also been adversely affected by the pandemic. Containment costs, higher public expenditures to provide relief to the unemployed and informal workers as well as weak revenues is estimated to have increased the fiscal deficit to 9 percent of GDP in 2020 (from the original budget target of 2¾ percent of GDP), thereby surpassing the limit established under the Social and Fiscal Responsibility Law (SFRL). Expenditure pressures stemming from COVID-19 and hurricane ETA were partly contained by reallocating non-executed public investment projects towards extraordinary health and social spending needs. The additional financing needs were covered with multilateral loans (including the RFI), additional bond placements, and limited recourse to the Savings Fund. NFPS debt is estimated to have risen from 41 percent of GDP in 2019 to almost 54 percent of GDP in 2020. The fiscal position is expected to improve in 2021 as tax collections recover with the economy and expenditure pressures ease.

Fiscal Accounts
(In percent of GDP)

		Est.	Projection	
	2019	2020	2021	2022
Revenues	**18.4**	**15.1**	**17.9**	**19.4**
Tax revenues	8.2	5.9	7.4	8.5
Non-tax revenues	10.2	9.2	10.5	10.8
Expenditures	**21.5**	**24.1**	**25.4**	**23.4**
Current primary	14.3	17.5	17.2	16.1
Interest payments	1.9	2.3	2.6	2.4
Capital	5.3	4.3	5.6	4.9
Overall Balance	**-3.1**	**-9.0**	**-7.4**	**-4.0**

Source: MEF and Fund staff estimates.

[4] Compared to 2019, net re-exports from Colon Free Zone in 2020 are estimated to have fallen by around 10 percent (one third of the decline during the Global Financial Crisis (GFC)), while tourism and canal receipts are estimated to have declined by around 50 percent and 20 percent, respectively, due to adverse global economic conditions. Net FDI inflow is assumed to have fallen by 35 percent due to the weaker economic situation in source countries, close to the magnitude seen during the GFC. Although net portfolio inflows have been relatively stable in recent years, sudden global capital stops could result in a significant decline. Net portfolio inflows are estimated to have declined by 30 percent in 2020, relative to 2019 similar to the aftermath of the Argentinian Financial Crisis of 2002.

11. The balance of risks remains tilted to the downside. The economic outlook continues to be subjected to an unusual degree of uncertainty related to the impact of COVID-19 on the global economy and Panama. Staff projections assume that the spread of the disease will be contained at moderate levels and activity will resume relatively rapidly as the health crisis begins to wane. However, the situation could evolve along a more negative trajectory, with a second wave of the pandemic exacerbating risks to human lives and the economy. To prevent social tensions, which could disrupt economic activity, and polarize society, additional measures to strengthen domestic health services and provide support to vulnerable populations would be needed. These would be partially covered by further reallocation of the budget toward health and social needs, supported by additional external financing. Moreover, a worsening of the COVID-19 pandemic could lead to a more severe disruption of global trade and capital flows, accelerating de-globalization, oversupply and volatility in the oil market, and intensified geopolitical tensions and security risks, negatively impacting activity of canal and logistics sectors, and further deteriorating Panama's balance of payments as a result of additional pressures on the current account, foreign direct investment, portfolio inflows, and the rollover of external debts (Box 2). This would require additional resources to address the resulting increase in gross external financing needs. A deeper or more protracted shock could further weaken aggregate demand, lower tax revenues and amplify spending needs, widen the current account deficit, and consequently lower GDP growth prolonging the economic recovery. Similarly, absent meaningful progress in improving its AML/CFT framework, Panama's ongoing public listing by the FATF could have a potential adverse effect on correspondent banking relations and possible key credit channels, particularly if the FATF were to publicly consider elevating Panama to the list of high-risk jurisdictions (also referred to as the black list), subject to a call for action. In addition, cyberattacks can bring significant disruptions to digital infrastructure, while more frequent and severe climate-change related natural disasters can adversely affect Canal activity, agriculture and tourism. The upside risks from faster-than-expected recovery from the pandemic are low, given that COVID-19 contagion in Panama is one of the worst in the region.

PRECAUTIONARY AND LIQUIDITY LINE ISSUES

A. Assessment of PLL Qualification

12. Panama is eligible for the PLL arrangement as it meets the necessary qualification criteria. In particular, staff assesses Panama to perform strongly in 3 out of the 5 qualification areas (external, fiscal and monetary), and not to substantially underperform in the other 2 areas (financial and data). In the 2020 Article IV Consultation (completed on a lapse-of-time basis on March 24, 2020) the Executive Board supported the generally positive assessment of Panama's policies and frameworks. During the Board meeting on the Rapid Financing Instrument (completed on April 15, 2020), the Executive Board also supported Panama's policy response to the pandemic.

I. External Position and Market Access. *Panama performs strongly in the external and market access area. While the current account deficit has been large in the past, it has been the reflection of relatively large investment rates (around 40 percent of GDP, on average, over the last decade) and historically high growth over the last quarter of a century (the highest in Latin America).*

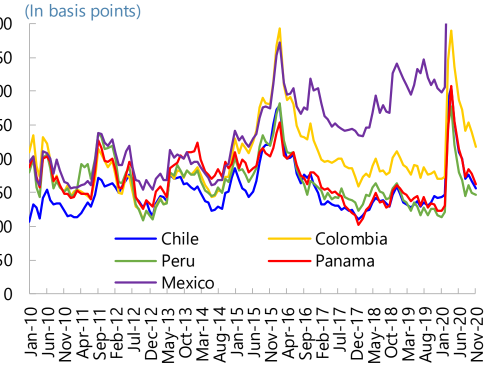
Indeed, gross FDI inflows have financed 105 percent of the current account deficit, on average, over the past decade. Panama has enjoyed investment grade status over the last decade and continuously placed sovereign bonds in international capital markets at spreads comparable to other investment grade sovereigns and significantly lower than most other Latin American countries.

- ***Criterion 1. Sustainable external position.*** The external balance assessment conducted during the 2020 Article IV is in line with the [Precautionary And Liquidity Line Operational Guidance Note (2018)](). [5] In particular, the external position was assessed to be moderately weaker than fundamentals and desirable policy settings. The current account is estimated to improve steadily over the medium term, underpinned by a rebound in canal traffic, tourism, and re-exports from the free zone as the world economy recovers, as well as higher exports from the new copper mine. Moreover, Panama remains competitive vis-à-vis peers (see Annex II).

- ***Criterion 2. Capital account position dominated by private flows.*** The bulk of Panama's external debt is owed to private creditors, with public debt averaging only 19 percent of total debt over the past 3 years. Private capital flows constitute the largest share of the capital account, amounting to 69 percent, on average, between 2017 and 2019, while FDI is the largest component of capital flows, accounting for 79 percent of the total, on average, during this period. Deposits and other external liabilities in the banking sector alone account for 50 percent of total external liabilities, reflecting Panama's position as the region's financial hub and the dominance of its large (private) financial sector. The net international investment position (NIIP) is projected to improve over the medium term—due to higher net exports (particularly from the free trade zone), canal receipts, and tourism, as well as higher exports from the new copper mine—premised on a strong recovery in the medium term post-COVID-19.

- ***Criterion 3. Track record of steady sovereign access to capital markets at favorable terms.*** Panama has a long track record of tapping international capital markets on favorable conditions. Sovereign global bond issuances in the last 5 years amounted to 2,160 percent of Panama's quota, far exceeding the minimum threshold of 50 percent for the market access criterion. Panama has also placed bonds every year in the last decade, exceeding the minimum of placing sovereign bonds in 3 out of the last 5 years. Despite the onset of the COVID-19 pandemic, Panama managed to raise

EMBIG Spreads
(In basis points)



Source: Bloomberg.

[5] The core indicator requires the member's external position to have been assessed, in the most recent Board document (Article IV or ESR), as "broadly consistent", "moderately stronger (weaker)", "stronger", or "substantially stronger" than implied by fundamentals and desirable policies.

US$2½ billion in late March 2020 through global bond issuance in the international capital market, with a 35-year maturity and 4½ percent yield (spread of 307 basis points against 30-year U.S. Treasury). Subsequently, Panama placed another US$2½ billion in September 2020 in international capital markets, through a combination of instruments, including a new 12-year bond with a yield of 2¼ percent (spread of 158 basis points against the relevant U.S. bond). Panama achieved investment grade status a decade ago (2010) and has enjoyed low borrowing costs for many years. Its EMBI spread stood at 150 bps as of December 17, 2020, which was low relative to the average in emerging markets (327 bps) and the region (400 bps). These tight spreads reflect favorable credit ratings from the leading rating agencies.

- *Standard & Poor's* rated the long-term debt at BBB in November 2020.
- *Fitch* reaffirmed Panama sovereign rating at BBB during the last five years.
- *Moody's* upgraded Panama's foreign currency long-term rating from Baa2 to Baa1 in March 2019.

International rating agencies cited Panama's strong economic growth, increasing economic diversification, and moderate net general government debt burden as reasons that underpinned their ratings decision, taking into account the country's vulnerability to sharp swings in global economic conditions, an underdeveloped but growing domestic capital market, and developing political institutions. More recently, Moody's has lowered the outlook from stable to negative citing the sharp economic contraction and large fiscal deficit for 2020.

Sovereign Bond Issuances

Date	Amount (US$ bn)	Yield (%)	Spread 1/ (bps)	Maturity (year)	Bond Type	Demand relative to offer (times)
Sep 2014	1.25	4.00	...	2024	Global	6
Mar 2015	1.25	3.75	...	2025	Global	...
Nov 2016	1.25	3.88	...	2028	Global	...
May 2017	1.17	4.50	150	2047	Global	4
Apr 2018	1.20	4.50	150	2050	Global	3
Oct 2018	0.55	4.95	155	2050	Global	2
Apr 2019	1.00	3.75	140	2026	Local	2
July 2019	1.25	3.16	140	2030	Global	5
July 2019	0.75	3.87	165	2060	Global	5
Nov 2019	1.00	3.60	135	2053	Global	...
Nov 2019	0.30	2.83	105	2030	Global	...
Mar 2020	2.50	4.50	307	2056	Global	3
Sep 2020	1.25	2.25	158	2032	Global	4
Sep 2020	1.00	3.28	186	2060	Global	4
Sep 2020	0.33	2.77	249	2026	Local	4

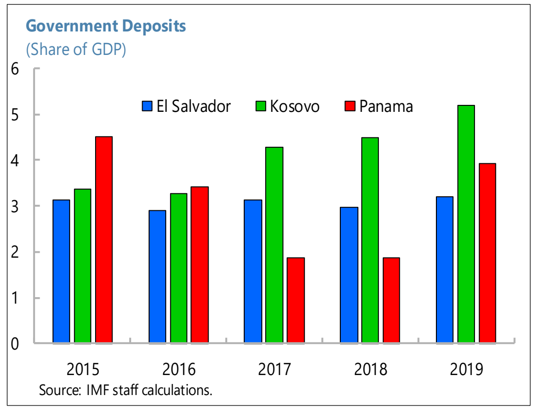
Source: Panamanian authorities.
1/ Computed as spread against relevant U.S. treasury yields.

- ***Criterion 4. A comfortable reserve position***. Panama is a fully dollarized economy since inception and does not have its own currency or central bank.[6] Given that fiscal and banking sector liquidity needs drive the need for foreign currency reserves, the assessment of the reserve position qualification criterion needs to be based on individual traditional metrics—namely the adequacy of liquidity buffers to cover the external financial obligations of the government and banking sector—in line with the recommendations in IMF Guidance Note (2016).

[6] While the official currency of Panama is the Balboa, it is mostly a unit of account tied to the U.S. dollar at a 1 to 1 parity. In practice all prices are quoted in U.S. dollars and U.S. dollar bills circulate freely. Balboas exist only in coin form as it is too costly to transport coins from the U.S.

The standard ARA metric does not work for Panama because of lack of control by the authorities over banks' foreign exchange liquidity.[7] Instead an assessment is made based on individual traditional metrics, reaching the conclusion that liquid reserves are adequate in the banking sector and government.

- *Fiscal liquidity reserve buffer.* Central government deposits at commercial banks are above the recommended benchmark of 1 month of expenditure.[8] The average coverage is 2.2 months of central government expenditure from 2009 to 2019, which is broadly in line with or higher than in other dollarized economies. Moreover, Panama has a Sovereign Wealth Fund of about 2 percent of GDP (in foreign assets abroad), which could be considered adequate to cover the financial needs of a relatively lean government with small deficits during normal times.



- *Banking sector liquidity reserve buffer.* Liquid assets in the banking sector are high, covering 60 percent of deposits, on average, since the introduction of the statutory liquidity requirement in 2009.[9] As of end-2019, this ratio stood at 57 percent, nearly double the minimum statutory requirement of 30 percent. In other dollarized jurisdictions such as Kosovo and El Salvador, the minimum requirements are set at 10 percent and 21.6 percent, respectively. In addition, the short-term assets cover more than ⅔ of banks' short-term external liabilities, reinforcing the high level of liquidity buffer in the banking sector as a result of stringent legal requirements and conservative banking practices.

[7] For statistical purposes, international reserves in Panama had been historically measured as the net foreign assets of the National Bank of Panama (the third largest commercial bank in Panama, which is government-owned) and the Ministry of Economy and Finance (adjusted for IMF transactions). This has been an inadequate measure of international reserves, but it has proved difficult to create an alternative one.

[8] Wiegand (2013) recommends the use of one month of central government expenditure as benchmark for fiscal reserve buffer. For further details, refer to Wiegand, Johannes, 2013, "Euroization, Liquidity Needs, and Foreign Currency Reserves," Chapter 3, IMF Country Report 13/223, Washington, International Monetary Fund.

[9] Panama's Banking Law of 2008 stipulates that banks must hold a minimum amount of liquid assets against qualifying deposits as the statutory liquidity requirement, set by the Superintendency of Banks (SBP). Pursuant to the Law, the SBP defines the statutory liquidity requirement as "Legal Liquidity Index" (LLI) and set the minimum at 30 percent.

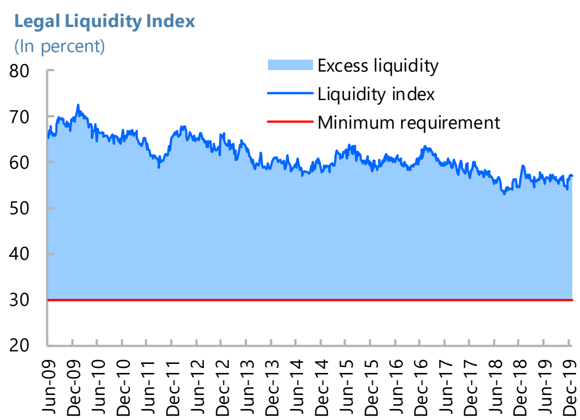
Reserves Adequacy Metrics

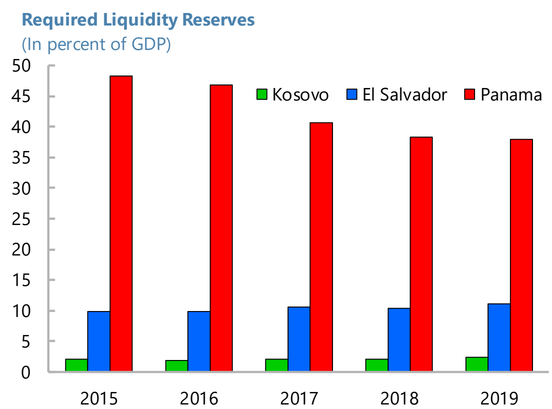
NIR Coverage

Metric	Benchmark coverage	2016	2017	2018	2019	Projection 2020	2021	2022	2023	2024	2025
Central Government liquidity coverage 1/	1 month	2.4	1.3	1.3	2.8	1.7	1.6	1.7	1.6	1.6	1.5
Banks' statutory liquidity buffers 2/	30%	62.8	60.0	59.4	57.0	59.4	58.9	58.3	57.7	57.0	56.4
Short-term debt coverage 3/		70.1	75.4	73.4	79.2	79.5	83.9	84.9	85.5	84.9	83.2

Sources: National authorities and IMF staff calculations.
1/ Refers to Central Government deposits at financial institutions, expressed in months of expenditure (fiscal reserve buffer). Wiegand (2013) proposed a minimum of one month of government expenditure for dollarized countries.
2/ Defined as the ratio of liquid assets to net deposits. The minimum statutory requirement is 30 percent.
3/ Computed as banks' liquidity buffers (defined as liquid assets up to 186 days) relative to banks' short term debt.

Banks' Statutory Liquidity Reserves





Source: Superintendency of Banks and national authorities.

II. Fiscal Policy. *Panama performs strongly in the fiscal policy area. While the fiscal position deteriorated in 2020 due to the COVID-19 pandemic, fiscal management has been consistently prudent in the past. The authorities managed to reduce public debt from about 60 percent of GDP in 2005 to around 40 percent of GDP in 2019, and debt remains sustainable with high probability. They introduced a fiscal rule in 2008 and their sovereign bonds reached investment grade in 2010, with some of the lowest spreads in emerging markets.*

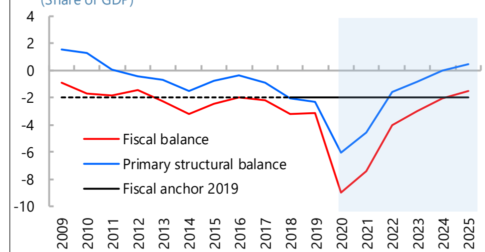
- ***Criterion 5. Sound public finances, including a sustainable public debt position with high probability and sound fiscal framework.*** The 2008 Social and Fiscal Responsibility Law (SFRL) set up the framework to anchor fiscal management. This framework has been modified in the past and by 2019 was based on medium-term anchors for NFPS deficit and gross debt of 2 and 40 percent of GDP respectively, as well as a growth rule for current expenditure.[10] The SFRL includes an escape clause for emergency situations and economic

[10] Current expenditure growth is limited to potential growth plus the inflation rate.

slowdowns and establishes a maximum period of 3 years for bringing the deficit back to the anchor. Deviations from the medium-term anchor in the previous decade have been limited, the maximum one being -1¼ percent of GDP in 2018.

The fiscal rule has facilitated the decline in NFPS gross debt from 60 to 41 percent of GDP over the last two decades. Furthermore, NFPS financial assets were sizeable by the end of 2019, with over 10½ percent of GDP in bank deposits and 2 percent of GDP in holdings by the Savings Fund of Panama. These assets provide a sizeable cushion for the government in difficult times and increase its margin for addressing adverse shocks. As a result, net debt amounted to 28¼ percent of GDP in 2019, the third lowest in Latin America (after Chile and Peru). Relatedly, sovereign ratings of Panama rank third in the region, after the same countries, while sovereign spreads on Panama's bonds are similar to those of Chile and Peru.

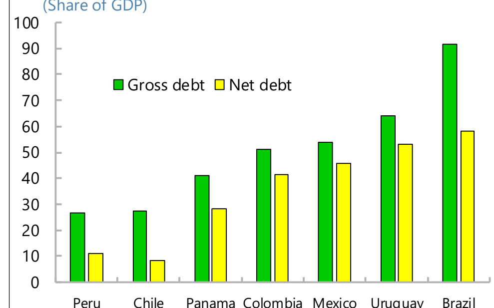
Fiscal Balance [1/]
(Share of GDP)



Source: MEF and IMF staff calculations.
1/ The fiscal anchor was set at -2 percent of GDP in 2019, but had different values before that date.

Amidst the COVID-19 outbreak, the National Assembly approved a relaxation of the fiscal targets for 2020–23 to accommodate the shock, with a view to return to the original anchor of 2 percent of GDP by 2024 and then adhering to a new fiscal deficit anchor of 1½ percent of GDP in 2025 and thereafter. This provided needed fiscal support in 2020, which will be gradually withdrawn thereafter to avoid an excessively contractionary impulse to the economy at a time when the output gap remains negative.[11] This will be made possible by the temporary nature of the increase in health and social spending in 2020, as well as the gradual return of the tax to GDP ratio to its pre-crisis historical average values (above 9 percent of GDP).[12] The cyclically adjusted primary balance is expected to improve by 3 percent of GDP between 2019 and 2025, which will bring the fiscal balance to -1½ percent of GDP by 2025.

Public Gross and Net Debt, 2019
(Share of GDP)



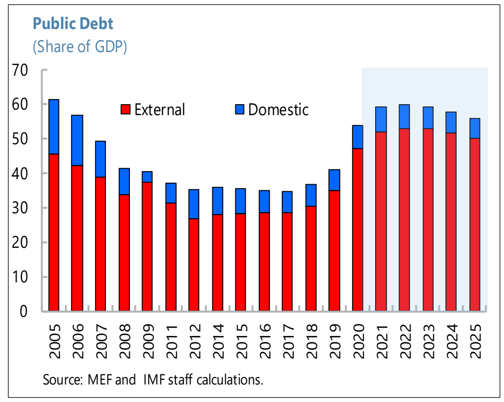
Source: MEF and IMF staff calculations.

Debt is assessed to be sustainable with high probability under the baseline scenario, as it also was in the 2020 Article IV Consultation and the RFI staff reports. The debt sustainability analysis shows that public debt would peak at 60 percent of GDP in 2022, declining

[11] The size of fiscal impulse may be overstated, particularly in 2020 and 2021, by the fact that the standard cyclical sensitivity of revenues largely understates the observed effects of confinement on tax collection.

[12] Baseline projections assume that the pre-crisis tax collection in dollar terms is reached again in 2022, once the large cyclical slack caused by the COVID-19 shock unwinds. The period 2023–25 reflects the return to the medium-term historical relation between taxes and nominal GDP. In view of the downward trend of the tax revenue to GDP ratio before the COVID-19 shock, downside risks would be best addressed by medium-term revenue mobilization reforms.

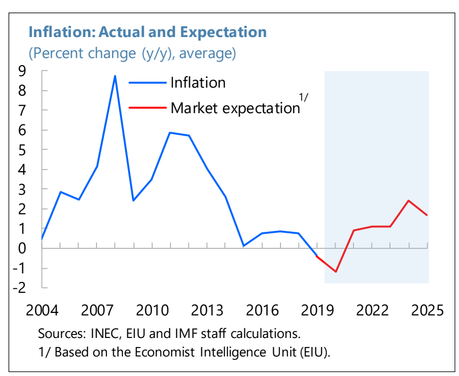
thereafter below 56 percent of GDP by 2025 (see Annex I).[13] Accordingly, the largest financing needs were reached in 2020, with US$6.9 billion (or 11.5 percent of GDP). Most of this amount was financed by external debt (US$ 6.6 billion).[14] Moreover, public debt can be expected to remain below 70 percent of GDP in all stress scenarios but the financial contingent liabilities one, and from 2023 stays on a declining trend in all of them. Debt would also be sustainable with a high probability in the adverse scenario described in Annex I.



Despite relatively sound fiscal institutions, there is room for improvement in some areas of public financial management. The new government (that took over in July 2019) discovered unrecorded central government liabilities worth US$1.5 billion (2.3 percent of GDP), accumulated from 2014.[15] Based on a preliminary breakdown carried out by the Ministry of Finance (MEF) (see Section H and Annex IV), 0.6 percent of GDP of this could be considered floating debt (i.e. either commercial credit not yet due, or refinanced), and another 0.6 percent of GDP was related to unreported unpaid social contributions to the social security fund (i.e., intra-NFPS arrears). Thus, true commercial arrears to the private sector amounted to 1.2 percent of GDP. Avoiding the re-emergence of arrears in the future will require a number of measures (including in the areas of medium-term budgeting, execution control and reporting, see Section H for more details), which the authorities intend to implement during the PLL arrangement.

III. Monetary Policy. *Panama performs strongly in the monetary policy area. While Panama adopted the U.S. dollar as its currency in 1904 when it was not an optimal currency area, with time Panama has integrated with the world economy and its business cycle is more in sync with that of the U.S., making monetary policy in the U.S. more adequate for Panama and anchoring inflation at low and stable levels.*

- ***Criterion 6. Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.*** Panama is a dollarized economy without independent monetary policy. This has led to stable and low single-digit inflation in Panama. In fact, inflation has remained below 2 percent over the last 5 years and in single digits since the Global



[13] The analysis estimates the use of government assets for US$1.1 billion in 2020, coming mostly from government deposits (almost US$ 1 billion), and to a lesser extent, assets from the FAP of US$ 0.1 billion.

[14] External borrowing includes US$ 4.8 billion in global bonds and US$ 1.8 billion from multilaterals. .

[15] Since part of these liabilities were related to central government debt to the social security (CSS), after consolidation the total amount for the NFPS is lower, US$1.4 billion or 2.1 percent of GDP.

Financial Crisis (2008). Panama has no central bank. The dollarization regime has been in place for over a century and there is no expectation of a change in regime. Inflationary expectations are well-anchored and remain below 2 percent over the medium term.[16]

IV. Financial Sector Soundness and Supervision. *Panama does not substantially underperform in the financial sector soundness and supervision area. Panama has a sound financial system that is supervised following modern best practices (i.e., Basel III). However, the financial system is exposed to potential money laundering risks as Panama was placed on the FATF grey list in June 2019, which puts at risk correspondent banking relations and possible key credit channels. The authorities feel that the current COVID-19 shock is an opportune time to develop instruments to strengthen financial stability (including liquidity and credit stimulus facilities for banks, which are being implemented and could be perfected during the PLL arrangement) and take decisive measures to exit the FATF grey list.*

- ***Criterion 7. Sound financial system and the absence of solvency problems that may threaten systemic stability.*** Panama's banking system is stable, well capitalized, and solvent. Liquidity remains above prevailing regulatory norms, and about 80 percent of banks already meet the new liquidity coverage ratio (LCR) under Basel III, which will be fully enforced by the end of 2021. As of end-2019, the ratio of deposits to loans stood at 77 percent according to the FSI database, and liquid assets constituted 57 percent of deposits.[17] There is no evidence of solvency or recapitalization needs. Capital adequacy ratio and provisioning remained strong, at 16.6 percent and 102.3 percent of nonperforming loans, respectively, for the banking system as a whole as of December 2019. Although credit growth has decelerated, the credit gap remains moderate. Panama has a high level of financial deepening and the credit to GDP ratio is the highest in Latin America. Aggregate asset quality indicators suggest that credit dynamics continue to evolve in line with fundamentals, with low and well-provisioned NPLs relative to Panama's peers. NPLs ratios have not exceeded 3 percent in Panama in the last decade, and were below 2 percent before the pandemic. Stress-tests conducted by the SBP indicated, that at the end of 2019, the banking system was well-capitalized to withstand severe shocks to domestic output and interest rates. While Panama has been placed on the FATF grey list in June 2019 due to serious AML/CFT weaknesses, the authorities committed to an action plan with the FATF whose implementation would prevent adverse effects on the financial system, including through pressures on correspondent banking relationships.

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[16] Panama may experience higher inflation in the future due to increases in productivity in the tradeable sector relative to the non-tradeable (the Balassa-Samuelson effect), leading to some real appreciation.

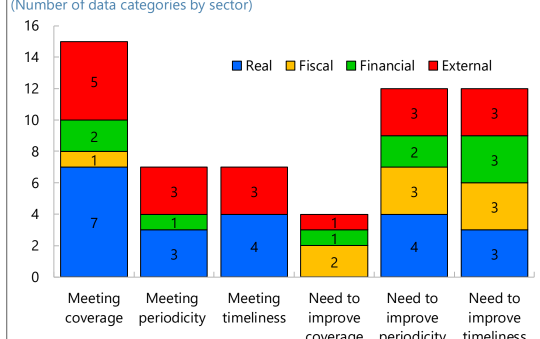
[17] Funding for Panama's banks is different from other countries in the region, which rely heavily on domestic private deposits. Panamanian banks have two additional sources of stable funding: (i) a high level of public financial assets (over 10 percent of GDP, mostly from the social security system); and (ii) strong links and access to international capital markets being an international financial center with the largest banks having investment grade. While domestic private deposits fund about 77 percent of the loan portfolio, public sector deposits finance an additional 15 percent of the loans; and another 15 percent of the funding come mostly from foreign banks (of which over ⅔ constitutes long-term deposits), taking the deposit base to loan ratio to around 107 percent. In early August 2020, the National Bank of Panama (BNP) placed a 10-year bond for US$1 billion (around 1½ percent of GDP) in international capital markets at an interest rate of 2½ percent to fund domestic credit operations.

- ***Criterion 8. Effective financial sector supervision.*** Panama's authorities have implemented most of the recommendations from the last Financial Sector Stability Assessment (FSSA), conducted in 2011. In particular, they introduced the real-time gross settlement system (RTGS), started to implement stress tests and monitor real estate developments and a housing price index. The authorities also updated the regulatory system to transition to the Basel III framework, with the liquidity coverage ratio (LCR) gradually increasing through 2020. The banks are well regulated and supervised in Panama under a modern regulatory framework and use international accounting standards (IFRS9 was adopted in 2019; see SIP 2020). At the same time, weaknesses in the financial system include: (i) lack of lender of last resort facilities (LOLR); (ii) absence of a deposit insurance scheme; and (iii) weaknesses in the AML/CFT framework, including on AML/CFT supervision (see Section F, and Annex III). The authorities are setting up a liquidity fund (akin to a partial LOLR-type facility) and remain fully committed to implement an action plan with the FATF.

V. Data Adequacy. *Panama does not substantially underperform in the data adequacy area. While data provided to the Fund are broadly adequate for surveillance, some weaknesses remain, and data transparency could be further enhanced by subscribing to the Special Data Dissemination Standard (SDDS). The authorities have recently signaled strong interest in statistical improvement, indicating a willingness to implement the recommendations of a recent Data ROSC mission, including setting an ambitious timetable for subscribing to the SDDS—a requirement for this core area. The assessment of the February 2020 Data ROSC mission was that for the most part, Panama observes or largely observes international best practices and has made progress toward meeting the SDDS requirements.*

- ***Criterion 9. Data transparency and integrity.*** Data provision, quality, and transparency are broadly adequate, but coverage, periodicity, and timeliness of some data series need improvement. Panama's metadata are regularly updated on [the Dissemination Standards Bulletin Board (DSBB)](). The authorities asked for a formal assessment of their macroeconomic statistics as part of the Report on the Observance of Standards and Codes (ROSC) in 2006, 2014, and (most recently) in February 2020.[18] Since the first ROSC in 2006, the authorities demonstrated a commitment to the implementation of recommendations, passing new statistical legislation, creating the National Institute of Statistics and Census (INEC) and enhancing statistical compilation and dissemination practices, supported by Fund technical assistance. Panama has participated in the Enhanced General Data Dissemination System (e-GDDS) since 2000, and started publishing key data through the [National Summary Data Page]()

Compliance with SDDS: Coverage, Periodicity, Timeliness
(Number of data categories by sector)



Source: ROSC 2020 TA report and IMF staff calculations.

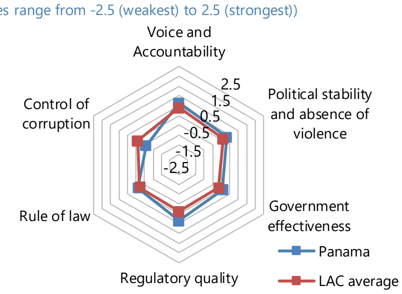
[18] The ROSC in 2014 focused on AML/CFT issues.

(NSDP) in October 2018, a step towards SDDS.[19] The 2020 data ROSC update concluded that Panama has a well-developed macroeconomic statistical system and the government recognizes the importance of good statistics for policy and investment decisions, and that for the most part Panama observes or largely observes international best practices and has made progress toward meeting the SDDS requirements. In particular, to subscribe to SDDS, Panama has to improve data coverage, periodicity and timeliness (see the text chart). Improving coverage is needed in 4 out of 19 data categories (central and general government operations, interest rates, and reserves); periodicity and timeliness are desired for 12 data categories across sectors. The authorities are transparent about their plans for improvement, with some to be addressed in the context of the PLL (see Section I).

13. Track record. Panama continues to have a sustained track record of implementing very strong policies, including in response to previous significant shock episodes, owing to its strong fiscal framework and a dollarized economy. According to staff's assessment, key relevant core indicators were met in each of the five most recent years. The authorities remain committed to maintaining strong policies in the future.

14. Institutional strength. As a dollarized economy, Panama's institutional quality of economic policy is centered on fiscal policy and underpinned by the fiscal and social responsibility law, providing a fiscal anchor. As a large financial center, Panama's institutional strength relies on an effective prudential and modern regulatory framework following best international practices, allowing effective adjustment to shocks, including during the Global Financial Crisis. According to the 2019 Worldwide Governance Indicators, which report on six dimensions of governance, Panama outperforms the Latin American and Caribbean average in most dimensions.[20] Voice and accountability as well as regulatory quality in Panama are high at a point estimate of 0.6 and 0.4 respectively. Areas where governance could be improved include Panama's control of corruption with a point estimate of -0.6, the rule of law with a point estimate of -0.1, and government effectiveness with a point estimate of 0.1.

Worldwide Governance Indicators, 2019
(Estimates range from -2.5 (weakest) to 2.5 (strongest))



Source: The Worldwide Governance Indicators and IMF staff calculations.

B. Access and Duration

15. Panama is able to finance its external financing needs in the baseline scenario. Gross external financing requirements for Panama are estimated at around US$17 billion in 2021, financed by a rollover of obligations, borrowing from multilateral organizations, foreign direct investment, and the placement of additional global bonds in international capital markets.

[19] In 2000, Panama became a participant in the General Data Dissemination Standard (GDDS), which the Board enhanced in 2015 (e-GDDS) by encouraging broader data publication. Since then about 60 percent of these countries —including Panama—have their NSDP.

[20] The Worldwide Governance Indicators (WGI) estimate ranges from -2.5 (the weakest) to 2.5 (the strongest), with zero corresponding to a median governance performance.

16. However, the balance of payments remains highly vulnerable to external shocks in the adverse scenario, justifying support under the PLL arrangement. A "second wave" of the pandemic outbreak could lead to significant disruptions to capital flows and deterioration in public finances in Panama. Under this scenario, the country's macroeconomic outlook would deteriorate further (Box 2). The current account deficit could increase by US$0.3 billion (0.5 percent of GDP) in 2021, driven by a decline in exports, particularly copper. At the same time, dislocations in the global capital market could result in a further deterioration in FDI, and put pressures on the rollover of external private debts (which could trigger the use of US$1 billion in the liquidity in program for banks under the Fund for Economic Stimulus, see Section G).

17. Higher budgetary financing needs and limited debt roll-over might trigger the use of the PLL in the adverse scenario. In the baseline scenario, public sector financing needs would amount to US$6.7 billion in 2021, mostly financed by issuing medium and long-term (MLT) debt. However, staff estimates that financing needs would rise in the adverse scenario to US$7.4 billion. In that scenario, the additional US$0.7 billion in financing needs for 2021 and reduced access to international sovereign debt markets could justify the use of PLL resources (amounting to 250 percent of quota). In 2022, staff assumes higher financing needs by US$0.3 billion under the adverse scenario, together with lower access to international capital markets, which could justify another 250 percent of quota under the PLL arrangement, despite the use of government financial assets.

Fiscal Scenarios

	2021			2022		
	Baseline	Adverse	Δ	Baseline	Adverse	Δ
	(In percent of GDP)					
Revenues	17.9	17.1	-0.8	19.4	18.9	-0.4
Tax revenues	7.4	6.7	-0.7	8.5	8.1	-0.4
Non-tax revenues	10.5	10.4	-0.1	10.8	10.8	0.0
Expenditure	25.4	26.1	0.7	23.4	23.8	0.4
Current primary	17.2	18.2	1.0	16.1	17.0	1.0
Interest payments	2.6	2.8	0.3	2.4	2.9	0.4
Capital	5.6	5.0	-0.6	4.9	3.9	-1.0
Overall balance	**-7.4**	**-9.0**	**-1.6**	**-4.0**	**-4.8**	**-0.8**
	(In billions of U.S. dollars)					
Financing needs	**6.7**	**7.4**	**0.7**	**4.8**	**5.0**	**0.3**
Overall balance	-4.7	-5.3	-0.7	-2.7	-3.0	-0.3
Liquidity Facility 1/	0.2	0.2	0.0	0.1	0.1	0.0
Amortizations	1.9	1.9	0.0	2.0	2.0	0.0
Potential financing	**6.7**	**7.4**	**0.7**	**4.8**	**5.0**	**0.3**
IMF (RFI)	0.0	0.0	0.0	0.0	0.0	0.0
IMF (PLL)	0.0	1.3	1.3	0.0	1.3	1.3
Other IFIs	1.5	1.5	0.0	0.7	0.7	0.0
Official bilateral	0.0	0.0	0.0	0.0	0.0	0.0
Government assets	0.0	0.5	0.5	0.0	0.5	0.5
ST domestic bonds	0.3	0.3	0.0	0.3	0.3	0.0
MLT bonds	4.9	3.7	-1.2	3.7	2.1	-1.6
o/w Domestic	1.2	0.7	-0.5	1.3	0.4	-0.9
o/w External	3.7	3.0	-0.7	2.4	1.7	-0.7

Source: Fund staff estimates.

1/ From 2021, includes small amounts from capital subscriptions to multilateral institutions.

18. PLL Access. Staff estimates that a PLL for 500 percent of quota (SDR 1.884 billion) is justified given the severity of the shocks under the adverse scenario, which would generate large balance of payments and fiscal financing gaps. The external financing gap could widen by US$2.6 billion (over 4 percent of GDP) in 2021–22, particularly if external market financing becomes less favorable, which is consistent with a total access level of 500 percent of quota, and falls under the exceptional access policy.[21] Panama meets the criteria for exceptional access (Box 3). The proposed access would be available with two scheduled potential purchases of 250 percent of quota, available at the beginning of each of the two years of the arrangement.

[21] In the case of Panama where there is no Central Bank and Fund resources are used by the Ministry of Finance, only when the balance of payments need is similar to the fiscal financing gap would Fund resources be utilized.

Box 2. Access Considerations Under an Adverse Scenario

Key assumptions on current account, foreign direct investment, and external debt rollover rates in the adverse scenario are informed by past shocks faced by Panama and shocks adopted by other FCL and PLL arrangements. This configuration is also consistent with an adverse external scenario in which global growth is expected to register a significant additional decline by 3 percentage points relative to the baseline while financial volatility in emerging markets is further accentuated. A gradual, moderate economic recovery is assumed for 2021 and 2022 in the adverse scenario, in tandem with the recovery in the global economy, but at a weaker pace than the baseline, by 2 percentage points.

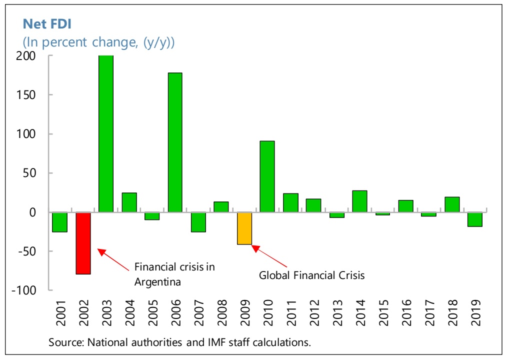
- **Current account**. Under the adverse scenario, exports are projected to decline by an average of 18 percent relative to the baseline projections in 2021 and 2022, driven by a continuing decline in copper exports, which account for 10 percent of total goods exports. In this scenario, copper prices are assumed to decline by 15 percent (y/y) vis-à-vis their baseline in both years, triggered by a prolonged weaker-than-expected global economic recovery. This assumption is close to $^{2}/_{3}$ of the decline in copper prices seen during the Global Financial Crisis (GFC). It is worth noting that the shock to exports and copper prices are also in line with recent FCL arrangements (Chile and Peru).

Assumptions Underlying the Illustrative Adverse Scenarios
(In percent change vis-à-vis baseline, unless otherwise indicated)

	2021	2022
Copper prices	-15	-15
FDI	-15	-15
Rollover rates (in percent):		
- ST private external debt	66	66
- MLT private external debt	68	68
- MLT public external debt	591	486
Memorandum:		
Real GDP growth (%, Y/Y)		
- *Baseline*	*+4*	*+5*
- *Adverse*	*+2*	*+3*

Source: Fund staff estimates.

- **Foreign Direct Investment**. While inward FDI to Panama had proven resilient in the past, it had also experienced large contractions, particularly in times of heightened global uncertainties. As such, in the adverse scenario, net FDI is assumed to be 15 percent weaker than the baseline in 2021 and 2022 to account for heightened uncertainty, tepid global capital flows, and potential regional spillovers (this is on top of a sizable decline under the baseline scenario). This corresponds to two thirds of the magnitude of the decline in FDI observed during the 2002 Argentinian financial crisis and is in line with recent FCL arrangements (Peru and Mexico), as well as the exceptionally large contraction in world growth assumed in the adverse WEO scenario.



- **Debt rollover**. With an investment grade sovereign credit rating, external financing had been forthcoming, especially for the public sector in the past, underpinning the historical rollover rates above 100 percent. For the public sector, there has not been any short-term (ST) external debt. The authorities had successfully issued a total of US$5 billion in global bonds as of September 2020 and solicited financing from multilateral organizations, including the IMF, World Bank, IDB and the Development Bank of Latin America (CAF). The significant net placements of bonds will continue in 2021 and 2022, in line with past trends as the authorities had been very successful in terming out the maturity profile of public debts. As such, the rollover rates for public MLT debts are assumed to be around 500 percent in 2021 and 2022, which also reflects an already high fiscal deficit under the baseline scenario (that required a much higher rollover rate) and an even higher fiscal deficit under the adverse scenario to meet increased health-related spending to tackle the pandemic.

Box 2. Access Considerations Under an Adverse Scenario (continued)

This is in line with other recent FCL arrangements, where public MLT rollover rates exceed 200 percent (see figure below with distributions of historical shocks to emerging markets). Moreover, low global interest rates are favorable for public bond issuance. For private sector external debts (ST and MLT), rollover rates of between 66 to 68 percent are assumed, reflecting their historical rollover rates seen during 2008 (GFC) and 2013 (U.S. taper tantrum) to account for tail risks in the event of disruptions in global financing flows.

- **External financing needs.** Under these extreme shocks in the adverse scenario, which are assumed to persist over the PLL duration of two years from January 2021 to January 2023, the bulk of the financing needs would be fulfilled by credit facilities from multilateral organizations (under "public MLT disbursements") and government assets (FAP and cash deposit). Unlike other countries, Panama does not have a central bank and holdings of international reserves. During the first year of the PLL arrangement, the remaining financing gap, estimated at US$1.3 billion, could be financed by drawing down part of the PLL equivalent to 250 percent of quota. In the second year, under the adverse scenario, Panama's economic recovery would remain sluggish, at 2 percentage points below baseline growth, while external conditions would remain challenging. Under this adverse scenario, the improvement in the BOP would be tepid, prompting a further financing need of around US$1.3 billion (equivalent to another 250 percent of quota) in the second year, which could be filled by drawing down the remaining PLL access that would become available upon completion of the first and second reviews.

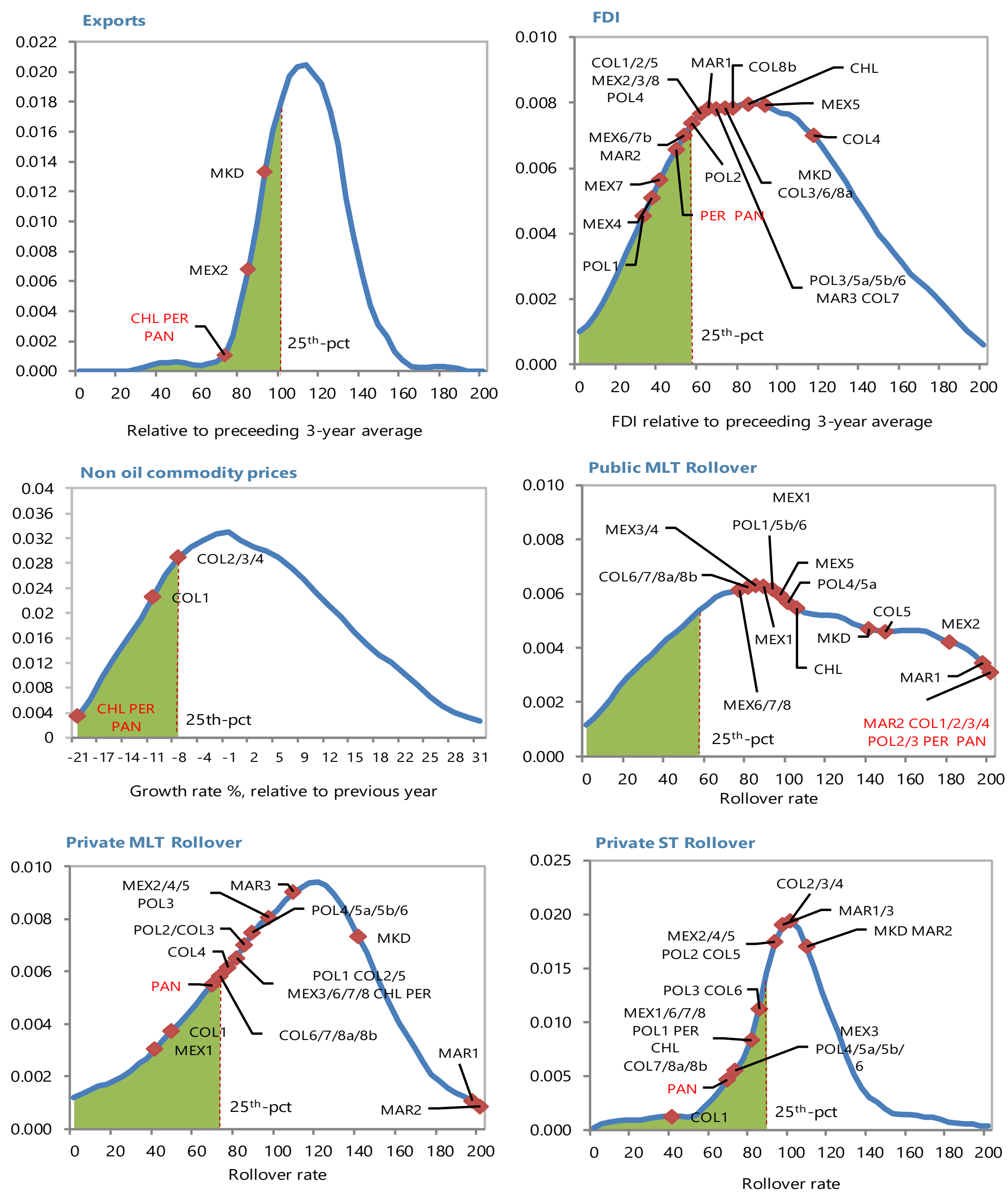
Gross External Financing Needs under the Adverse Scenario[1/]

In US$ billion	2021			2022		
	Baseline	Adverse	Contribution to Gap	Baseline	Adverse	Contribution to Gap
Gross External Financing Needs	**16.8**	**17.1**	**0.3**	**13.9**	**14.1**	**0.2**
Current account	3.7	4.1	0.3	3.2	3.4	0.2
MLT amortizations	3.9	3.9	-	3.5	3.5	-
Public	0.9	0.9	-	0.5	0.5	-
Private	3.1	3.1	-	3.0	3.0	-
ST amortizations (private)	9.1	9.1	-	7.1	7.1	-
Available Financing	**16.8**	**15.8**	**1.0**	**13.9**	**12.7**	**1.1**
FDI	3.0	2.5	0.5	3.3	2.8	0.5
MLT disbursements	7.3	6.6	0.7	5.2	4.4	0.8
Public [2/]	5.2	4.5	0.7	3.1	2.3	0.8
Private	2.1	2.1	0.1	2.1	2.0	0.1
ST disbursements (private)	6.3	6.0	0.3	4.9	4.7	0.2
Other financial flows	0.2	0.2	0.0	0.4	0.4	0.0
Government assets	0.0	0.5	-0.5	0.0	0.5	-0.5
Financing gap	-	**1.3**	**1.3**	-	**1.3**	**1.3**
(in percent of quota)		*250*			*250*	

Source: Fund staff estimates.
1/ The PLL is a two-year arrangement. In this table, 2021 and 2022 are indicatives of the first year and second year of the arrangement.
2/ Includes external bonds and disbursements from IMF and other IFIs.

Box 2. Access Considerations Under an Adverse Scenario (concluded)

FCL/PLL Cases Compared with Distribution of Historical Shocks to Emerging Markets[1]
(Probability Density)



Source: IMF staff calculations.

1/Kernel density distributions of the variables are estimated from past exogenous stress episodes for emerging markets. FCL-PLL arrangements shocks parameters are then placed in these empirical distributions. For Panama, the represented shocks correspond to the ones in 2020.

Box 3. Exceptional Access Criteria

The PLL arrangement would involve exceptional access. Staff's assessment is that Panama meets each of the four substantive criteria for exceptional access:

- ***Criterion 1. The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current or capital account, resulting in a need for Fund financing that cannot be met within the normal limits***. Following the RFI disbursement in 2020, Panama does not face a remaining actual balance of payments need. However, in the near term, it is exposed to the risk of a second wave of a global outbreak of the COVID-19 pandemic, resulting in a protracted period of recession or anemic growth in advanced countries and other trading partners, large decline in global commodity prices which affect copper exports, and surges in global financial market volatility. These could curtail export growth, including tourism and canal traffic; undermine copper production; and lead to reversals in capital flows. Staff is of the view that the materialization of such a stress scenario gives rise to a potential balance of payments need beyond normal access limits.

- ***Criterion 2*. *A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term***. In the baseline scenario, public debt would peak at 60 percent of GDP in 2022 and decline thereafter to below 56 percent in 2025 with gradual fiscal consolidation. Public debt and gross financing needs thresholds (70 and 15 percent of GDP respectively) would be exceeded only if a financial sector contingent liability shock materialized. In the adverse scenario, the debt would also reach its peak in 2022 (close to 67 percent of GDP) and follow a declining path from that year onwards. There are sufficient safeguards for Fund resources in the baseline and adverse scenarios as Panama would continue to have access to capital markets.

- ***Criterion 3*. *The member has prospects of gaining or regaining access to capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund***. Panama has successfully tapped into international capital markets recently, including the successful issuance of two tranches of sovereign bonds in 2020 (US$2.575 billion in September and US$2.5 billion in March; and a total of US$3.3 billion international sovereign bond issuance throughout 2019. Each issuance benefited from low spreads and long maturities (10 to 35 years) reflecting the confidence placed in Panama by international capital markets. Moreover, Panama has maintained its investment grade status since 2010 and has enjoyed low borrowing costs for many years. Its EMBI spread stood at 150 bps as of December 17, 2020, which was low relative to the average in emerging markets (327 bps) and the region (400 bps), reflecting favorable credit ratings from the leading international rating agencies, and the absence of notable effect of the FATF listing on sovereign spreads.

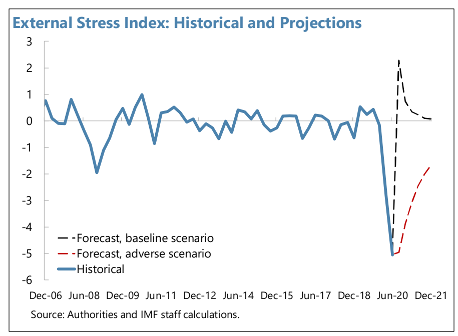
- ***Criterion 4. The policy program (and institutional and political capacity to deliver it) provides a reasonably strong prospect of success***. Panama is the fastest growing economy in Latin America, expanding at 6 percent annually, on average, over the last 25 years. Despite its strong growth, inflation remained benign, anchored on a fully dollarized regime since its inception. The authorities' track record of sound macroeconomic policies is supported by solid institutions, including an independent SBP which supervises and regulates the banking sector, while the management of public finances is guided by an established fiscal rule. Prudent macroeconomic management and sound financial sector policies and oversight underpinned the country' resilience observed during the 2008 Global Financial Crisis, reinforcing confidence in continued sound policies and stability over the longer term. The authorities are also committed to advancing structural fiscal reforms to facilitate a return to their fiscal anchor once the pandemic recedes, and to address the strategic AML/CFT deficiencies identified by the FATF.

Box 4. External Economic Stress Index

- **The external economic stress index is based on four major variables which capture external risks for Panama.** The variables include: (i) the U.S. growth rate (a proxy for the risks to FDI inflows); (ii) world exports (a proxy for net exports in the current account); (iii) the change in the 10-year U.S. Treasury yield (a proxy for risks to the portfolio liabilities in the financial account), and (iv) the volatility index VIX (a proxy for the risks to other investments in the financial account). The index is calculated as a weighted sum of standardized deviations of the above variables from their means. The weights are estimated using balance of payments and international investment position data, all expressed as shares of GDP. The weight on U.S. growth rate corresponds to the net FDI inflows. The weight on world growth corresponds to the net exports of goods and services. The weight on the VIX corresponds to the stock the other investment in the financial account. The weight on the U.S. Treasury government bond corresponds to the sum of portfolio liabilities in the financial account.

External Risks	Channels	External Proxy Variables	Weights
External demand	Net exports	World Growth	0.31
	FDI	US GDP growth	0.18
Global financial conditions	Portfolio investment	Change in 10-year Treasury yield	0.11
	Other investment	VIX	0.40

- **Baseline ESI is already very unfavorable, at a historically low level**. This reflects the sharp contraction of U.S. GDP and world trade and increased volatility in financial markets in the first half of 2020, although it assumes a bounce back in the U.S. and world GDP in Q3-2020. The adverse scenario reflects external risks from the prolonged COVID-19 effects without the recovery of the U.S. and world GDP in Q3-2020, before the start of the second wave of the pandemic, which causes growth to slow down again, and with persistent market volatility. On average, in 2020/21 the ESI is -0.5 in the baseline and -3.3 in the adverse scenario, with the worst value of -5 in June 2020, compared to the average of -0.5 in 2008/2009 financial crisis, with the lowest value of -1.9 in December 2008.



19. **Duration of the PLL arrangement.** The authorities have requested a two-year PLL arrangement. Staff believes that a two-year arrangement would be appropriate, given that: (i) the COVID-19 pandemic, weaknesses in global trade, and more broadly volatile global financial conditions are unlikely to improve markedly in the near term; and (ii) a two-year period is necessary to address remaining vulnerabilities and further strengthen macroeconomic buffers that would allow for a successful exit should external circumstances warrant.

C. Impact on Fund Financing, Risks and Safeguards

20. **The proposed PLL arrangement would have a moderate impact on the Fund's liquidity and potential risk exposure**. The Fund's liquidity position as measured by the Forward Commitment Capacity (FCC) would decline by 1.2 percent upon approval of the proposed

arrangement. Should the authorities make a purchase of the amount available at the approval of the PLL arrangement, GRA credit to Panama would be equivalent to about 1.5 percent of current GRA credit outstanding (as of mid-December 2020) or 8 percent of the Fund's end-FY2020 precautionary balances. Even if the arrangement were to be fully drawn, Fund exposure to Panama would represent a small share of the Fund's total credit outstanding.

21. If the proposed arrangement were to be fully drawn, capacity to repay the Fund would be adequate and risks to the Fund moderate. The authorities have indicated that they intend to treat the proposed arrangement as precautionary. In a scenario of full disbursement by end-December 2022, Fund credit outstanding would peak at 600 percent of quota (about 5.3 percent of GDP). Debt service to the Fund would peak at SDR 1,064.5 million (about 2 percent of GDP) in 2024 (Table 9). Several factors would mitigate risks to the Fund, including the strong policy framework, Panama's long history of market access, and its excellent track record of meeting its obligations to the Fund.

22. Safeguards. A first-time safeguards assessment of the Banco Nacional de Panama (BNP), conducted in connection with the recent RFI purchase, was completed in September 2020.[22] The assessment found strong institutional arrangements, including with respect to BNP's governance and control environment, as well as transparency and accountability practices. However, the BNP should enhance its investment practices, and the authorities should finalize the framework implementing the Fund for Economic Stimulus, including on aspects of its decision-making processes and operational modalities.

23. Risks. Panama faces risks that are highlighted in the October 2020 WEO and the Risk Assessment Matrix (External Economic Stress Index, see Box 4). Specifically, the risks that would most significantly affect the Panamanian economy include:

- ***A protracted period of slower growth in Panama's main trading partners, particularly the U.S***. As set out in the WEO, growth prospects have deteriorated significantly for advanced economies, including through spillbacks from potential lockdowns should the COVID-19 pandemic escalate further. The resulting weak external demand would worsen the current account through lower canal revenues, exports and tourism receipts, as well as reduced inward FDI and remittance flows.

- ***Unexpected worsening of the COVID-19 pandemic***. In recent months, some of the planned reopening of the economy have been postponed following a surge in the number of infection cases. A "second wave" of the outbreak could lead to another lockdown episode, triggering a protracted recession, and to significant disruptions in capital flows which could put further pressures on Panama's public finances and BOP needs.

[22] While Panama does not have a central bank, BNP is in charge of some functions that would otherwise be performed by a monetary authority, in particular, being the financial agent of the government. In its relations with the IMF, Panama has designated the BNP as its fiscal agent and depository. The absence of a central bank implies that the use of Fund resources always has a fiscal dimension, either to finance public spending or support a public entity.

- ***Accelerating de-globalization***. An intensification of global trade tension could precipitate further deteriorations in global trade. This would adversely affect re-exports from Panama's free trade zone and canal revenues, resulting in a higher-than-expected external deficit.

- ***More volatile global financial conditions***. Heightened investor risk aversion and uncertainty could trigger a further flight to safe assets and another outflow of capital from emerging market economies. For Panama, a materialization of this scenario could result in higher borrowing costs in international markets, and lower FDI and portfolio flows.

- ***Absence of meaningful progress on AML/CFT***. While the authorities committed to implement the action plan agreed with the FATF by January 2021, delays could have a potential adverse effect on correspondent banking relations and possibly key credit channels.

- ***Unexpected natural disasters.*** Although Panama is less prone to natural disasters than other countries in the region, any unanticipated severe catastrophe, such as Hurricane Eta, could result in loss of lives and economic damages, and disrupt trade, thereby exacerbating the adverse impact of the COVID-19 pandemic on the domestic economy.

D. Exit Strategy

24. Access to the PLL is not to expected to go beyond the 2-year period agreed, provided the current unprecedented risks recede. The authorities underscored that the PLL arrangement is requested under the current extraordinary circumstances and will not form part of a permanent strategy for medium term resilience. Staff considers that the authorities' policies, as described below, will be instrumental to continue reducing key vulnerabilities and strengthening the economy's resilience. The authorities intend to treat the PLL arrangement as precautionary, with the level of access providing insurance against extreme adverse risks, preserving investor confidence, and supporting the authorities' macroeconomic strategy. Once these extreme risks subside, with the benefits of additional policy buffers, Panama should be in a strong position to exit the PLL arrangement. This is expected to take place at the end of the PLL arrangement in November 2022.

POLICY AGENDA

A. Adapting and Re-Anchoring Fiscal Policy

25. Fiscal policy should accommodate the implications of the pandemic on the budget in the short term, while adhering to a gradual consolidation process over the medium term. The expectation is that the pandemic will continue for part of this year. During this period, fiscal policy should aim at ensuring proper health services to the population and adequate social support to vulnerable groups to ensure social cohesion, minimize human suffering and prevent social tensions. As the pandemic recedes, and contagion rates are under control, fiscal consolidation should be underpinned by an enhancement of tax policy and revenue administration and a strategic prioritization of expenditure. Following the recently approved modification to the fiscal responsibility law, baseline projections assume an improvement in the fiscal balance of 7½ percent of GDP in the next 5 years, from a deficit of 9 percent of GDP in 2020 to a deficit of 1½ percent in 2025. This medium-term anchor would ensure a steadily declining path of public debt, and provide fiscal space to deal with fiscal risks, such as climate change. Fiscal consolidation is predicated on a gradual return of tax and non-tax revenue to its historical averages (a gain of 3½ and 2 percent of GDP, respectively) and a decline in primary expenditure (about 2 percent of GDP). Although cyclical factors will facilitate the adjustment efforts, achieving this consolidation will require prioritizing inclusive expenditure and value-generating investment. Further, additional revenue mobilization would allow to comply with fiscal targets while reinforcing expenditure on social priorities. Revenue and expenditure reform plans should rely on realistic macroeconomic projections and be carefully phased-in to minimize pro-cyclicality. To ensure proper functioning of the public sector, it will be important to maintain an adequate level of public liquidity buffers. To that end, the government intends to follow best practices and maintain at least US$1,000 million (1½ percent of GDP) or about 1 month of spending in deposits at the National Bank of Panama (indicative target). The authorities are creating a working group supported by IMF staff to monitor fiscal policy.

Fiscal Policy

Objective	Accommodate the effects of the pandemic, while ensuring debt sustainability over the medium term.
Policy	Relaxation of the fiscal position to accommodate the sanitary emergency in 2020 and a subsequent gradual fiscal consolidation in line with the modified fiscal rule.
Monitoring	Working group on Fiscal Policy composed of MEF, WHD, and FAD.

MEF: Ministry of Finance.

26. Tax policy reforms should address revenue mobilization, efficiency, equity and transparency considerations. The tax revenue to GDP ratio (8¼ percent in 2019) is almost half the average of Latin American countries with similar income levels of around 16½ percent of GDP. This is partly due to tax expenditure, estimated between 3 and 4 percent of GDP in 2016 by the Panamanian authorities. This tax expenditure (concentrated on the VAT, CIT and to a lesser extent the PIT) mostly benefits the highest deciles of household or corporate income, harms efficiency and could in most cases be replaced by targeted tax credits or transfers.[23] The production of detailed tax expenditure reports would enhance the transparency of the system, shed light on the beneficiaries of this expenditure and lay the ground for the formulation of a reform roadmap. Some tax rates are among the lowest in the world (especially the VAT rate at 7 percent) and could be adjusted in the medium-term to raise revenues.[24]

[23] In the case of the CIT, this is complicated by the proliferation of special regimes, exemptions, fixed fees and presumptive regimes. Distorting effects of some CIT expenditure can be particularly large in some economic sectors. This is the case of the asymmetric treatment of interest and dividend deductibility for large companies.

[24] IMF (2020). *Panama: General Diagnostic of the Tax System, Including Tax Exemptions*. TA Report (forthcoming). The authorities are encouraged to sequence these recommendations according to counter-cyclical considerations and postpone possible tax policy measures until the recovery is well underway. Shorter-term action could be focused on efficiency-raising measures with no adverse effects on incomes, such as the simplification of the CIT or the introduction of a VAT refund mechanism. From the perspective of revenue administration, strengthening technical capacity of the tax authority through technical assistance would also contribute to raising tax collection while minimizing possible pro-cyclical pressures.

27. Expenditure prioritization will need to factor social needs and the legacy of the COVID-19 crisis. Poverty has experienced a significant decline in Panama over the last two decades, from 35 percent in 2000 to 14 percent in 2017 (compared to 26 percent on average in Latin America).[25] However, rural poverty remains high, particularly among the indigenous population. Public spending on education, which is key to promote social mobility and long-term growth, is one of the lowest in the region, along with enrollment rates in primary and secondary levels and expected years of schooling. Education outcomes are relatively poor too.[26] In addition, the COVID-19 crisis is severely hitting the most vulnerable sectors of the population, particularly low-skilled workers or those with difficulties to adapt to structural changes in the labor market.[27] These challenges highlight the need to rebalance expenditure towards social spending, particularly education and active labor market policies.

28. Efforts should be made to ensure the financial sustainability of the pension system over the medium term. The two existing defined benefit schemes will likely face sustainability challenges in the next decades in the absence of policy measures. According to staff projections, the first of these schemes, applicable to workers older than 35 in 2006, is expected to deplete its reserves in the next few years.[28] The situation of the defined benefit component of the mixed system introduced in 2005 is less pressing, but problems will manifest themselves in the long run, with its reserves peaking around 2055 and going down thereafter.[29]

B. Enhancing Financial Integrity

29. The Financial Action Task Force (FATF) placed Panama on its grey list in June 2019.[30] While Panama improved technical compliance with the FATF standard over the last several years (including by introducing legislation to criminalize tax evasion in 2019), the FATF designated Panama as a "jurisdiction with strategic deficiencies" due to weak compliance on 9 out of the 11

[25] See IMF (2020). Panama. 2020 Article IV Consultation. Selected Issues Papers.

[26] Education policy is one of the key pillars of the National Strategic Plan 2019-2024, which describes priority actions in this area while stressing the need to continue raising the investment in education. These priorities should be maintained, within the framework of the envisaged fiscal consolidation, in the updated medium-term expenditure plans of the government.

[27] Until early June, the government approved some new programs to address emergency social needs created by the COVID-19 crisis (mainly *Vale Solidario, Bolsa Solidaria and Agua Solidaria*, totaling close to US$300 million until mid-September). Likewise, *Fondo Solidario de Vivienda* (a program to subsidize the purchase of the first dwelling by low income families) has been strengthened with additional US$80 million. These programs target the hardest hit groups, by channeling in-kind and cash transfers into the beneficiaries of pre-existing programs for low-income and highly exposed households (*Panama Rural, Panama de las Comarcas and Panama de los Barrios*). However, a more prolonged support could warrant further efforts. Beyond the COVID-19 crisis, reinforcing social programs to ensure the inclusion of the poorest indigenous population in remote regions of the country will be important, building on new distribution platforms and databases developed during the COVID-19 crisis.

[28] IMF (2016). Panama: Pension Reform Options to Improve Sustainability and Equity. TA Report, FAD.

[29] The defined contributions component of the 2005 mixed system is expected to be fully funded.

[30] The FATF grey list currently includes 16 jurisdictions. FATF had placed Panama in the grey list before, from June 2014 to February 2016 (20 months). Right after coming out of the grey list, the Mossack Fonseca scandal broke out in April 2016, detailing financial information of over 200,000 offshore entities, some of which were involved in fraud and tax evasion in other jurisdictions.

immediate outcomes (IOs) on effectiveness. In response, the authorities agreed on an action plan with the FATF in June 2019, which includes specific commitments addressing: (i) national and sectoral ML/TF risks (IO-1); (ii) supervision and sanctions against AML/CFT violations (IO-3); (iii) verification and update of beneficial ownership information of legal persons and arrangements (IO-5); and (iv) investigation and prosecution of ML involving foreign tax crimes (IO-7) (see Annex III) with the expectation of implementing all the necessary reforms by January 2021 and of exiting the FATF grey list by June 2021.

Financial Integrity

Objective	Exit FATF grey list.
Policy	Implement FATF action plan.

FATF: Financial Action Task Force.

30. The authorities need to promptly address the items on the FATF action plan to exit the grey list. With the change of administration in July 2019, key staff on AML/CFT issues changed, and Panama struggled to make progress in implementing the action plan as originally envisaged. Nevertheless, Panama reaffirmed its commitment to the action plan and the original timetable during the FATF meetings of February and June 2020. In light of the global COVID-19 pandemic, the test dates have been postponed for three months with the last items now scheduled for implementation by January 2021.

Roadmap to Exit FATF Grey List

Area	Action	Timeline
Risks (IO-1)	Raise awareness of terrorist financing risks. Improve understanding and supervision of the use of cash in high risk sectors. Update risk analysis of vulnerable segments of the corporate sector.	Sep. 2020
Sanctions (IO-3)	Identify unlicence money remitters and apply appropriate sanctions. Risk-based supervision of designated non-financial businesses and professions. Supervision manual and improved compliance of obligated entities. Apply effective and proportional sanctions where there are violations.	Sep. 2020
Ownership (IO-5)	Ensure resident agents verify and update beneficial ownership information. Risk analysis to define and implement specific measures related to ownership. Improve monitoring of the corporate sector.	Sep. 2020
Prosecution (IO-7)	Ensure investigation guidelines are approved and used. Increase use of financial inteligence in money laundering investigations. Demostrate ability to prosecute foreign tax crimes. Demostrate exception from punishment provides an adequate deterrant effect. Focus investigations in high risks areas.	Jan 2021

Source: FATF.

31. The PLL will focus on facilitating the authorities' efforts to promptly exit the FATF grey list. As the FATF is due to assess progress in the implementation of the action plan at the February FATF plenary meeting, no structural benchmark is proposed in this area at this time. Depending on the outcome of the February 2021 plenary meeting, conditionality could be established at the time of the first PLL review to ensure that the FATF action plan is fully implemented by the time of the second review.

C. Bolstering Financial Stability

Financial Safety Net

32. The financial system is vulnerable to the COVID-19 shock. Panama is a dollarized economy with no domestic monetary authority or lender of last resort (LOLR). Under an adverse scenario, bank liquidity could dry up. Corporations may also face difficulties rolling over external liabilities forcing them to run down deposits in the domestic financial system to meet their external obligations. In addition, banks could face a sudden reversal in their external position if correspondent banking relationships are interrupted. Like in most countries, the financial system is not likely to be able to withstand any large-scale deposit withdrawal. Against this background, the authorities are creating a Fund for Economic Stimulus (FES) to safeguard the financial system by providing them with timely liquidity and credit in times of financial stress (resembling a LOLR facility).

33. The authorities believe that the introduction of the Fund for Economic Stimulus would safeguard stability in the banking system and enhance its resilience to external shocks. While the banking sector is highly liquid (with liquid assets covering 60 percent of deposits at end-May 2020), it relies partly on external borrowing that could come under pressure in the event of global financial stress amid the pandemic or other major crises. While the authorities were not enthusiastic in the past about creating a liquidity/credit facility for banks to address possible systemic liquidity shortages, the magnitude of this shock has persuaded them of the value of establishing such a facility. Against this background, the authorities designed a FES comprising two programs: (i) a liquidity program to support banks; and (ii) a stimulus program to channel additional resources as credit to support the economy. The FES was designed by the MEF, in consultation with the SBP, BNP, and Panama's Banking Association, and was launched in early August 2020 (see Box 5). The funding for this facility has been set initially at US$1 billion (about 1½ percent of GDP) and came from the MEF and BNP in equal amounts.[31] Additional financing may come in the future from a combination of public and private sources; the PLL could initially serve as a (precautionary) backstop for the envisaged public funding (under an adverse scenario).

34. The liquidity program will resemble a lender of last resort facility but with limited resources. The liquidity program will discount public bonds and bank's high-quality portfolio in a short-term repurchase agreement (up to 6 months) at a preferential rate (3.25 percent). An interested bank would send a request to SBP, if SBP deems the bank solvent, and that the request is due to market-wide events and not bank-specific liquidity problems related to credit quality issues, it will instruct BNP to go ahead with the operation. The program will be subject to the highest governance and access standards. BNP is not expected to play any key role in the management of the liquidity program but only as an operator following strict instructions. Since the structure of the program was consulted with the banking community, banks do not feel there is a conflict of interest on the part of BNP (given that BNP is a commercial bank too). The program will be carefully monitored for prompt corrective action to avoid moral hazard and a weakening of market discipline.

35. The stimulus program will resemble a credit facility already in place at the BNP. Historically BNP has been a very liquid bank as it is the banker of the government and has to intermediate the assets of the social security system (about 7 percent of GDP). BNP offers some of its excess liquidity to other banks for them to intermediate. Currently, BNP has about US$800 million in excess liquidity, with US$600 million having been intermediated in previous years, and

[31] The Ministry of Finance is earmarking the resources under the RFI (US$ ½ billion) to fund the FES, which will be subject to high governance standards.

US$200 million still available. The stimulus program will provide access to the US$1 billion from the FES to the money already available at BNP. The lending will be for up to 3 years at a market interest rate, and these operations will be collateralized with high-quality assets from the borrowing bank. Since the US$1 billion in funding for the stimulus program is the same as the liquidity window, resources would be used on a first-come, first-serve basis.

Macroprudential Measures

36. Macroprudential policies should be used to safeguard stability in the banking sector. The financial system should remain under tight supervision. The authorities recently implemented measures to alleviate the effects of the COVID-19 pandemic, including a negotiated moratorium on a broad range of loan repayments, elimination of the minimum payment on credit cards, and in some cases reductions in interest rates. Considering the elevated credit risk from restructured exposures (which may lead to the increasing NPLs), the SBP has advised banks to increase their provisioning beyond the level already constituted under the dynamic provisions. A specific timeframe should be adopted for phasing out these measures when the pandemic recedes, with a supervisory action plan and close monitoring. A risk-focused loan portfolio examination would help assess banks credit exposures and capital buffers.

Macroprudential Issues

Objective	Improve regulatory framework to fortify the financial sector and mitigate systemic risk.
Policy	Request a TA mission from MCM to enhance regulatory and supervisory frameworks along international standards and practices (including the macroprudential policy framework), and design an action plan.
Monitoring	Working group on Macroprudential Issues comprising SBP, WHD and MCM.

SBP: Superintendency of Banks.

37. Building liquidity buffers and enhancing supervisory capacity remains critical to maintaining financial and external stability. Staff supports the authorities' decision to introduce a liquidity and credit facility, funded by the Ministry of Finance, supervised by the Superintendency of Banks, but operated by the National Bank (BNP). Any solvent bank would have access to the liquidity or the credit funds, using public debt instruments or high-quality loans as collateral. Finding enough financing for the creation of these facilities will be a challenge but can be done incrementally over time. Official banks will lead by example and thereby commit to maintain a liquidity buffer of at least 30 percent of their collective deposits (indicative target). Supervisory capacity in macroprudential policy, systemic risk monitoring, and stress testing could be enhanced after a diagnostic mission from MCM takes place later in the year as well as training the supervisory staff at the SBP.

38. Steps to further strengthen supervisory capacity are needed to ensure effective supervision of banks. Actions that would further enhance supervision include macroprudential policy calibration and stress testing, systemic risk monitoring, indirect AML/CFT risks, cybersecurity risks, crisis preparedness and resolution. These could be supported by capacity development programs from MCM, CAPTAC and other IFIs. The authorities are creating a working group supported by IMF staff to monitor macroprudential issues.

Box 5. Fund for Economic Stimulus

The onset of the COVID-19 pandemic presents unprecedented challenges to Panama's economy and risks to the financial sector that may be unknown, particularly as the moratorium and loan restructuring are extended to households and business until mid-2021. To mitigate such risks, the government established the "Fund for Economic Stimulus" (FES) with dual objectives of providing liquidity to banks in times of need and extending credit to support the economy during these challenging times. The government launched the Fund in August 2020, supervised by SBP and operated BNP.

- **Structure.** The Fund will be structured as a trust, fully owned by the MEF and operated by the BNP in consultation with SBP, with a tenure of 2 years but extendable thereafter. The initial amount would be US$1 billion, comprising two programs—(i) a liquidity program to support banks; and (ii) a stimulus program to enable the channeling of credit to support the economy. The government will continually review the effectiveness and demand for this Fund to ascertain its continuity after two years. The authorities are providing US$1 billion to support this Fund, with the PLL resources serving as additional financing backstop.

- **Liquidity program (LP).** This program will be operated jointly by the SBP and BNP to assist solvent banks in meeting short term liquidity demands in the event of market dislocation. The LP is structured as a revolving, short-term repo facility (up to 6 months), and is collateralized. The interest rate will be fixed at 3.25 percent. Commercial banks that wish to access this program will submit an online request to SBP. The SBP is responsible for providing financial soundness assessment of the bank, based on its supervisory information, with a turnaround of 2 days. After the SBP approves the request, BNP will undertake the assessment of collateral and the disbursement of funds. The turnaround for the whole process—from the time the request is made until its approval and disbursement of funds—would take no more than 4 days. The authorities envisage this program to be used mainly by medium and smaller banks.

- **Stimulus program (SP)**. This program will be operated by BNP, based on existing guidelines and procedures. It is an extension of BNP's existing US$800 million credit facility for commercial banks. The SP will be a collateralized, medium-term revolving credit facility (1-3 years). BNP will undertake the assessment of credit worthiness of the collateral, which will also underpin the haircut that it applies to the collateral. BNP has put in place a collateral framework, which includes eligibility criteria and risk mitigation measures, based on its existing credit facility to commercial banks. Out of the US$800 million, BNP has disbursed US$600 million under this facility to 23 banks, representing 40 percent of the banking sector. The interest rate for this program will be higher than the interbank rate, given its longer tenure. A recent facility has been established jointly with the IDB to support micro, small, and medium enterprises in agriculture and commerce. An initial amount of US$300 million was earmarked for this joint program for a duration of two years.

- **Preparation.** The design of the FES is a product of consultation between the authorities and banks. The terms and conditions for access have been disseminated to the Banking Association. The IT systems to enable commercial banks to submit applications for this facility has been set up by BNP and SBP.

D. Improving Public Financial Management

39. While budget execution has generally performed well, efforts should be stepped up to avoid new domestic arrears in the future.[32] Deviations from budget forecasts on the spending side have been relatively small in the past. However, full and timely reporting and service of government commercial liabilities is a must to strengthen transparency and preserve fiscal

[32] Panama does not have external arrears and has not had external arrears in the last two decades since the completion of the Brady operation in the mid-1990s.

credibility, particularly when it comes to the execution of public investment. The authorities are working to upgrade the legal rank of the Budget Law and toughen sanctions for committing unappropriated expenditure, but other actions on the technical side are also needed. It will be important to strengthen expenditure quality, to that end, staff recommends that the authorities follow best procurement practices, including that government procurement contracts be regularly published online, along with the names of the winning companies and their beneficial owners, and ensure ex-post audits of COVID-related expenditure. Annex IV details some PFM weaknesses that could have favored the existence of unreported arrears, particularly regarding the medium-term and strategic orientation of the budget, timely registration of commercial debt and payment identification[33]. A forthcoming FAD technical assistance mission will identify possible challenges in these areas, possible PFM solutions and whether they should be supported by legislative changes. A working group composed of MEF, WHD and FAD will follow-up on the implementation of these recommendations.

Public Financial Management

Objective	Avoid domestic arrears in the future.
Policy	Request a TA mission from FAD to identify PFM weaknesses (including the adoption of GFSM 2014 in fiscal reports) and design an action plan.
Monitoring	Working group on PFM Issues composed of MEF, WHD and FAD.

MEF: Ministry of Finance.

40. The assessment of fiscal performance is hampered by lack of fiscal reporting in accrual terms. Current quarterly fiscal balances published by MEF combine cash and accrual accounting criteria, and this complicates their interpretation. Besides, information on financing is fragmented across different sources, and the coverage of liabilities is limited to debt loans and securities. The MEF should adapt the format of its quarterly reports to the Government Finance Statistics Manual 2014, publish above and below the line operations together and capture changes in commercial debt and, when applicable, arrears. Fiscal balances of recent years, after adjustment for undisclosed expenditure should also be adjusted to accrual terms and published. Since the transition to full accrual will take some time, in the meantime the MEF could publish cash data alongside with the current mixed cash-accrual system, and comprehensively report arrears.

E. Strengthening Data Adequacy

41. The authorities have embraced the recommendations of the 2020 Data ROSC mission and are committed to statistical improvement, including subscription to the SDDS within two years. They plan to begin with the update of the National Statistical Plan for 2020–24, which is aligned with other policies including the modernization plan of the National Institute of Statistics and Census (INEC),

Data Adequacy

Objective	Achieve SDDS status.
Policy	Implement ROSC action plan.
Monitoring	Working group on Data Adequacy Issues composed of MEF, INEC, WHD and STA.

MEF: Ministry of Finance; and INEC: Statistical Institute.

[33] More specifically, medium-term budgeting could benefit from more robust linkages between the fiscal strategy and the macro-fiscal framework, a more explicit consideration of fiscal risks and an improved programmatic structure.

increasing INEC resources, and establishing the National Statistical Coordination Committee to improve coordination and oversee the statistical reform. With increased efforts and resources, Panama should meet SDDS requirements by 2022.

42. **Improving data timeliness and periodicity will requires more financial and human resources.** The INEC modernization plan should cover enough resources to invest in new computer equipment, create an innovation team headed by a Chief Innovation Officer, and strengthen main statistical programs, reducing staff attrition and investing in staff training (especially in the BOP program).

43. **Improving coverage is key for Panama to meet the SDDS requirements**. Panama meets most SDDS coverage requirements, except in government finance and external sector statistics. On the former, INEC needs to restart publication of data on the general and central government operations, including financing. The latter requires the authorities to compile the Data Template on International Reserves and Foreign Currency Liquidity (Reserve Template), which is usually prepared by the Central Bank. In Panama's fully dollarized economy without a central bank, the concept of international reserves requires adjustments and a comprehensive analysis of the subject in this context, including the liquidity of the external assets of the National Bank of Panama (BNP), and whether these assets would be available to address a balance of payments financing need. Supported by the Fund, the Ministry of Economy and Finance (MEF) will work with the BNP to agree on suitable definitions, including the composition of the official reserve assets, following the definition in the methodology of the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6).

Roadmap to Modernize Statistical System

	Area	Action	Timeline
		General Reforms	
1	**Planning**	Prepare modernization plan for the INEC and update the National Statistical Plan for 2020-24.	Q4-2020
2	**Resources**	Improve brand of the INEC, increase its budget, modernize main statistical programs.	2021-22
3	**Coordination**	Reconstitute National Statistical Council, establish National Statistical Coordination Committee.	2021-22
		Reforms for Transition to SDDS	
4	**Timeliness**	Improve timeliness for production index (from 55 days to 6 weeks); for deposit corporations survey (from 2 months to 1 month); for interest rates (from 50 days to 1 day); for stock market and exchange rates (from 1 month to 1 day); for official reserve assets (from 1 month to 1 week), for external debt (from 2 quarters to 1 quarter); for central government operations (to 1 month); for general government operations (to 2 quarters).	Q4-2021
5	**Periodicity**	Improve periodicity for labor market data (from semiannual to quarterly); for interest rates, exchange rates and stock market (from monthly to daily); for producer price index (from quarterly to monthly); for central government operations (to monthy); and for general government operations (to annual).	Q1-2022
6	**Coverage**	Restart compilation and improve coverage for the central and general government operations; improve classification of the official reserve assets and begin producing the reserves template.	Q2-2022

Source: ROSC 2020.

44. **Statistical conditionality will be used to guide the process of achieving SDDS status.** In particular, there will be 3 structural benchmarks in the statistical area under the PLL: (i) establish a National Statistical Coordination Committee by May 2021 (structural benchmark) that meets twice a year with INEC serving as a secretariat and overseeing the operational aspects of the Committee's work; (ii) publish the Data Template on International Reserves and Foreign Currency Liquidity on the

National Summary Data page (NSDP) with assistance from the Fund by September 2021 (structural benchmark); and (iii) resume quarterly publication on the INEC website of the Fiscal Operations of Central Government (CG) and General Government (GG), adding detailed financing data by March 2022 (structural benchmark). The authorities are creating a working group supported by IMF staff to monitor data adequacy issues.

STAFF APPRAISAL

45. **Panama meets most qualification areas**. Panama has strong fundamentals and a track record of strong performance and policy frameworks. Staff assesses that Panama qualifies under the PLL as 3 out of the 5 qualification areas (and the majority of the 9 qualification criteria) are met, with data adequacy and financial area (related to money laundering risks) being the two areas where improvements are needed to achieve strong performance. The country's external position and market access continue to be underpinned by improvements in the current account, reinforced by copper exports from one of the largest copper mines in the world; an expected increase in national savings; and easy access to international capital markets, supported by investment grade sovereign credit rating since 2010 with some of the lowest spreads in emerging markets. A prudent track record of fiscal management has been maintained as the authorities managed to reduce public debt from about 60 percent of GDP in 2005 to around 40 percent of GDP in 2019, supported by a fiscal rule introduced in 2008. Dollarization has helped to anchor inflation at low levels. At the same time, the financial system is strong—with no bank liquidity or solvency issues—and well supervised following international best practices and Basel standards. There are, however, some deficiencies in the area of data adequacy, and a roadmap has been formulated for Panama to fully achieve SDDS status for data dissemination by the end of the PLL. Similarly, Panama is on the FATF grey list and staff encourages the authorities to promptly implement the action plan agreed with FATF due for completion by January 2021 to exit such list.

46. **Staff recommends approval of the authorities' request for a PLL arrangement for Panama and considers that access at 500 percent of quota is appropriate.** The PLL arrangement would provide adequate insurance against external shocks**.** Staff supports the authorities' efforts to fortify economic fundamentals and policy frameworks, as well as safeguard financial stability. The PLL is expected to be precautionary, as a backstop for fiscal financing needs and for bank liquidity support in an adverse scenario, possibly on account of a further significant intensification of the global COVID-19 pandemic and its economic effects. Staff welcomes the authorities' commitment to continue cooperating with the Fund in addressing any balance of payments and fiscal imbalances.

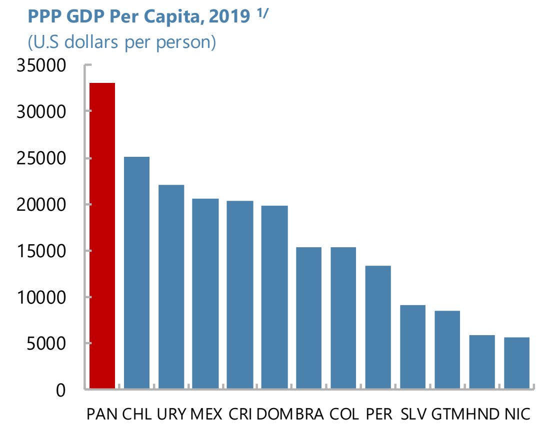
47. **In staff's view, Panama has sustainable debt with high probability and an adequate capacity to repay the Fund.** Staff projects public debt to increase as a percent of GDP during the pandemic and then to follow a downward path. This is consistent with the experience for most of the last 2 decades. The proposed PLL would be for SDR 1.884 billion (500 percent of quota), which is about 4½ percent of GDP. If the proposed arrangement were to be fully drawn, Panama's capacity to repay the Fund would remain adequate assuming steady program implementation and

continued market access.[34] Moreover, the Fund's risks from this PLL exposure will be limited given the authorities' excellent track record of servicing their debt obligations. The DSA shows debt to be sustainable with a sufficient buffer even after the impact of the pandemic, ensuring that Panama has the capacity to repay the Fund.

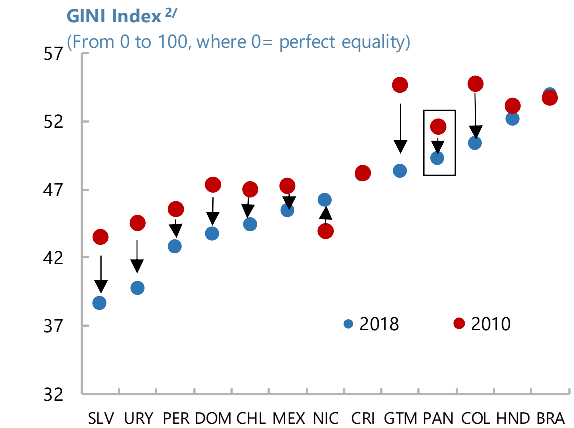
[34] See attached Risk Assessment Annex

Figure 1. Panama: Socio-Economic Indicators

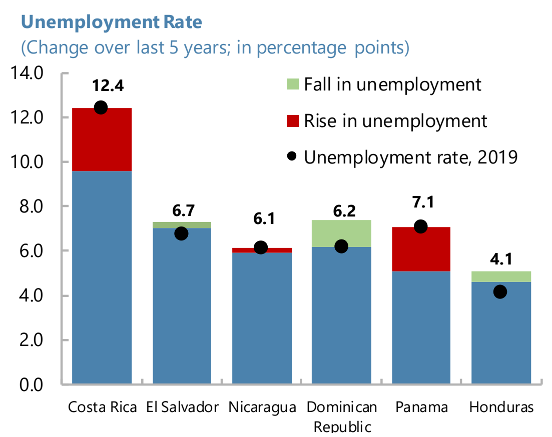
Per capita income is the highest in Latin America…



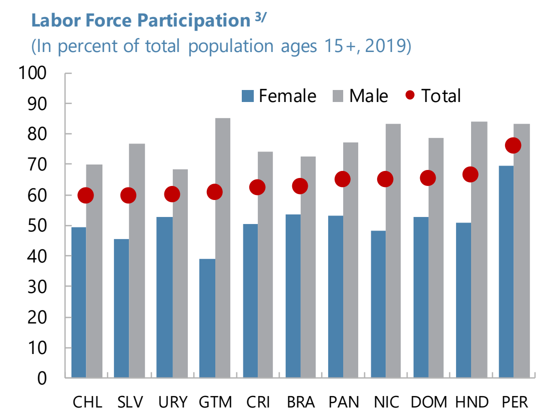
…but inequality remains high relative to regional peers.



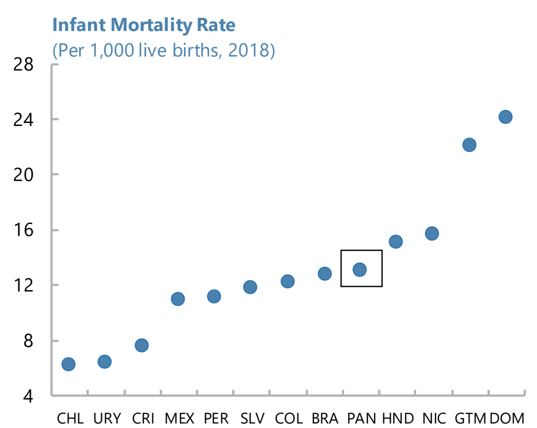
Unemployment has increased but remains comparable to regional peers.



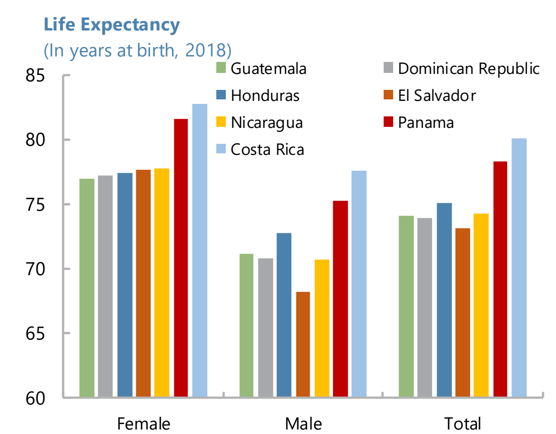
Labor force participation rates are in line with regional peers.



Infant mortality is comparable to regional peers, but…



…life expectancy is higher than in most regional peers.



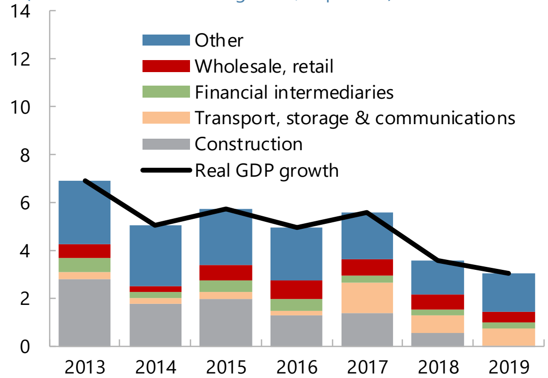
Sources: WEO, October 2020; World Bank, World Development Indicators, and IMF staff calculations.
1/ LA6 (Brazil (BRA), Chile (CHL), Colombia (COL), Mexico (MEX), Peru (PER) and Uruguay (URY)) and CAPDR Costa Rica (CRI), Honduras (HND), Nicaragua (NIC), El Salvador (SLV), Dominican Republic (DOM), Guatemala (GTM), and Panama (PAN).
2/ For 2010, data for NIC, CHL and BRA is from 2009 and GTM is from 2006. For 2018, NIC and GTM is from 2014, and for CHL is from 2017.
3/ Data for HND and SLV are from 2018, for GTM is from 2017 and for NIC is from 2014.

Figure 2. Panama: Real Sector Developments

Transport and communication supported economic activity in 2019…

Real GDP Growth

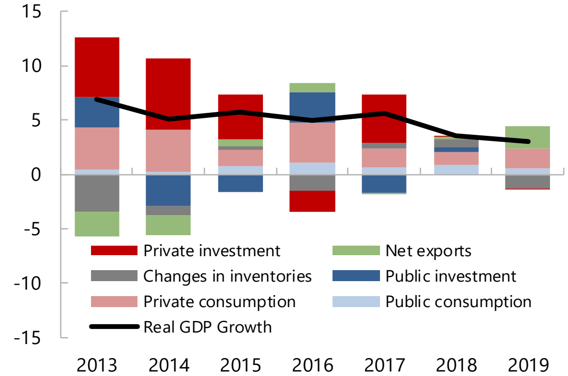
(Sectors' contribution to growth, in percent)



…but, declining investment dragged economic growth down.

Real GDP Growth

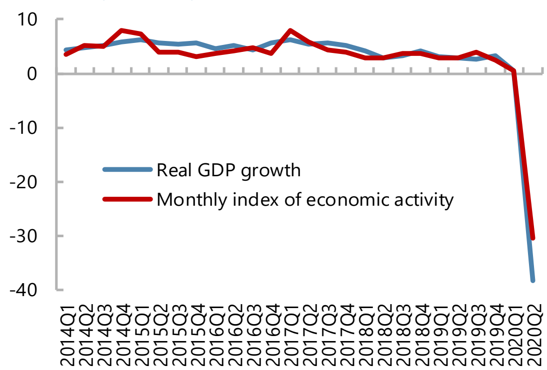
(Demand side contribution to growth, in percent)



The outbreak of COVID-19 pandemic had led to significant deterioration in the economic activities…

Economic Activity

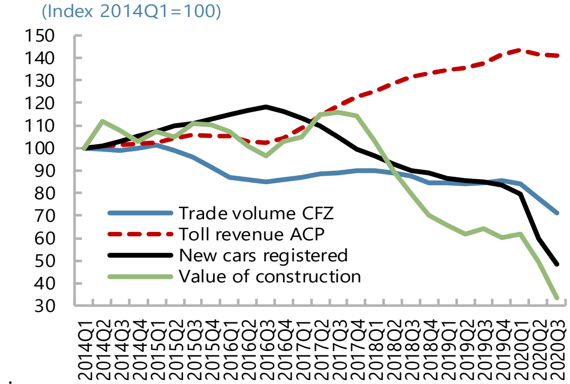
(Percent; year-over-year)



…as major sectors tumbled, despite the resilience in canal operations.

High-Frequency Indicators 1/

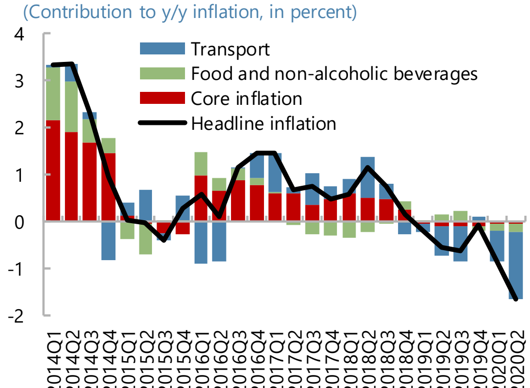
(Index 2014Q1=100)



Prices continued to decline, exacerbated by weak domestic demand…

Inflation

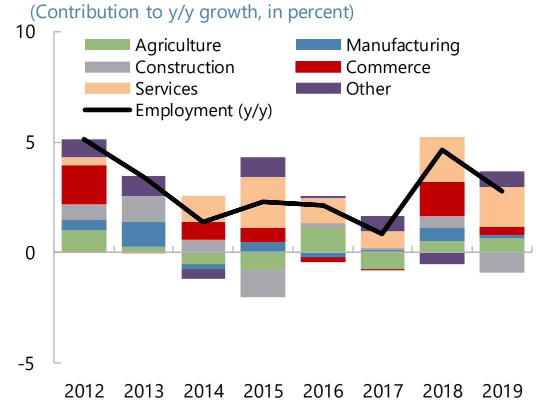
(Contribution to y/y inflation, in percent)



… as aggregate employment growth slowed, particularly in construction.

Employment Growth

(Contribution to y/y growth, in percent)



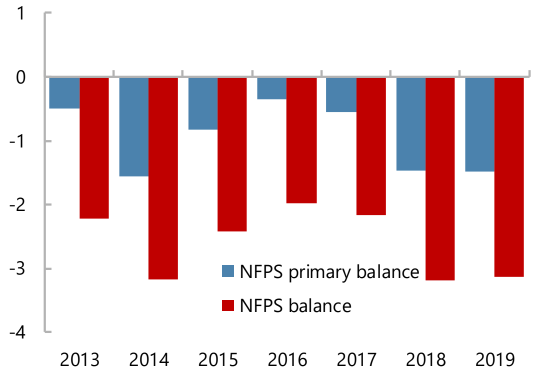
Sources: National authorities and IMF staff calculations.

1/ 4-quarter moving averages. Colon Free Zone (CFZ) measured in gross metric tons.

Figure 3. Panama: Fiscal Developments

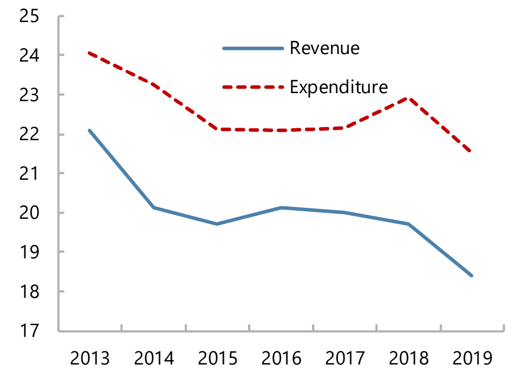
The fiscal deficit remained stable in 2019 …

Fiscal Balances 1/
(In percent of GDP)



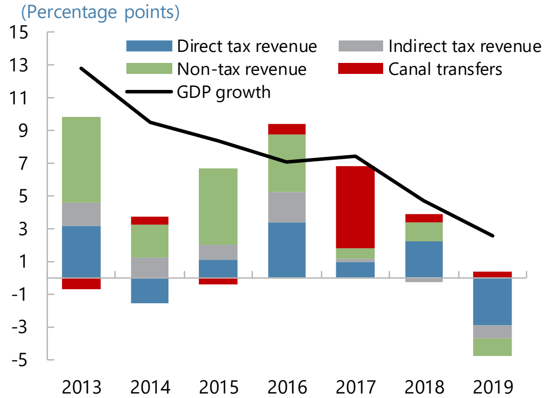
… despite a fall in revenue due to the combination of cyclical and structural factors.

Revenue and Expenditure 1/
(In percent of GDP)



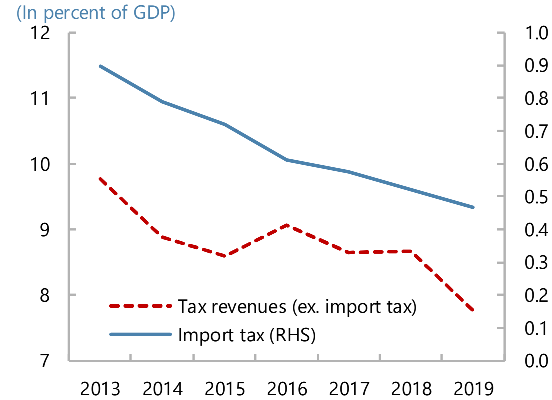
Low tax revenue explains most of the revenue decline…

Revenue Contribution 2/
(Percentage points)



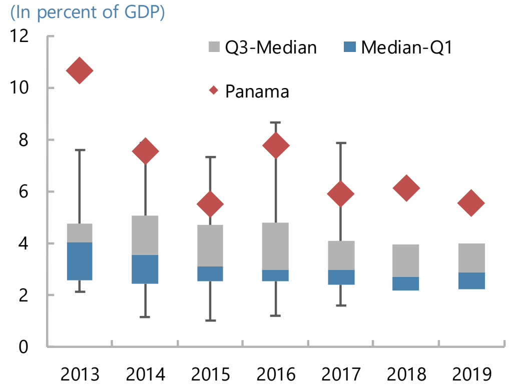
…and challenges in tax and customs administration, and tax exceptions continue to affect tax and tariff collection.

Tax Revenues
(In percent of GDP)



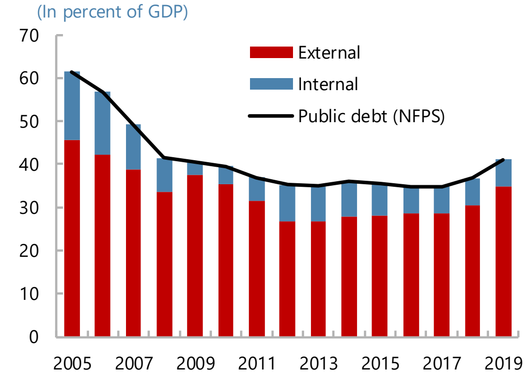
Public investment has fallen after the completion of several large infrastructure projects.

Public Gross Fixed Capital Formation 3/
(In percent of GDP)



Public debt increased by over 6 percent of GDP in the past three years.

Public Debt
(In percent of GDP)

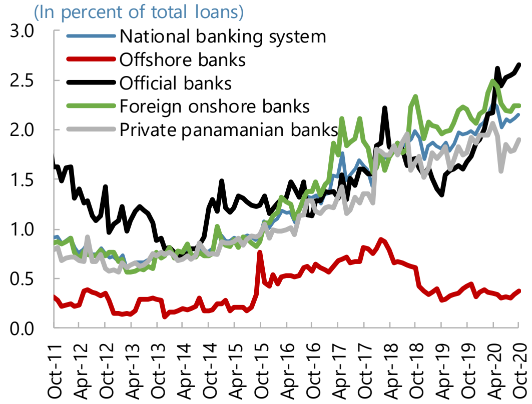


Sources: National Authorities, WEO and IMF staff calculations.
1/ Non-Financial Public Sector.
2/ Data refer to the Central Government.
3/ Countries in the chart are CAPDR (Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica, Panama and Dominican Republic) and LA6 (Brazil, Chile, Colombia, Mexico, Peru, and Uruguay).

Figure 4. Panama: Banking Sector Soundness

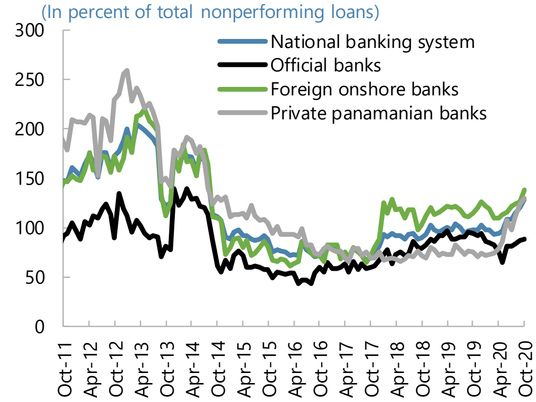
NPLs are rising amid challenging operating conditions following the COVID-19 pandemic …

Nonperforming Loans
(In percent of total loans)



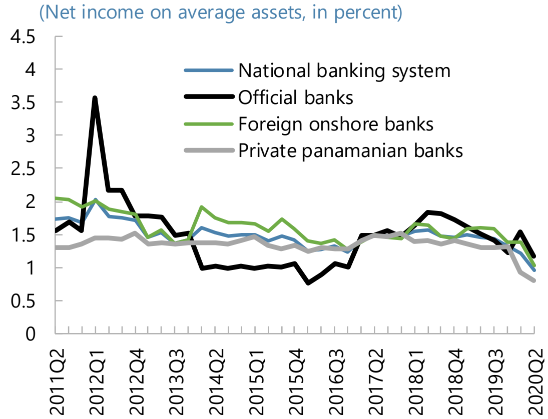
… but, provision coverage remains high as banks continue to adopt strict provisioning standards.

Provisioning
(In percent of total nonperforming loans)



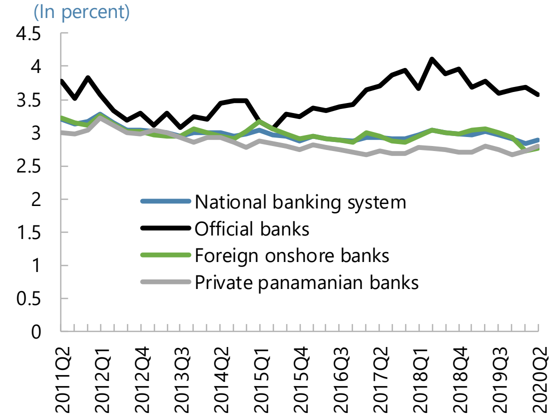
Banks' profitability is declining amidst higher credit costs…

Return on Assets
(Net income on average assets, in percent)



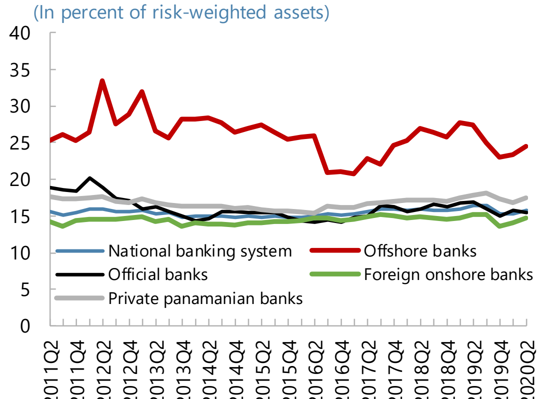
… and net interest margins have narrowed slightly.

Net Interest Margin
(In percent)



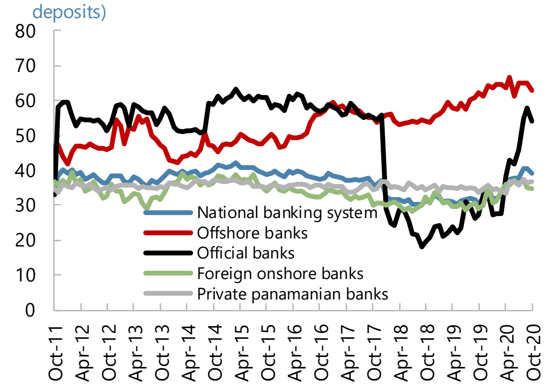
Banks' capital adequacy continues to be strong, well in excess of regulatory minimum…

Capital Adequacy Ratio
(In percent of risk-weighted assets)



… while liquidity remains ample

Bank Liquidity
(Ratio of liquid assets plus marketable securities to total deposits)

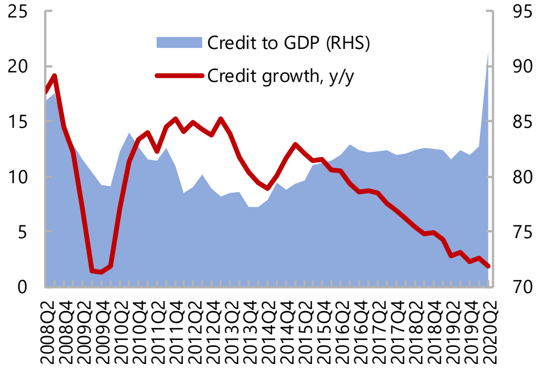


Sources: SBP and IMF staff calculations.

Figure 5. Panama: Macrofinancial Developments

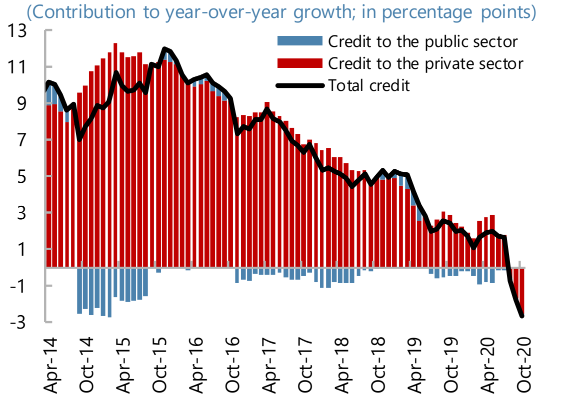
Declining economic activities precipitated a fall in credit growth …

Growth of Credit to the Private Sector
(In percent)



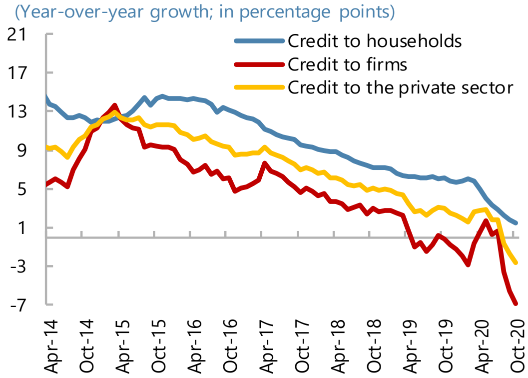
… the pandemic had a contraction in credit growth in recent months

Credit Growth: Public vs. Private Sector
(Contribution to year-over-year growth; in percentage points)



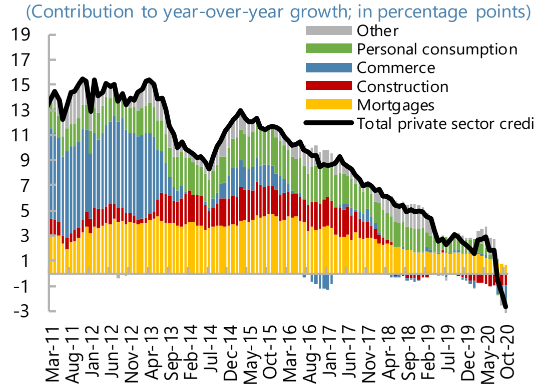
Credit to firms and households had declined sharply…

Private Sector Credit Growth
(Year-over-year growth; in percentage points)



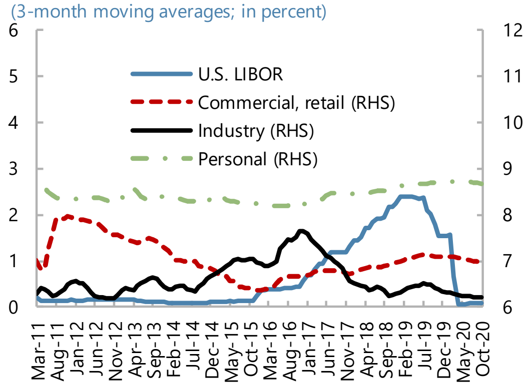
…as lending to major sectors tumbled, except mortgages.

Credit to the Private Sector
(Contribution to year-over-year growth; in percentage points)



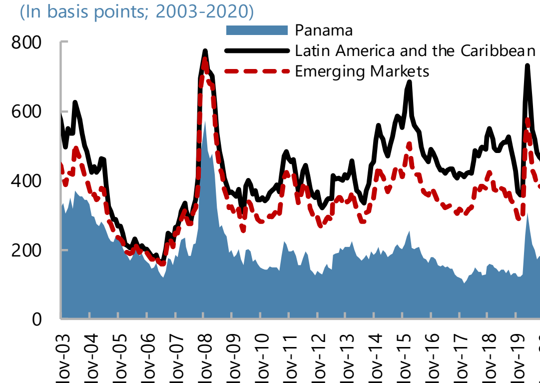
Domestic interest rates continue to adjust in line with U.S. interest rates …

Interest Rates
(3-month moving averages; in percent)



… while sovereign spreads remain among the lowest in the region, underpinned by its investment grade rating.

EMBIG Spreads
(In basis points; 2003-2020)

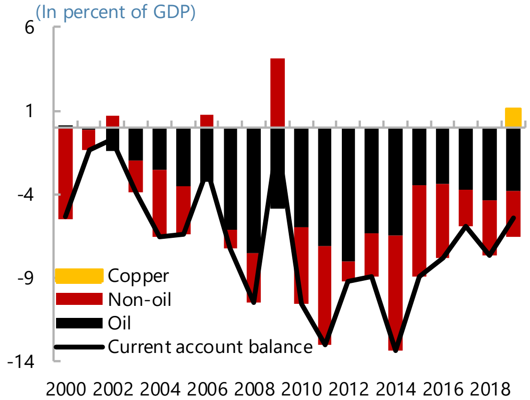


Sources: SBP, INEC, U.S. Federal Reserve, Bloomberg and IMF staff calculations.

Figure 6. Panama: External Sector Developments

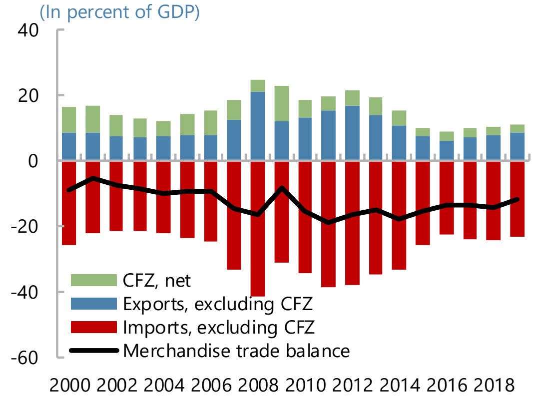
The current account deficit improved in 2019, benefitting from copper exports while oil prices fell…

Current Account Oil and Non-oil
(In percent of GDP)



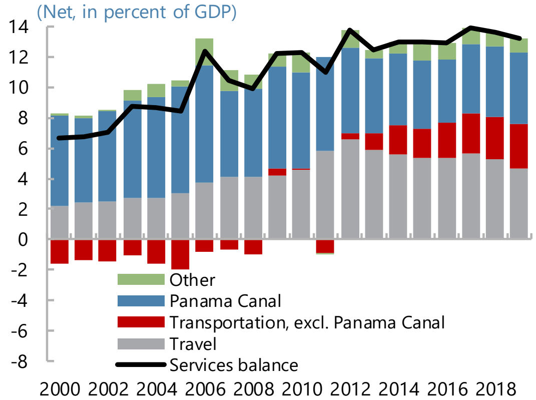
… reducing the merchandise trade deficit.

Merchandise Trade Balance
(In percent of GDP)



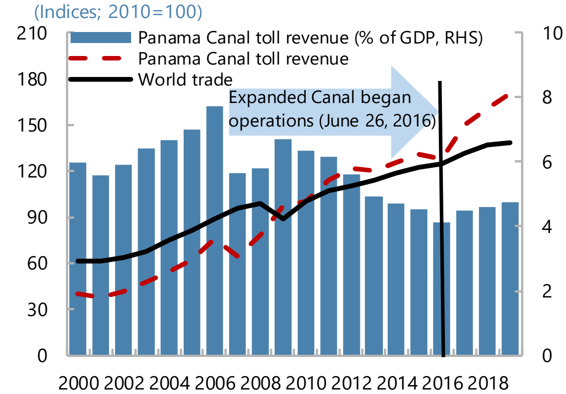
Services exports weakened slightly, driven by weak tourism …

Trade in Services
(Net, in percent of GDP)



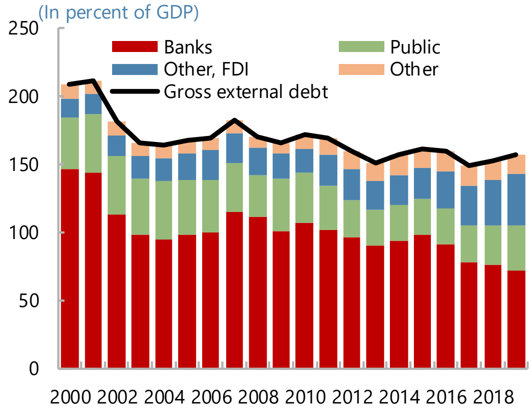
… but revenues from the Panama Canal continued to grow, albeit at a slower rate.

Panama Canal Toll Revenue and World Trade
(Indices; 2010=100)



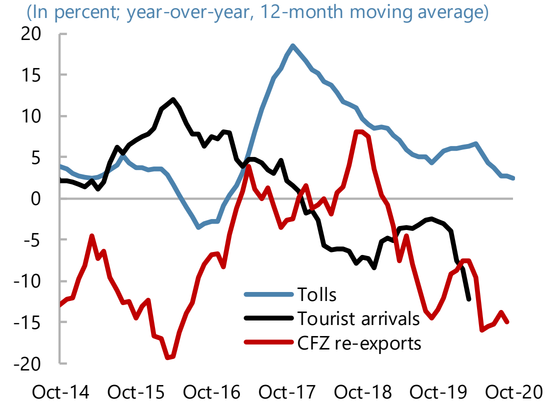
External debt inched up slightly, reflecting strong FDI inflows and banking sector deposits.

External Debt
(In percent of GDP)



However, the COVID outbreak had triggered declines in CFZ, tourism and canal receipts in recent months.

High-Frequency Export Data
(In percent; year-over-year, 12-month moving average)



Sources: IMF WEO; INEC and IMF staff calculations.

Table 1. Panama: Selected Economic and Social Indicators, 2015–25

Population (millions, 2019)	4.2	Poverty line (percent, 2017)	20.7
Population growth rate (percent, 2019)	1.4	Adult literacy rate (percent, 2018)	95.4
Life expectancy at birth (years, 2017)	78.1	GDP per capita (US$, 2019)	15,831
Total unemployment rate (August, 2019)	7.1	IMF Quota (SDR, million)	376.8

						Est.	Projections				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						(Percent change)					
Production and prices											
Real GDP (2007 prices)	**5.7**	**5.0**	**5.6**	**3.6**	**3.0**	**-9.0**	**4.0**	**5.0**	**5.0**	**5.0**	**5.0**
Consumer price index (average)	0.1	0.7	0.9	0.8	-0.4	-0.8	0.2	1.1	2.0	2.0	2.0
Consumer price index (end-of-year)	0.3	1.5	0.5	0.2	-0.1	-0.5	0.5	2.0	2.0	2.0	2.0
Output gap (% of potential)	-0.3	-0.1	1.7	2.9	4.6	-5.5	-3.2	-1.1	0.0	0.0	0.0
Demand components (at constant prices)											
Public consumption	**7.6**	**10.1**	**6.4**	**7.7**	**4.5**	**1.8**	**-6.1**	**-11.1**	**-8.4**	**-0.3**	**1.8**
Private consumption	2.8	7.1	3.1	2.3	3.6	-2.0	1.0	2.0	3.2	4.5	5.0
Public investment 1/	-20.4	49.0	-20.7	6.9	-1.6	-24.4	34.0	-8.3	6.0	4.2	5.3
Private investment	12.6	-5.5	14.9	-0.4	-2.8	-31.6	15.9	19.9	7.7	5.9	3.5
Exports	0.9	-4.3	5.0	5.1	-0.1	-28.4	19.4	8.3	6.9	7.6	7.5
Imports	-0.1	-4.8	4.3	4.1	-3.3	-31.6	28.6	5.5	4.0	5.0	5.0
Financial sector											
Private sector credit	**11.4**	**8.4**	**6.5**	**4.5**	**2.4**	**-2.0**	**2.0**	**6.2**	**7.1**	**7.1**	**7.1**
Broad money	5.5	4.2	5.2	2.8	2.3	-0.7	7.0	7.1	8.0	8.1	8.1
Average deposit rate	1.7	1.6	1.6	1.8	2.1	2.0	…	…	…	…	…
Average lending rate	7.7	7.8	7.9	7.7	7.9	7.8	…	…	…	…	…
						(In percent of GDP)					
Saving-investment balance											
Gross domestic investment	**42.8**	**40.5**	**41.7**	**41.5**	**39.3**	**28.5**	**32.5**	**35.5**	**36.3**	**36.5**	**36.0**
Public sector	5.5	7.8	5.9	6.2	6.0	4.5	5.8	5.1	5.1	5.1	5.1
Private sector	37.2	32.7	35.8	35.3	33.2	24.0	26.7	30.4	31.2	31.4	30.9
Gross national saving	33.8	32.7	35.8	33.8	33.9	26.0	26.6	30.7	32.4	33.6	33.5
Public sector	3.0	3.9	4.2	4.2	2.5	-4.3	-2.3	0.5	1.6	2.6	3.2
Private sector	30.8	28.8	31.5	29.6	31.4	30.3	28.9	30.1	30.7	31.0	30.4
Public finances 1/											
Revenue and grants	**22.7**	**22.6**	**22.0**	**22.0**	**20.8**	**17.6**	**20.3**	**21.8**	**22.5**	**22.7**	**22.9**
Expenditure	25.9	24.8	24.2	24.9	23.4	26.1	27.3	25.4	25.0	24.3	24.0
Current, including interest	16.8	16.7	17.0	17.2	17.8	21.6	21.5	20.3	19.9	19.2	18.9
Capital	9.0	8.0	6.9	6.5	5.6	4.5	5.8	5.1	5.1	5.1	5.1
Overall balance, including ACP	-3.2	-2.2	-2.2	-2.9	-2.6	-8.5	-7.0	-3.6	-2.5	-1.6	-1.1
Overall balance, excluding ACP	-2.4	-2.0	-2.2	-3.2	-3.1	-9.0	-7.4	-4.0	-3.0	-2.0	-1.5
Total public debt											
Debt of Non-Financial Public Sector 2/	**35.5**	**34.8**	**34.8**	**36.9**	**41.0**	**53.8**	**59.4**	**60.0**	**59.4**	**57.9**	**55.9**
External	28.2	28.5	28.7	30.6	34.9	47.1	52.1	53.1	52.9	51.8	50.2
Domestic	7.3	6.3	6.1	6.3	6.1	6.7	7.2	6.9	6.5	6.1	5.6
Debt of ACP	5.1	4.7	4.4	4.2	3.9	4.2	3.8	3.4	3.0	2.7	2.4
Other 3/	3.1	3.8	3.4	4.2	4.1	4.6	4.4	4.1	3.8	3.6	3.4
External sector											
Current account	**-9.0**	**-7.8**	**-5.9**	**-7.6**	**-5.4**	**-2.5**	**-6.0**	**-4.8**	**-3.9**	**-2.9**	**-2.5**
Net exports from Colon Free Zone	2.7	2.9	3.0	2.5	2.7	2.7	2.1	2.2	2.4	2.4	2.4
Net oil imports	3.5	3.4	3.8	4.4	3.8	2.6	2.8	2.8	2.8	2.8	2.8
Net foreign direct investment inflows	7.3	7.9	6.9	7.6	5.5	4.1	4.7	4.9	4.9	5.0	5.0
External Debt	161.3	159.9	149.6	153.0	156.8	194.1	193.6	191.6	188.8	186.5	184.8
Memorandum items:											
GDP (in millions of US$)	54,092	57,908	62,203	64,928	66,788	60,315	62,832	66,709	71,445	76,518	81,951

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.

1/ Includes Panama Canal Authority (ACP). Includes Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.

2/ Non-Financial Public Sector according to the definition in Law 31 of 2011.

3/ Includes debt of public enterprises outside the national definition of NFPS (ENA, ETESA, and AITSA) and non-consolidated agencies.

Table 2. Panama: Summary Operations of the Non-Financial Public Sector, 2015–25[1]
(In percent of GDP)

						Est.	Projections				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Non-Financial Public Sector					
Revenues	**19.7**	**20.1**	**20.0**	**19.8**	**18.4**	**15.1**	**17.9**	**19.4**	**20.1**	**20.4**	**20.6**
Current revenue	19.6	20.1	20.0	19.8	18.4	15.2	17.0	18.7	19.4	19.7	20.0
Tax revenue	9.3	9.7	9.2	9.2	8.2	5.9	7.4	8.5	9.0	9.3	9.5
Nontax revenue	3.7	3.4	4.5	4.4	4.2	4.0	4.1	4.3	4.4	4.4	4.4
o/w: Panama Canal fees and dividends	1.8	1.8	2.6	2.6	2.6	3.0	2.9	2.9	2.9	2.8	2.8
Social security agency	5.6	5.8	5.7	5.6	5.6	5.0	5.2	5.5	5.6	5.6	5.6
Public enterprises' operating balance	0.2	0.1	0.0	0.0	0.0	-0.1	0.1	0.1	0.1	0.1	0.1
Other 2/	0.7	1.0	0.5	0.5	0.5	0.2	0.3	0.3	0.3	0.4	0.5
Capital revenue	0.1	0.0	0.0	0.0	0.0	-0.1	0.9	0.7	0.7	0.7	0.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**22.1**	**22.1**	**22.2**	**23.0**	**21.5**	**24.1**	**25.4**	**23.4**	**23.0**	**22.4**	**22.1**
Current primary expenditure	13.6	13.5	13.6	13.7	14.3	17.5	17.2	16.1	15.8	15.3	15.1
Central government 3/	8.1	7.9	8.0	8.1	8.4	10.6	10.0	9.2	9.0	8.6	8.5
Rest of the general government	5.5	5.6	5.6	5.6	5.9	6.8	7.2	6.9	6.7	6.7	6.6
Social security agency	5.0	5.1	5.2	5.2	5.5	6.3	6.6	6.4	6.3	6.2	6.1
Decentralized agencies	0.4	0.4	0.4	0.4	0.4	0.6	0.6	0.4	0.4	0.4	0.4
Interest	1.7	1.7	1.7	1.8	1.9	2.3	2.6	2.4	2.3	2.2	2.1
Capital	6.6	6.7	6.5	6.3	5.3	4.3	5.6	4.9	4.9	4.9	4.9
Accrued spending 4/	0.2	0.2	0.3	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 5/	**-2.4**	**-2.0**	**-2.2**	**-3.2**	**-3.1**	**-9.0**	**-7.4**	**-4.0**	**-3.0**	**-2.0**	**-1.5**
Net financing 6/	**3.0**	**1.7**	**2.8**	**4.5**	**3.6**	**9.0**	**7.4**	**4.0**	**3.0**	**2.0**	**1.5**
External	2.4	2.1	2.1	3.1	5.1	8.4	7.0	4.0	3.3	2.4	1.9
Domestic	0.6	-0.5	0.8	1.4	-1.5	0.5	0.5	0.1	-0.4	-0.4	-0.4
						Panama Canal Authority (ACP)					
Revenue	**4.8**	**4.3**	**4.6**	**4.8**	**5.0**	**5.4**	**5.3**	**5.4**	**5.3**	**5.2**	**5.1**
Expenditure	**5.6**	**4.6**	**4.7**	**4.6**	**4.5**	**5.0**	**4.8**	**4.9**	**4.8**	**4.8**	**4.7**
Current primary expenditure	1.4	1.4	1.5	1.6	1.5	1.7	1.6	1.7	1.7	1.7	1.7
Transfers to the government	1.8	1.8	2.6	2.6	2.6	3.0	2.9	2.9	2.9	2.8	2.8
Interest payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure	2.4	1.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Overall balance	**-0.8**	**-0.3**	**-0.1**	**0.3**	**0.5**	**0.4**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**
						Consolidated Non-Financial Public Sector					
Overall balance (incl. ACP)	**-3.2**	**-2.2**	**-2.2**	**-2.9**	**-2.6**	**-8.5**	**-7.0**	**-3.6**	**-2.5**	**-1.6**	**-1.1**
Memorandum items:											
Primary balance (excl. ACP)	-0.8	-0.3	-0.5	-1.5	-1.5	-6.9	-5.1	-1.8	-0.9	0.0	0.4
Structural primary balance (excl. ACP) 7/	-0.8	-0.3	-0.9	-2.0	-2.3	-6.1	-4.6	-1.6	-0.9	0.0	0.4
Primary balance (incl. ACP)	-1.5	-0.4	-0.4	-1.0	-0.6	-6.1	-4.4	-1.1	-0.1	0.7	1.1

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Official presentation excludes the operations of the ACP as it is not part of the NFPS.
2/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies.
3/ Different from Table 3 as it excludes the transfers to other agencies.
4/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.
5/ For 2015 - 2017, includes spending allowed under Article 34 of Law 38 of 2012.
6/ Includes staff adjustment for net financing through the change in obligations related to unrecorded expenditure for 2015-2019. For 2019, also accounts for deposits accumulated in pre-financing operations.
7/ Primary balance adjusted for the output gap.

Table 3. Panama: Summary Operations of the Central Government, 2015–25[1]
(In percent of GDP)

						Est.			Projections		
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenues and grants	**13.4**	**13.3**	**14.0**	**13.9**	**12.6**	**10.3**	**12.6**	**13.7**	**14.3**	**14.5**	**14.7**
Current revenue	13.2	13.3	13.9	13.9	12.6	10.2	11.7	13.1	13.7	14.0	14.1
Taxes	9.3	9.7	9.2	9.2	8.2	5.9	7.4	8.5	9.0	9.3	9.5
Direct taxes	4.8	5.1	4.9	5.1	4.4	3.5	4.2	4.7	5.0	5.1	5.1
Income tax	4.3	4.6	4.4	4.6	4.0	3.3	4.0	4.5	4.7	4.8	4.8
Tax on wealth	0.5	0.5	0.5	0.5	0.4	0.2	0.2	0.3	0.3	0.3	0.3
Indirect taxes	4.5	4.6	4.3	4.1	3.8	2.5	3.2	3.8	4.0	4.2	4.3
Import tax	0.7	0.6	0.6	0.5	0.5	0.3	0.4	0.5	0.5	0.5	0.5
ITBMS	2.4	2.6	2.5	2.3	2.2	1.4	1.8	2.2	2.3	2.5	2.6
Petroleum products	0.4	0.5	0.4	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.4
Other tax on domestic transactions	0.9	0.9	0.8	0.8	0.8	0.5	0.6	0.7	0.8	0.8	0.8
Nontax revenue	3.9	3.6	4.7	4.6	4.4	4.3	4.3	4.6	4.7	4.7	4.7
Dividends	1.6	1.5	2.3	2.4	2.2	2.1	2.0	2.3	2.2	2.2	2.2
Of which : Panama Canal Authority	1.1	1.2	1.9	1.8	1.8	2.1	2.0	2.1	2.0	2.0	2.0
Panama Canal Authority: fees per ton [1/]	0.7	0.7	0.7	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.8
Transfers from decentralized agencies	0.5	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Other	1.1	0.9	1.2	1.0	0.9	0.8	0.9	0.9	1.1	1.1	1.1
Capital revenue	0.1	0.1	0.1	0.0	0.0	0.0	0.8	0.6	0.6	0.5	0.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	**17.4**	**17.5**	**17.5**	**17.5**	**16.7**	**19.1**	**20.0**	**17.7**	**17.2**	**16.5**	**16.1**
Current	11.1	10.7	10.9	11.0	11.5	15.3	15.5	14.1	13.5	12.9	12.5
Wages and salaries	4.0	4.3	4.6	4.7	4.8	6.0	6.0	5.6	5.6	5.3	5.3
Goods and services	1.4	1.3	1.4	1.2	1.2	1.2	1.2	1.1	1.1	1.0	1.0
Current expenditure of CSS	0.7	0.5	0.6	0.6	0.7	1.6	1.8	1.3	1.1	0.9	0.7
Transfers to public and private entities	3.2	2.8	2.7	2.7	3.0	4.3	3.7	3.2	3.0	2.8	2.7
Interest	1.7	1.7	1.7	1.8	1.9	2.3	2.8	2.9	2.8	2.8	2.8
Domestic	0.3	0.3	0.4	0.3	0.4	0.5	0.5	0.4	0.3	0.3	0.3
External	1.4	1.4	1.4	1.4	1.5	1.8	2.3	2.5	2.5	2.5	2.5
Capital	6.0	6.5	6.1	5.8	5.2	3.8	4.5	3.6	3.7	3.7	3.7
Accrued spending [2/]	0.3	0.3	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings [3/]	2.2	2.6	3.0	2.9	1.1	-5.1	-3.7	-1.0	0.1	1.1	1.7
Overall balance [4/]	**-4.1**	**-4.1**	**-3.6**	**-3.7**	**-4.1**	**-8.9**	**-7.4**	**-4.0**	**-3.0**	**-2.0**	**-1.5**
Financing (net) [5/]	4.4	2.6	3.3	4.4	2.6	8.9	7.4	4.0	3.0	2.0	1.5
External	2.4	2.1	2.4	3.3	5.5	8.4	7.0	4.0	3.3	2.4	1.9
Of which : Multilateral lenders	1.5	1.2	1.5	1.4	1.2	3.1	2.4	1.1	0.6	0.5	0.5
Of which : Private creditors	2.3	1.7	2.4	2.7	4.9	7.9	5.9	3.6	4.0	4.8	4.1
Of which : Other lenders	-1.4	-0.8	-1.5	-0.7	-0.7	-2.6	-1.3	-0.7	-1.2	-2.9	-2.7
Domestic	2.0	0.5	0.9	1.0	-2.8	0.4	0.5	0.0	-0.4	-0.4	-0.4
Of which: Net credit from banks	0.2	-0.4	-0.3	0.5	-2.2	1.6	-0.5	0.0	0.0	0.0	0.0
Of which: Net credit from non-banks	1.6	0.6	0.8	-0.3	1.6	-1.2	0.9	0.1	0.0	0.0	0.0
Of which: Other lenders	0.2	0.3	0.4	0.8	-2.3	0.1	0.0	0.0	-0.4	-0.4	-0.4
Memorandum items:											
Primary balance	-2.4	-2.4	-1.8	-1.9	-2.2	-6.6	-4.6	-1.1	-0.1	0.8	1.3
GDP (in millions of US$)	54,092	57,908	62,203	64,928	66,788	60,315	62,832	66,709	71,445	76,518	81,951

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes public service fees.
2/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.
3/ Current revenues and grants less current expenditure.
4/ For 2015 - 2017, includes spending allowed under Article 34 of Law 38 of 2012.
5/ Includes staff adjustment for net financing through the change in obligations related to unrecorded expenditure for 2015-2019. For 2019, also accounts for deposits accumulated in pre-financing operations.

Table 4. Panama: Public Debt, 2015–25

(In percent of GDP)

						Est.	Projections				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					Central Government						
Gross debt 1/	38.3	38.5	39.2	41.9	46.4	59.8	65.1	65.4	64.4	62.6	60.3
of which: held by social security (CSS)	2.5	3.2	3.7	4.8	5.4	6.0	5.7	5.4	5.0	4.7	4.4
Domestic	9.4	9.4	9.6	10.2	10.2	11.2	11.5	11.0	10.2	9.6	8.9
of which: previously unrecorded	1.0	1.2	1.6	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	28.9	29.2	29.6	31.7	36.3	48.6	53.6	54.5	54.2	53.0	51.3
Financial assets	6.8	5.6	4.0	3.8	6.0	6.1	6.2	5.9	5.9	5.9	5.8
Deposits 2/	4.5	3.4	1.9	1.9	3.9	2.8	2.7	2.5	2.3	2.2	2.0
Sovereign Wealth Fund 3/	2.3	2.2	2.1	2.0	2.1	2.2	2.1	2.0	2.2	2.4	2.6
Loans	0.0	0.0	0.0	0.0	0.0	1.2	1.4	1.4	1.3	1.2	1.2
Net debt	31.6	32.9	35.2	38.1	40.4	53.7	58.9	59.5	58.6	56.7	54.4
					Non-Financial Public Sector						
Gross debt 1/	35.5	34.8	34.8	36.9	41.0	53.8	59.4	60.0	59.4	57.9	55.9
of which: previously unrecorded	0.6	0.7	1.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial assets	15.3	14.5	11.9	11.0	12.8	13.6	13.4	12.7	12.2	11.8	11.3
Central government	6.8	5.6	4.0	3.8	6.0	6.1	6.2	5.9	5.9	5.9	5.8
Decentralized institutions (incl. CSS) 2/	8.5	8.9	7.9	7.2	6.8	7.5	7.2	6.8	6.3	5.9	5.5
Net debt	20.2	20.3	22.9	25.9	28.2	40.2	46.0	47.4	47.2	46.1	44.5
Memorandum items:											
Net Debt as defined under SFRL 4/	36.1	36.4	37.1	39.9	44.4	57.6	63.0	63.5	62.2	60.1	57.6

Source: Ministry of Finance and IMF staff calculations.

1/ Includes staff adjustment for accumulated obligations related to unrecorded expenditure in 2015-2018.

2/ Deposits at the National Bank (BNP).

3/ For 2020, it includes a withdrawal of US$ 0.2 billion for deficit financing.

4/ Central Government gross debt minus assets of the Sovereign Wealth Fund (FAP).

Table 5. Panama: Summary Accounts of the Banking System, 2015–25[1]

	2015	2016	2017	2018	2019	Est. 2020	Projections 2021	2022	2023	2024	2025
					(in millions of balboa at end of period)						
Net foreign assets	**5,021**	**3,974**	**1,752**	**542**	**2,547**	**7,758**	**7,855**	**8,792**	**9,436**	**10,116**	**10,840**
Short-term foreign assets, net	5,021	3,974	1,752	542	2,547	7,758	8,224	8,792	9,436	10,116	10,840
National Bank of Panama	3,678	4,331	2,957	2,218	3,646	8,822	9,191	9,759	10,454	11,197	11,994
Rest of banking system	1,343	-356	-1,204	-1,677	-1,099	-1,064	-967	-967	-1,018	-1,081	-1,153
Long-term foreign liabilities	0	0	0	0	0	0	0	0	0	0	0
Net domestic assets	**31,565**	**34,250**	**38,337**	**40,747**	**39,035**	**34,578**	**37,477**	**39,747**	**43,006**	**46,561**	**50,434**
Public sector (net credit)	-7,046	-8,099	-7,425	-6,929	-9,431	-9,425	-9,425	-9,425	-9,425	-9,425	-9,425
Central government (net credit)	-1,112	-1,209	-505	-305	-1,507	-1,501	-1,501	-1,501	-1,501	-1,501	-1,501
Rest of the public sector (net credit)	-5,934	-6,890	-6,920	-6,624	-7,924	-7,924	-7,924	-7,924	-7,924	-7,924	-7,924
Private sector credit	44,439	48,161	51,310	53,631	54,901	53,803	54,879	58,265	62,402	66,832	71,577
Private capital and surplus	-8,872	-9,597	-10,390	-10,676	-11,384	-10,281	-10,710	-11,371	-12,178	-13,043	-13,969
Other assets (net)	3,045	3,785	4,841	4,720	4,949	480	2,733	2,278	2,207	2,196	2,250
Liabilities to private sector	**37,008**	**38,546**	**40,565**	**41,690**	**42,631**	**42,352**	**45,332**	**48,539**	**52,442**	**56,677**	**61,275**
Total deposits	36,687	38,342	40,410	41,475	42,239	41,974	44,929	48,112	51,984	56,187	60,750
Demand deposits	8,186	8,226	8,337	8,710	7,892	7,522	8,212	9,129	10,233	11,472	12,860
Time deposits	19,135	20,493	21,796	22,368	23,849	23,922	25,495	27,068	28,990	31,048	33,253
Savings deposits	9,367	9,622	10,278	10,398	10,498	10,530	11,223	11,915	12,761	13,667	14,637
Bonds	321	204	155	215	392	378	403	427	458	490	525
Deposit as % of private sector credit	82.6	79.6	78.8	77.3	76.9	78.0	81.9	82.6	83.3	84.1	84.9
					(12-month change in relation to liabilities to the private sector at the beginning of the period)						
Net foreign assets	-3.2	-2.8	-5.8	-3.0	4.8	12.2	0.2	2.1	1.3	1.3	1.3
Net domestic assets	9.2	7.3	10.6	5.9	-4.1	-10.5	6.8	5.0	6.7	6.8	6.8
Public sector credit (net)	-2.8	-2.8	1.7	1.2	-6.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	13.0	10.1	8.2	5.7	3.0	-2.6	2.5	7.5	8.5	8.4	8.4
Private capital and surplus	2.1	2.0	2.1	0.7	1.7	-2.6	1.0	1.5	1.7	1.6	1.6
Other assets (net)	1.1	2.0	2.7	-0.3	0.5	-10.5	5.3	-1.0	-0.1	0.0	0.1
Liabilities to the private sector	5.5	4.2	5.2	2.8	2.3	-0.7	7.0	7.1	8.0	8.1	8.1
					(12-month percent change)						
Memorandum items:											
M2 [1/]	5.5	4.2	5.2	2.8	2.3	-0.7	7.0	7.1	8.0	8.1	8.1
Net domestic assets	11.4	8.5	11.9	6.3	-4.2	-11.4	8.4	6.1	8.2	8.3	8.3
Public sector credit (gross)	-6.1	-37.3	-10.1	21.3	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	11.4	8.4	6.5	4.5	2.4	-2.0	2.0	6.2	7.1	7.1	7.1
Share of demand deposits in total deposits (in percent)	22.3	21.5	20.6	21.0	18.7	17.9	18.3	19.0	19.7	20.4	21.2
					(In percent of GDP)						
Total deposits	67.8	66.2	65.0	63.9	63.2	69.6	71.5	72.1	72.8	73.4	74.1
Credit to private sector	82.2	83.2	82.5	82.6	82.2	89.2	87.3	87.3	87.3	87.3	87.3

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and IMF staff calculations.
1/ M2 comprises bank deposits; estimates of U.S. currency in circulation are not available.

Table 6. Panama: Financial Soundness Indicators, 2013–19

(In percent, end of period)

	2013	2014	2015	2016	2017	2018	2019
				(In percent)			
Core indicators							
Regulatory capital to risk weighted assets 1/	14.8	14.7	14.9	15.3	16.0	15.7	16.5
Regulatory Tier 1 capital to risk-weighted assets 1/	13.9	14.1	14.3	16.3	17.0	16.9	17.8
Non-performing loans net of provisions to capital	-3.4	0.5	1.4	1.3	1.4	0.0	-0.3
Non-performing loans to total gross loans	0.7	0.9	1.0	1.3	1.4	1.7	2.0
Return on assets	1.4	1.5	1.4	1.2	1.5	1.5	1.8
Return on equity	13.7	14.8	14.0	11.8	13.4	13.1	15.3
Interest margin to gross income	53.5	55.3	55.3	53.9	52.5	50.6	47.6
Non-interest expenses to gross income	51.4	49.9	50.1	50.0	46.9	46.4	47.7
Liquid assets to total assets	16.6	17.7	16.0	15.7	12.8	12.1	12.8
Liquid assets to short-term liabilities	42.5	42.3	39.9	39.3	33.9	34.8	37.0
Net open position in FX to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sectoral distribution of loans							
Domestic residents	75.7	74.2	74.6	77.5	80.7	81.2	81.7
Deposit takers	0.7	0.7	1.0	1.0	0.9	1.2	1.3
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.6	2.2	2.2	2.8	2.6	2.8	2.6
General government	3.2	1.5	1.5	1.7	1.1	1.1	0.7
Nonfinancial corporations	36.8	37.2	36.4	36.3	37.8	36.7	35.8
Households	32.5	32.7	33.5	35.7	38.3	39.5	41.3
Nonresidents	24.3	25.8	25.4	22.5	19.3	18.8	18.3
Additional indicators							
Capital to assets (leverage ratio) 1/	9.8	10.0	10.2	11.4	12.5	12.5	13.1
Large exposures to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross assets position in derivatives to capital	0.3	0.2	0.1	0.1	0.2	0.1	0.2
Gross liabilities position in derivatives to capital	0.4	1.0	0.8	1.3	0.9	0.7	0.4
Trading income to total income	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Personnel expenses to total income	45.5	47.0	46.7	46.2	46.8	46.4	45.8
Customer deposits to total non-interbank loans	84.5	82.3	78.9	78.1	78.0	76.1	76.6
FX loans to total loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FX liabilities to total liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: IMF Financial Soundness Indicators.

1/ Data for 2019 corresponds to 3rd quarter 2019.

Table 7. Panama: Summary Balance of Payments, 2015–25
(In percent of GDP; unless otherwise stated)

						Est.	Projections				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						(In percent of GDP)					
Current account	**-9.0**	**-7.8**	**-5.9**	**-7.6**	**-5.4**	**-2.5**	**-6.0**	**-4.8**	**-3.9**	**-2.9**	**-2.5**
Merchandise trade excluding Colón Free Zone, net	-18.1	-16.3	-16.6	-16.7	-14.5	-10.1	-11.5	-11.5	-10.5	-9.8	-9.1
Exports, f.o.b.	7.5	6.3	7.2	7.7	8.5	6.4	7.9	8.2	8.4	8.9	9.3
Of which: Copper	0.0	0.0	0.0	0.0	1.1	1.8	3.6	3.5	4.2	3.7	3.3
Of which: Gold	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.3
Imports, f.o.b.	25.6	22.5	23.7	24.4	23.0	16.5	19.5	19.6	19.0	18.7	18.4
Of which: Oil	6.0	5.4	6.8	8.1	7.5	5.2	5.6	5.6	5.6	5.5	5.4
Merchandise trade from Colón Free Zone, net	2.7	2.9	3.0	2.5	2.7	2.7	2.1	2.2	2.4	2.4	2.4
Re-exports, f.o.b.	18.8	16.1	15.1	15.0	13.0	10.9	12.0	12.3	12.7	12.7	12.9
Imports, f.o.b.	16.1	13.2	12.1	12.5	10.3	8.2	9.9	10.1	10.4	10.3	10.5
Services, net	13.0	12.9	13.9	13.6	13.2	11.2	12.4	12.9	13.2	13.4	13.6
Travel, net	5.3	5.3	5.6	5.3	4.7	2.7	3.7	3.9	3.9	4.0	4.0
Transportation, net	6.4	6.5	7.2	7.4	7.7	6.8	7.5	7.8	7.9	8.0	8.0
Of which: Canal	4.5	4.1	4.5	4.6	4.8	4.2	4.5	4.5	4.5	4.4	4.3
Other services, net	1.2	1.2	1.1	1.0	0.9	1.7	1.1	1.3	1.4	1.5	1.6
Income, net	-6.6	-7.3	-6.2	-7.1	-6.8	-6.3	-8.9	-8.5	-9.0	-9.0	-9.4
Primary, net	-6.4	-7.1	-6.0	-7.0	-6.7	-6.1	-8.8	-8.4	-8.8	-8.7	-9.1
Of which: Direct investment	-5.0	-5.7	-4.5	-5.2	-5.1	-3.9	-6.4	-5.8	-6.1	-5.9	-6.2
Secondary, net	-0.2	-0.2	-0.2	-0.1	0.0	-0.2	-0.1	-0.2	-0.2	-0.3	-0.3
Of which: Workers' remittances	-0.7	-0.7	-0.6	-0.5	-0.5	-0.7	-0.5	-0.6	-0.7	-0.7	-0.7
Capital account	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**-12.0**	**-13.3**	**-9.3**	**-9.4**	**-7.1**	**-2.5**	**-5.9**	**-4.8**	**-3.9**	**-2.9**	**-2.5**
Foreign direct investment, net	-7.3	-7.9	-6.9	-7.6	-5.5	-4.1	-4.7	-4.9	-4.9	-5.0	-5.0
Of which: Reinvested earnings	-3.9	-3.7	-2.9	-2.9	-3.4	-2.0	-1.9	-2.0	-1.9	-1.9	-2.0
Portfolio investment, net	-0.6	-0.2	-1.1	-0.6	-4.8	-3.7	-3.0	-4.0	-4.2	-4.2	-4.3
Financial derivatives, net	-0.1	-0.1	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-3.8	-6.1	0.3	-0.4	1.2	-3.3	1.2	3.3	4.2	5.4	5.9
Reserve assets, net	-0.1	1.1	-1.6	-1.0	1.8	8.6	0.6	0.9	1.0	1.0	1.0
Net errors and omissions	**-3.1**	**-5.5**	**-3.4**	**-1.8**	**-1.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:											
Exports of goods and services (annual percent change)	-7.8	-3.3	7.7	5.2	-0.8	-28.1	22.7	9.1	9.7	8.8	8.9
Imports of goods and services (annual percent change)	-10.9	-6.9	5.8	7.2	-5.3	-34.0	28.1	7.1	5.9	6.2	6.6
Oil trade balance (percent of GDP)	-3.5	-3.4	-3.8	-4.4	-3.8	-2.6	-2.8	-2.8	-2.8	-2.8	-2.8
Gross external debt (percent of GDP)	161.3	159.9	149.6	153.0	156.8	194.1	193.6	191.6	188.8	186.5	184.8
Public Sector	28.9	29.2	29.6	31.7	36.3	48.6	53.6	54.5	54.2	53.0	51.3
Of which: Multilateral	*7.7*	*7.9*	*8.2*	*8.7*	*9.1*	*12.7*	*14.1*	*13.8*	*12.5*	*11.0*	*9.6*
Of which: Bilateral	*0.4*	*0.4*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.2*	*0.2*	*0.1*
Of which: Private	*20.8*	*20.9*	*21.0*	*22.7*	*26.9*	*35.6*	*39.3*	*40.4*	*41.4*	*41.8*	*41.6*
Private Sector	132.3	130.7	120.0	121.4	120.5	145.5	140.0	137.1	134.6	133.5	133.4

Sources: INEC; and IMF staff calculations.

Table 8. Panama: External Vulnerability Indicators, 2015–21

(In percent, unless otherwise specified)

	2015	2016	2017	2018	2019	Est. 2020	Proj. 2021
Financial indicators							
Broad money (12-month percent change)	5.5	4.2	5.2	2.8	2.3	-0.7	7.0
Private sector credit (12-month percent change)	11.4	8.4	6.5	4.5	2.4	-2.0	2.0
Deposit rate (6-month; in percent) 1/	1.8	1.7	1.8	1.8	2.2	…	…
External indicators							
Merchandise exports (12-month percent change)	-15.6	-9.0	6.8	6.8	-2.5	-27.6	20.3
Merchandise imports (12-month percent change)	-12.6	-8.2	7.7	7.5	-7.1	-33.1	24.0
Current account balance (in percent of GDP)	-9.0	-7.8	-5.9	-7.6	-5.4	-2.5	-6.0
Capital account balance (in percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (in percent of GDP)	-12.0	-13.3	-9.3	-9.4	-7.1	-2.5	-5.9
Of which : direct investment	-5.5	-4.1	-4.7	-4.9	-4.9	-5.0	-5.0
Non-Financial Public Sector external debt (in percent of GDP)	28.2	28.5	28.7	30.6	34.9	47.1	52.1
In percent of exports of goods and services 2/	58.5	65.5	65.7	69.7	82.3	139.5	131.2
External interest payments							
In percent of exports of goods and services 2/	8.5	9.2	9.7	10.1	10.5	9.4	7.9
External amortization payments							
In percent of exports of goods and services 2/	163.9	185.9	173.0	146.5	149.3	203.5	177.4
REER, percent change (average) 6/	-1.7	-8.3	-7.6	-1.2	1.0	…	…
Gross international reserves at end of period							
In millions of U.S. dollars 3/	4,143	4,745	3,788	3,149	4,375	9,550	9,920
In months of imports of goods and services	2.0	2.1	1.6	1.4	2.9	5.0	4.8
In percent of broad money 4/	11.2	12.3	9.3	7.6	10.3	22.6	21.9
In percent of short-term external debt 5/	9.4	10.9	9.8	8.1	11.9	23.6	26.9
Memorandum items:							
Nominal GDP	54,092	57,908	62,203	64,928	66,788	60,315	62,832
Exports of goods and services 2/	26,074	25,210	27,143	28,551	28,312	20,355	24,979
Imports of goods and services 2/	27,366	25,475	26,951	28,901	27,378	18,062	23,139

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.

6/ Negative sign indicates depreciation.

Table 9. Panama: Indicators of Fund Credit, 2020–26 1/

(In millions of SDR, unless otherwise specified)

	2020	2021	2022	2023	2024	2025	2026
Existing and Prospective drawings (100% of Quota)	376.8	942.0	942.0	…	…	…	…
(in percent of quota)	100	250	250	…	…	…	…
(Projected Debt Service to the Fund based on Existing and Prospective Drawings)							
Repurchases under the PLL	0.0	0.0	0.0	0.0	353.3	824.3	588.8
Repurchases under RFI	0.0	0.0	0.0	94.2	188.4	94.2	0.0
Total charges	4.0	27.0	55.1	56.4	58.4	31.5	4.8
Total debt service	0.0	27.0	55.1	150.6	600.1	949.9	593.6
(in percent of exports of G&S)	0.0	0.2	0.3	0.8	2.9	4.0	2.2
(in percent of GDP)	0.0	0.1	0.1	0.3	1.2	1.8	1.1
(in percent of GIR)	0.0	0.5	0.9	2.4	9.1	13.6	8.0
(Projected Level of Credit Outstanding based on Existing and Prospective Drawings)							
Outstanding stock	376.8	1,318.8	2,260.8	2,166.6	1,625.0	706.5	117.8
(in percent of quota)	100.0	350.0	600.0	575.0	431.3	187.5	31.3
(in percent of GDP)	0.9	3.2	5.3	4.8	3.3	1.4	0.2
(in percent of GIR)	6.7	23.3	38.8	35.1	24.8	10.1	1.6
Memorandum items:							
Exports of goods and services (US$ mn)	20,567	24,174	25,220	28,265	30,104	34,195	39,475
GDP (US$ mn)	58,233	59,230	61,327	65,601	70,259	75,247	80,590
US$/SDR exchange rate	1.42	1.43	1.44	1.44	1.45	1.45	1.46
Gross International Reserves (US$ mn)	7,979	8,104	8,366	8,899	9,481	10,104	10,771
Quota	377	377	377	377	377	377	377
Government revenue (in percent of GDP)	14.8	17.1	18.9	20.2	20.7	21.0	20.9
Stock of Fund credit (in percent of government revenue)	6.2	18.6	27.9	23.6	16.2	6.5	1.0
Debt service to the Fund (in percent of government revenue)	0.0	0.4	0.7	1.6	6.0	8.7	5.1

Source: Fund staff estimates.

1/ Projections are derived based on assumptions from the adverse scenario.

Table 10. Panama: Proposed Schedule of Reviews and Available Credit under the PLL Arrangement, 2021–22

Availability Date	Condition	Credit Available	
		Millions of SDRs (cumulative)	Percent of Quota (cumulative)
January 19, 2021	Approval of the PLL Arrangement	942	250
July 18, 2021	Completion of First Review	942	250
January 18, 2022	Completion of Second Review	1,884	500
July 18, 2022	Completion of Third Review	1,884	500
Total		**1,884**	**500**

Source: IMF staff.

Annex I. Public Debt Sustainability Assessment

1. **Gross non-financial public sector (NFPS) debt remained on a declining path from the mid-2000s until 2017, falling from 61 percent of GDP to 35 percent.** However, between 2018 and 2019 public debt rose to 41 percent of GDP, as a result of higher deficits and slower GDP growth. By the end of 2019, almost 100 percent of the debt was denominated in U.S. dollars with extended maturities (i.e., medium or long-term amortization schedules). Around 85 percent of this outstanding debt was held by non-residents, with global bonds the primary instrument in this category (26.3 percent of GDP), and the remainder mainly owed to multilaterals (9.1 percent of GDP).

2. **According to the baseline projections, public debt will reach 61 percent of GDP in 2022, driven by the COVID-related deterioration in the primary deficit and growth (-9 percent in 2020).** Borrowing would peak in 2020, with US$6.9 billion (of which 6.6 billion would be external debt, 1.9 billion multilateral and 4.7 billion global bonds). However, debt is expected to decline below 56 percent of GDP by 2025, thanks to the improvement in the primary balance (from a deficit of 6.9 percent to a 0.4 percent surplus) and the improvement in the growth-interest rate differential. Gross financing needs will remain moderate, averaging 7.9 percent of GDP over the projection period. Neither debt nor gross financing needs would breach the DSA thresholds in the baseline. Debt and gross financing needs would only exceed their indicative thresholds of potential distress (70 and 15 percent of GDP respectively) under the realization of a contingent liabilities shock stemming from the financial sector. This shock would involve the realization of transfers to the banking system of 13 percent of GDP, or 10 percent of the banking system assets (excluding claims on the government) existing at the end of 2019. A two-period one-standard deviation shock on real GDP growth during 2021–22 would increase debt to 66 percent of GDP in 2022, but it would thereafter follow a declining path. A combined persistent shock of 2 percent on real GDP growth, 2 percent on the revenue to GDP ratio and 25 basis points on interest rates would increase public debt to 69 percent of GDP in 2022, but it would afterwards come down to 67 percent in 2025. If contrary to government's plans, the primary balance remains unadjusted at the 2020 projected level over the medium term (i.e., -6.9 percent of GDP), public debt would increase monotonically and ultimately become unsustainable.

3. **Public debt would remain sustainable with a high probability in an adverse scenario consistent with a full PLL drawdown.** This scenario features lower GDP growth in 2021–22 (2 and 3 percent respectively), resulting in a higher primary deficit (6.4 and 2.2 percent of GDP in 2021 and 2022, respectively, against 5.1 and 1.8 in the baseline scenario). Higher volatility and risk aversion in international capital markets are assumed to raise the interest rates of debt issuances 1 percent, on average, above the baseline. The adverse scenario is assumed to trigger PLL drawdowns in 2021–22. In 2021, a drawdown worth US$1.3 billion would be necessary, given a larger deficit than in the baseline (by US$0.7 billion) and the difficulties to finance it in capital markets (medium and long term issuances would remain lower than in the baseline, this time by US$1.2 billion), which

would be only partially offset to a higher recourse to government's assets (by US$0.5 billion). In 2022, financing needs would be higher than in the baseline scenario by US$ 0.3 billion, and MLT bond financing lower by US$ 1.6 billion, while the recourse to government's assets would amount again to US$ 0.5 billion. Gross debt would rise to close to 67 percent of GDP in 2022, but equally decline below 62 percent in 2025. Financing needs in the adverse scenario would average US$ 6.2 billion a year in the period 2021–22, mostly met by issuing external bond (US$ 2.5 billion a year on average) and domestic instruments (US$ 0.9 billion a year on average). Government's assets would also play some role (US$ 0.5 billion a year on average). The residual average needs (US$ 2.2 billion a year on average) would be covered by the contribution of multilaterals, particularly the Fund through the PLL.

Figure A1.1. Panama: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

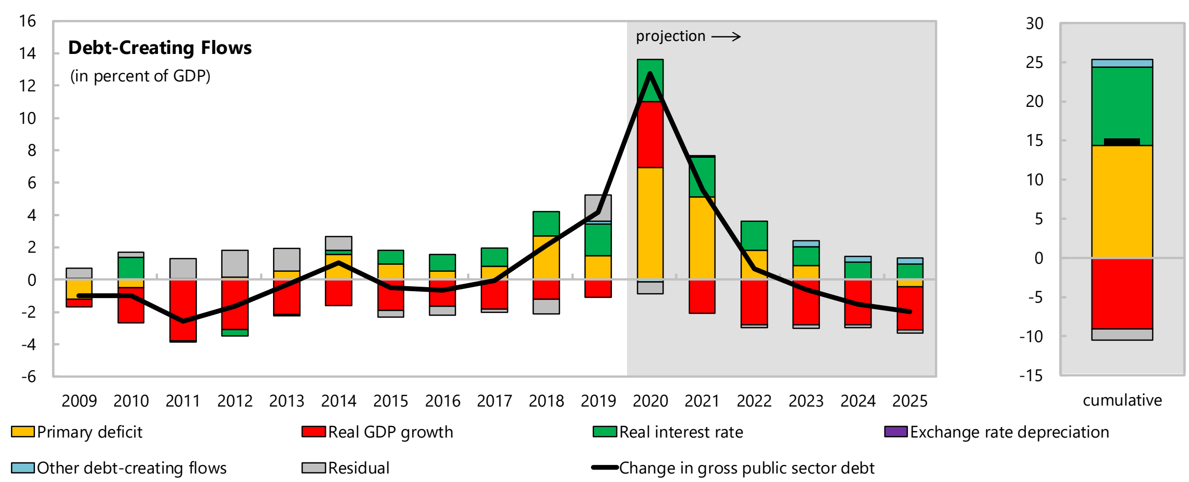
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2009-2017 [2]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	36.5	36.9	41.0	53.8	59.4	60.0	59.4	57.9	55.9
Public gross financing needs	6.8	7.4	6.4	12.1	10.4	7.1	5.7	7.3	4.6
Net public debt	21.3	25.9	28.2	40.2	46.0	47.4	47.2	46.1	44.5
Real GDP growth (in percent)	6.3	3.6	3.0	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	4.1	0.8	-0.2	-0.8	0.2	1.1	2.0	2.0	2.0
Nominal GDP growth (in percent)	10.6	4.4	2.9	-9.7	4.2	6.2	7.1	7.1	7.1
Effective interest rate (in percent) [4]	5.8	5.3	5.3	5.1	4.9	4.4	4.2	4.0	3.9

As of November 24, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		162
5Y CDS (bp)		52
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	BBB+	BBB+
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-0.7	2.1	4.2	12.7	5.6	0.7	-0.6	-1.5	-2.0	14.8	
Identified debt-creating flows	-1.3	3.0	2.5	13.5	5.5	0.8	-0.4	-1.3	-1.8	16.3	
Primary deficit	0.3	2.7	1.5	6.9	5.1	1.8	0.9	0.0	-0.4	14.3	-1.4
Primary (noninterest) revenue and grants	21.2	19.7	18.2	14.9	17.7	19.1	19.8	20.1	20.4	112.1	
Primary (noninterest) expenditure	21.5	22.4	19.6	21.8	22.8	20.9	20.7	20.2	20.0	126.4	
Automatic debt dynamics [5]	-1.6	0.3	0.9	6.7	0.4	-1.0	-1.6	-1.7	-1.7	1.0	
Interest rate/growth differential [6]	-1.6	0.3	0.9	6.7	0.4	-1.0	-1.6	-1.7	-1.7	1.0	
Of which: real interest rate	0.5	1.5	2.0	2.6	2.5	1.8	1.2	1.0	1.0	10.1	
Of which: real GDP growth	-2.1	-1.2	-1.1	4.1	-2.1	-2.8	-2.8	-2.8	-2.7	-9.1	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.2	-0.1	0.0	0.0	0.4	0.4	0.4	1.0	
GG: Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FAP asset changes	0.0	0.0	0.2	-0.1	0.0	0.0	0.4	0.4	0.4	1.0	
Residual, including other asset changes [8]	0.5	-0.9	1.6	-0.7	0.1	-0.2	-0.2	-0.2	-0.2	-1.5	



Source: IMF staff.

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

2/ Based on available data.

3/ EMBIG.

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.

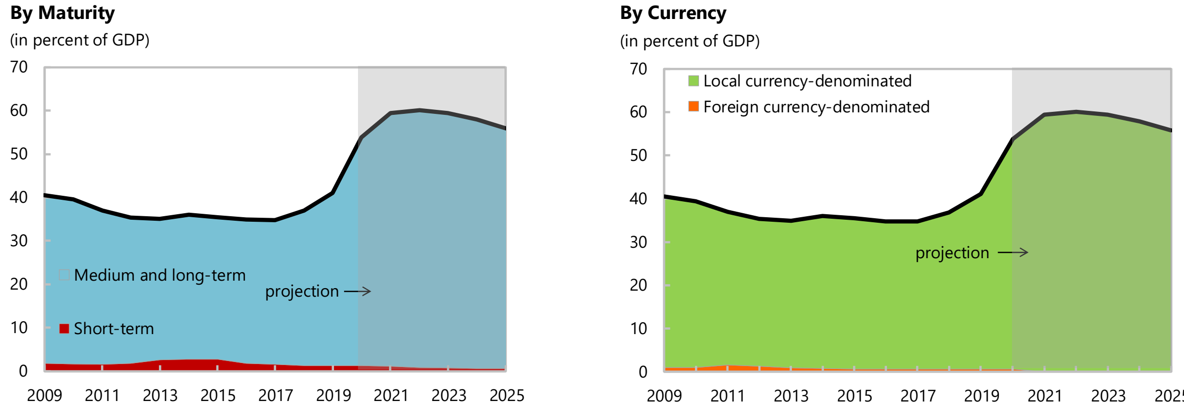
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

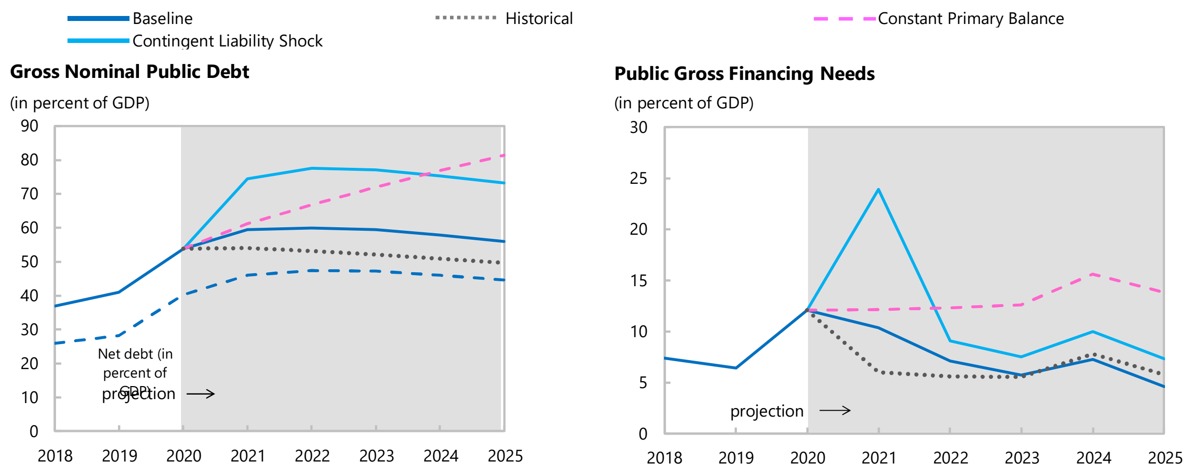
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A1.2. Panama: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

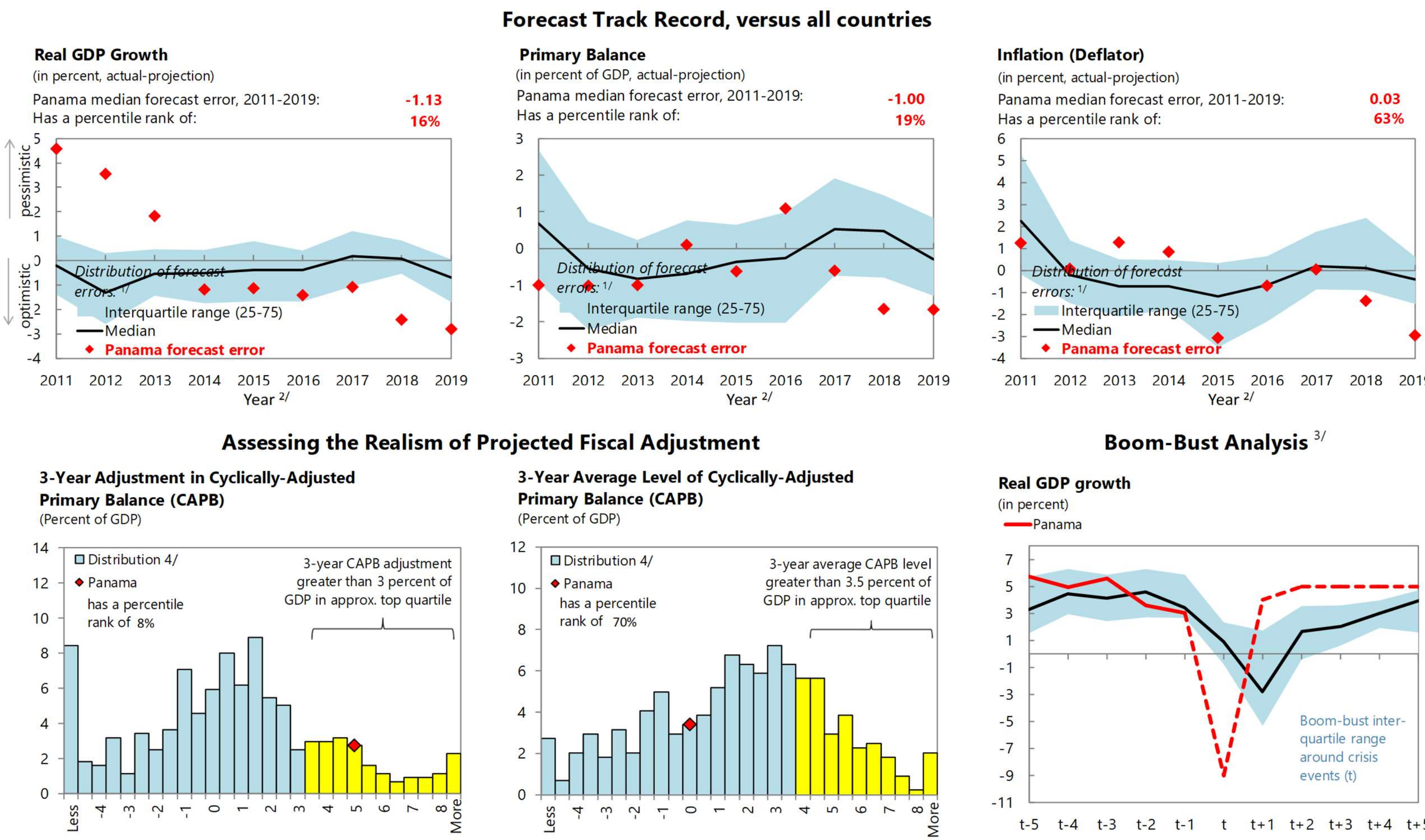
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation	-0.8	0.2	1.1	2.0	2.0	2.0
Primary Balance	-6.9	-5.1	-1.8	-0.9	0.0	0.4
Effective interest rate	5.1	4.9	4.4	4.2	4.0	3.9
Constant Primary Balance Scenario						
Real GDP growth	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation	-0.8	0.2	1.1	2.0	2.0	2.0
Primary Balance	-6.9	-6.9	-6.9	-6.9	-6.9	-6.9
Effective interest rate	5.1	4.9	4.3	4.0	3.8	3.6

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.0	6.2	6.2	6.2	6.2	6.2
Inflation	-0.8	0.2	1.1	2.0	2.0	2.0
Primary Balance	-6.9	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	5.1	4.9	4.5	4.1	3.9	3.6
Contingent Liability Shock						
Real GDP growth	-9.0	1.4	2.4	5.0	5.0	5.0
Inflation	-0.8	-0.5	0.5	2.0	2.0	2.0
Primary Balance	-6.9	-18.2	-1.8	-0.9	0.0	0.4
Effective interest rate	5.1	5.4	5.0	4.8	4.6	4.4

Source: IMF staff.

Figure A1.3. Panama: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

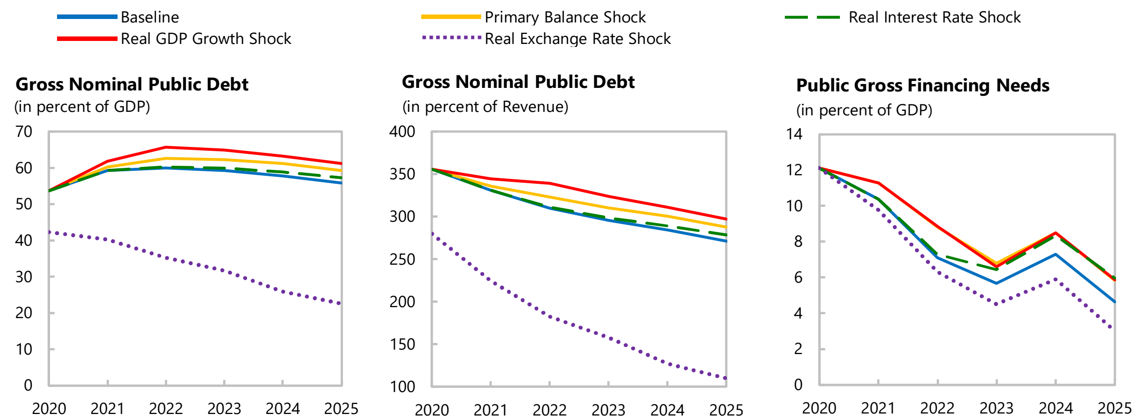
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Panama has had a positive output gap for 3 consecutive years, 2017-2019. For Panama, t corresponds to 2020; for the distribution, t corresponds to the first year of the crisis.

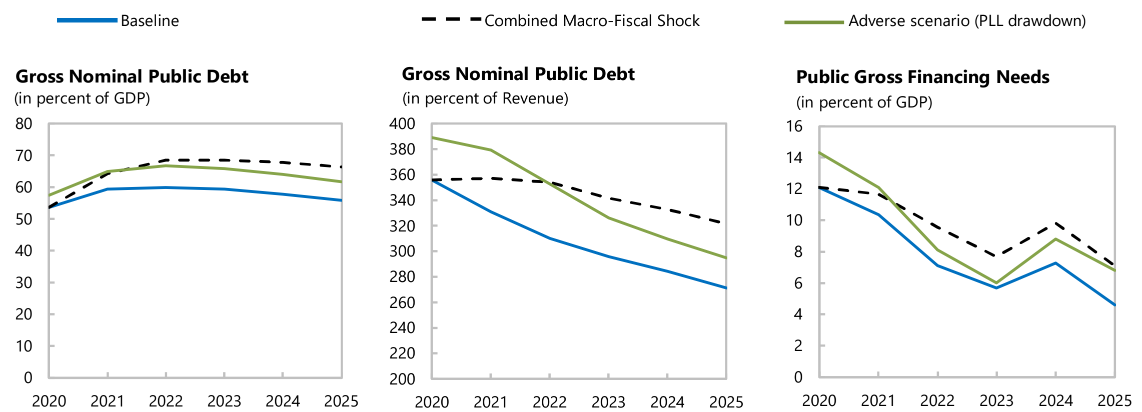
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A1.4. Panama: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation	-0.8	0.2	1.1	2.0	2.0	2.0
Primary balance	-6.9	-6.0	-3.5	-1.3	-0.4	0.2
Effective interest rate	5.1	4.9	4.4	4.2	4.0	4.0
Real Interest Rate Shock						
Real GDP growth	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation	-0.8	0.2	1.1	2.0	2.0	2.0
Primary balance	-6.9	-5.1	-1.8	-0.9	0.0	0.4
Effective interest rate	5.1	4.9	4.8	4.8	4.8	4.9
Combined Shock						
Real GDP growth	-9.0	1.4	2.4	5.0	5.0	5.0
Inflation	-0.8	-4.2	0.5	2.0	2.0	2.0
Primary balance	-6.9	-6.0	-3.5	-1.3	-0.4	0.2
Effective interest rate	5.1	4.9	4.8	4.7	4.8	4.9

Real GDP Growth Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.0	1.4	2.4	5.0	5.0	5.0
Inflation	-0.8	-0.5	0.5	2.0	2.0	2.0
Primary balance	-6.9	-5.8	-3.2	-0.9	0.0	0.4
Effective interest rate	5.1	4.9	4.4	4.2	4.0	3.9
Real Exchange Rate Shock						
Real GDP growth	-9.0	4.0	5.0	5.0	5.0	5.0
Inflation	-0.8	-4.2	1.1	2.0	2.0	2.0
Primary balance	-6.9	-5.1	-1.8	-0.9	0.0	0.4
Effective interest rate	5.1	5.6	5.4	5.4	5.3	5.5
Adverse shock						
Real GDP growth	-12.0	2.0	3.0	5.0	5.0	5.0
Inflation	-0.9	-0.3	0.5	1.9	2.0	2.0
Primary balance	-8.9	-6.4	-2.2	-0.5	0.4	0.8
Effective interest rate	5.1	5.0	4.6	4.4	4.4	4.3

Source: IMF staff.

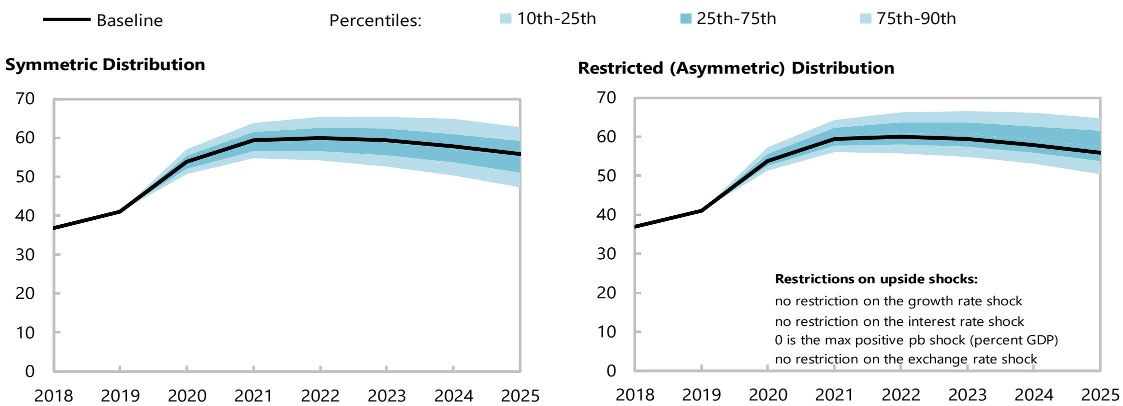
Figure A1.5. Panama: Public DSA – Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

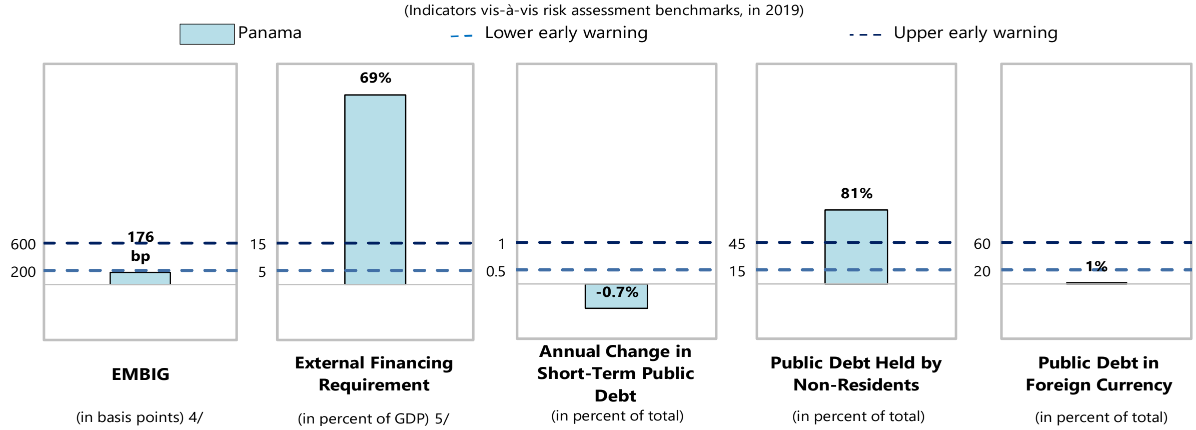
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

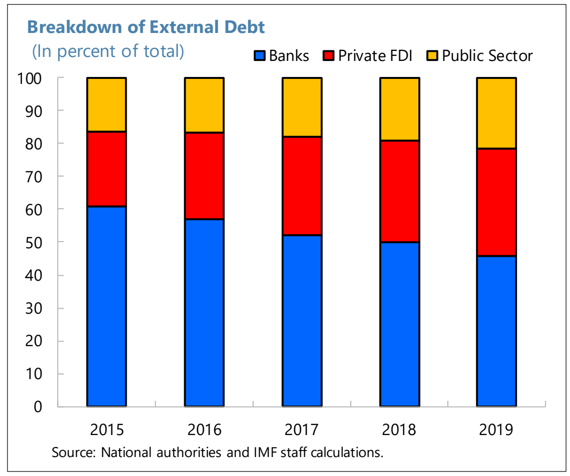
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 29-Jul-20 through 29-Oct-20.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II. External Debt Sustainability Analysis

1. Panama's external debt to GDP is expected to remain relatively high but stable over the medium term, reflecting the large FDI received and its position as the region's financial hub. The shock from the global COVID-19 pandemic is estimated to lead to an increase in external debt to 194 percent of GDP in 2020, from 157 percent of GDP in 2019. However, external debt would gradually decline to 185 percent of GDP in 2025, underpinned by the expected recovery in Panama's GDP growth and improvement in the current account (Table 1). Moreover, Panama remains competitive as the latest WEF Global Competitiveness Index indicates that it continues to outperform the average of Latin America and the Caribbean (LAC) in every pillar. FDI debt and deposits and liabilities in the banking sector accounted for the bulk of external debt as public external debt remained relatively small, amounting to only 23 percent of total external debt (or 36 percent of GDP) as of end-2019. Public external debt is projected to increase to 51 percent of GDP in 2022 due to higher fiscal deficit in the wake of the pandemic but will gradually decline to 48 percent of GDP by 2025 on the back of a gradual decline in the deficit to comply with the fiscal rule in the medium-term, post COVID-19. If the most extreme shock—standardized shock to growth—materializes, external debt could increase to 195 percent of GDP (Figure 2).



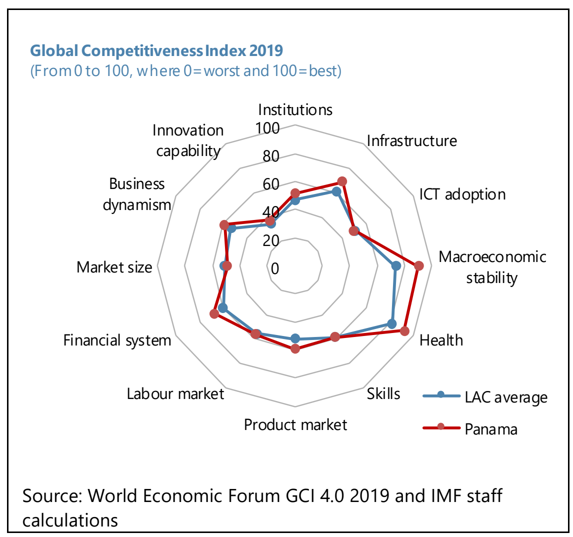
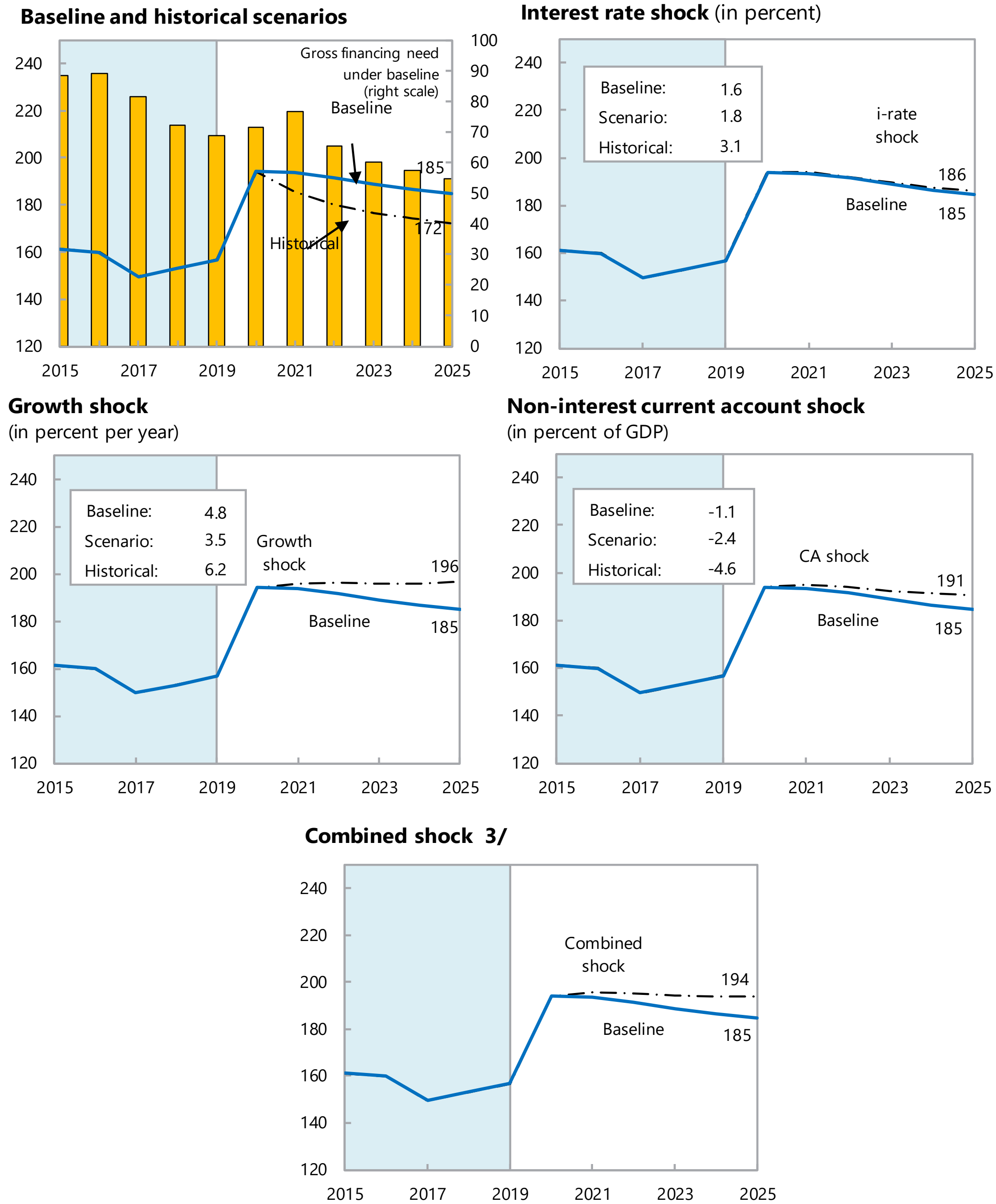


Figure A2.1. Panama: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ 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.

Table A2.1. Panama: External Debt Sustainability Framework,2015–25

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	161.3	159.9	149.6	153.0	156.8			**194.1**	**193.6**	**191.6**	**188.8**	**186.5**	**184.8**	**-14.6**
2 Change in external debt	4.0	-1.4	-10.3	3.4	3.7			37.3	-0.5	-2.0	-2.8	-2.3	-1.8	
3 Identified external debt-creating flows (4+8+9)	-10.5	-10.7	-12.0	-6.2	-4.4			14.1	-6.2	-9.2	-9.9	-10.9	-11.2	
4 Current account deficit, excluding interest payments	4.9	3.8	1.7	3.2	0.9			-0.7	2.8	1.8	1.0	0.1	-0.2	
5 Deficit in balance of goods and services	2.4	0.5	-0.3	0.5	-1.4			-3.8	-2.9	-3.7	-5.1	-6.1	-6.9	
6 Exports	48.2	43.5	43.6	44.0	42.4			33.7	39.8	40.8	41.8	42.5	43.2	
7 Imports	50.6	44.0	43.3	44.5	41.0			29.9	36.8	37.1	36.7	36.4	36.3	
8 Net non-debt creating capital inflows (negative)	-7.3	-7.9	-6.9	-7.6	-5.5			-4.1	-4.7	-4.9	-4.9	-5.0	-5.0	
9 Automatic debt dynamics 1/	-8.0	-6.6	-6.8	-1.9	0.2			18.8	-4.4	-6.0	-6.0	-6.0	-6.0	
10 Contribution from nominal interest rate	4.1	4.0	4.2	4.4	4.5			3.2	3.1	3.1	3.0	2.8	2.7	
11 Contribution from real GDP growth	-8.3	-7.5	-8.3	-5.2	-4.5			15.6	-7.5	-9.1	-8.9	-8.8	-8.7	
12 Contribution from price and exchange rate changes 2/	-3.8	-3.2	-2.7	-1.1	0.3			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	14.5	9.3	1.8	9.6	8.1			23.2	5.8	7.2	7.2	8.6	9.5	
External debt-to-exports ratio (in percent)	334.5	367.2	342.8	348.1	369.8			575.0	487.0	469.0	451.4	439.1	427.9	
Gross external financing need (in billions of US dollars) 4/	47712.0	51523.7	50759.9	46842.2	45947.6			43011.7	48120.9	43546.4	43006.4	43874.6	44901.8	
in percent of GDP	88.2	89.0	81.6	72.1	68.8	10-Year	10-Year	71.3	76.6	65.3	60.2	57.3	54.8	
Scenario with key variables at their historical averages 5/								**194.1**	**185.5**	**180.2**	**176.5**	**174.1**	**172.2**	**-17.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	5.7	5.0	5.6	3.6	3.0	6.2	2.6	-9.0	4.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	2.5	2.0	1.7	0.8	-0.2	3.1	2.2	-0.8	0.2	1.1	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.8	2.7	2.8	3.1	3.0	3.1	0.3	1.8	1.7	1.7	1.7	1.6	1.5	
Growth of exports (US dollar terms, in percent)	-7.8	-3.3	7.7	5.2	-0.8	4.8	12.1	-28.1	22.7	9.1	9.7	8.8	8.9	
Growth of imports (US dollar terms, in percent)	-10.9	-6.9	5.8	7.2	-5.3	5.5	15.3	-34.0	28.1	7.1	5.9	6.2	6.6	
Current account balance, excluding interest payments	-4.9	-3.8	-1.7	-3.2	-0.9	-4.6	2.6	0.7	-2.8	-1.8	-1.0	-0.1	0.2	
Net non-debt creating capital inflows	7.3	7.9	6.9	7.6	5.5	7.6	0.9	4.1	4.7	4.9	4.9	5.0	5.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

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

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

6/ 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.

Annex III. Financial Integrity

1. The authorities adopted an action plan supported by the FATF in response to the June 2019 grey listing. The plan includes the following commitments:

- Strengthen their understanding of the national and sectoral ML/TF risks and improve national policies to mitigate these risks.
- Proactively take action to identify unlicensed money remitters, and ensure effective, proportionate, and dissuasive sanctions again AML/CFT violations. More generally, supervision of designated nonfinancial businesses and professionals needs to improve.
- Ensure adequate verification and update of beneficial ownership (BO) information, establish an effective mechanism to monitor the activities of offshore entities, assess existing risks of misuse of legal arrangements to define and implement specific measures to prevent the misuse of nominee shareholders and directors, and ensure timely access to adequate and accurate beneficial ownership information.
- Ensure effective use of its Financial Intelligence Unit (FIU) for ML investigations, demonstrating their ability to investigate and prosecute ML involving foreign tax crimes and to provide constructive and timely international cooperation with such offences.

2. To achieve the commitments under the action plan, the authorities have recruited international AML/CFT experts. The new technical team of senior experts, whose experience includes working for the FATF and for a regional FATF-style body, is tasked with: (i) conducting a diagnostic of the current action plan and progress to date; and (ii) reviewing the draft legislation(s) before presenting them to the National Assembly for debate and enactment. Resources for the technical assistance are partially provided by the Inter-American Development Bank.

Table A3.1. Panama: Financial Integrity: FATF Immediate Outcomes (IOs) and Action Items [1/]

Immediate Outcome	Item No.	Action Item
IO-1	1.	**Terrorism financing risk**: (i) develop a comprehensive strategy for effectively disseminating the updated chapter's contents to the private sector, focusing on high risk sectors that have demonstrated poor understanding of terrorist financing threats and vulnerabilities (as distinct from terrorism risks); and (ii) ensure that competent authorities possess the staffing, training and capacity required to investigate and prosecute terrorism financing cases should they arise.
	2.	**Risk understanding of use of cash in high risk sectors**: (i) ensure that the assessment informs the risk assessment and mitigation measures of entities in high-risk sectors; and (ii) demonstrate there is effective supervision in that regard.
	3.	**Update the sectoral risk analysis of the concrete risks of the corporate sector**: Use effective supervision to ensure that Designated Non-Financial Business and Professions (DNFBPs) understand their risks and have implemented appropriate mitigating measures.
IO-3	4.	**Identifying unlicensed money remitters:** (i) demonstrate that the application of the amendment and existing authority are leading to identification and sanctioning (as appropriate) of unlicensed money remitters; and (ii) continue to demonstrate that Panama is proactively taking action to identify unlicensed money remitters and apply appropriate sanctions as necessary.
	5.	**Risk-based supervision for the DNFBP sector**: (i) describe how the offsite/onsite examinations will be impacted by the sector-specific risk studies, once finalized; and (ii) report on the frequency of both offsite and onsite examinations and how that was based on the proper understanding of the AML/CFT risk of the DNFBP sector.
	6.	**Supervision manual and improved compliance of obliged entities**: finalise this and demonstrate that the intendancy's actions have an effect on improving compliance of entities.
	7.	**Sanctions being applied**: (i) ensure that effective, proportionate, and dissuasive sanctions are being applied where there are violations; and (ii) continue to report that Panama is applying effective, proportionate, and dissuasive sanctions where FIs are found to have committed AML/CFT violations.
IO-5	8.	**Ensure that resident agents adequately verify and update beneficiary owner information**: (i) demonstrate how Panama ensures that resident agents adequately verify and update BO information of legal entities and monitor their activities; (ii) establish and implement effective mechanisms to monitor the activities of offshore entities, including better understanding the volume of assets or funds the authorities manage, and adopt measures to avoid their abuse.
	9.	**Risk analysis to define and implement specific measures**: (i) complete a comprehensive risk assessment of the sector; (ii) define and implement specific measures of control to prevent the misuse of nominee shareholders and directors; and (iii) adopt and implement measures to ensure timely access to adequate and accurate beneficial ownership information.
	10.	**Improve the monitoring of the corporate sector**: (i) improve the monitoring of the corporate sector and implement effective supervision, including by implementing remedial actions and/or sanctions for breaches of ML/TF preventative measures; (ii) continue to increase the percentage of law firms subjected to off-site examination to improve coverage of the sector commensurate with risk; and (iii) demonstrate that Panama conducts examinations based on other factors beyond volume of services provided to ensure supervisory activity is commensurate with risk, and not simply volume of activity.
IO-7	11.	**Ensure that the "Practical Guide for Parallel Financial Investigations" is swiftly approved and used**: demonstrate that it is being used prosecutors to pursue parallel financial investigations.
	12.	**Increase the use of FIU products for ML investigations**: (i) ensure that prosecutors make full use of UAF products in ML investigations; (ii) provide further update and details (related offence, number of ML investigation and related predicate offence) on cases opened on the basis of financial intelligence referred by authorities.
	13.	**Demonstrate the ability to investigate and prosecute ML having foreign tax crimes as a predicate offence and international cooperation**: (i) continue updating the Joint Group on the progress and details of these cases; and (ii) provide case examples to that the threshold for domestic tax offences of US$ 300,000 does not hinder effectiveness.
	14.	**Demonstrate that the exception from punishment provides an adequate deterrent effect and ensure that sanctions for tax crimes tax-based ML**: demonstrate that this is working in practice, particularly where legal entities are involved.
	15.	**Continue to focus on ML investigation in relation to high risk areas**: continue to pursue ML investigations in high-risk areas beyond trafficking and increase the number of ML investigations involving foreign predicates including seizing and/or confiscating proceeds of crime.

Source: FATF.
1/ As defined by the FATF in the most recent Mutual Evaluation Report (MER) adopted in December 2017.
TF = Terrorism Financing; ML = Money Laundering; AML/CFT = Anti-Money Laundering and Counter Financing of Terrorism; CFT = Combating the Financing of Terrorism;
DNFBP = Designated Non-Financial Businesses and Professions; BO = Beneficial Ownership; FIU = Financial Intelligence Unit; UAF = Panama's FIU (*La Unidad de Análisis Financiero*).

Annex IV. Undisclosed Domestic Arrears in Panama

1. **According to MEF's estimates, central government's unrecorded debt as at mid-2019 amounted to US$1.5 billion, or 2.3 percent of 2019 GDP (Table 1)[1].** This amount was quite evenly distributed by creditor, with the Social Security in the first place (social contributions and default interests), followed by commercial banks (subsidies to preferential interest rates on housing loans), suppliers and contractors. It was estimated that close to 25 percent of the total amount, or 0.6 percent of GDP, could be considered floating debt linked to commercial credit not yet due or refinanced [2,3]. Unreported arrears to the private sector sense were 1.1 percent of GDP (i.e. due and unpaid liabilities to commercial banks, suppliers and contractors).

2. **For the non-financial public sector (NFPS), unrecorded debt was lower (US$1.4 billion, or 2.1 percent of GDP)**, as the consolidation of the amounts due to the CSS was less by offset by debt of public enterprises and agencies. Prevailing creditors were in this case private suppliers, and commercial arrears amounted to 1 percent of GDP.

Table A4.1. Unrecorded Liabilities

(As of July 2019)

	Millions of US$	Percent of GDP
Central Government	**1,521.0**	**2.3**
By maturity date		
Floating debt	372.0	0.6
Arrears	1,148.9	1.7
By creditor		
Commercial banks	381.1	0.6
CSS	421.4	0.6
Suppliers	380.9	0.6
Contractors	337.6	0.5
Consolidated NFPS	**1,379.9**	**2.1**
By maturity date		
Floating debt	297.6	0.4
Arrears	1,082.3	1.6
By creditor		
Commercial banks	381.1	0.6
Suppliers	591.3	0.9
Contractors	407.4	0.6
By debtor		
Central government	1,099.6	1.6
CSS	107.9	0.2
Consolidated agencies	6.8	0.0
Other agencies	132.6	0.2
Public enterprises	33.1	0.0

Source: MEF and IMF staff calculations.

3. **Some undisclosed liabilities were related to non-appropriated expenditure.** According to the authorities, a part of this expenditure had initially been appropriated in the annual budget and the associated commitments had been authorized. However, project execution was delayed, and next year's budget did not contain any appropriation for the remaining sums. Further, this expenditure could go unrecorded since, for some types of contracts (particularly services and works), the registration of accrued spending upon invoicing is not automatic and has to be agreed by the ordering department. In sum, these transactions increased expenditure in accrual terms by comparison to reported figures.

4. **The disclosure of unrecorded expenditure required retrospective adjustments in fiscal accounts in accrual terms.** On the basis of a preliminary imputation of these liabilities between 2015 and 2018 conducted by the authorities, the fiscal balance in accrual was adjusted in the 2020 Article IV report to reflect the unreported expenditure. As a result, NFPS and central government deficits

[1] This preliminary information does not allow to break down central government's arrears by ministries or agencies.

[2] From a GFS perspective, this type of floating debt is usually categorized as trade credit.

[3] Estimated floating debt represents around 50 percent of unrecorded debt to suppliers and contractors.

experienced a maximum increase of 1.2 and 0.8 percent of GDP in 2018, respectively (Table 2). Additionally, gross liabilities became higher, in order to capture floating debt and outstanding arrears. However, an official revision of fiscal balances during this period is still to be published.

5. The existence of undisclosed liabilities could have been possible due to a number of possible interrelated factors, which a forthcoming TA mission will explore:

- ***Insufficient strategic orientation in budget preparation***. The Medium-Term Macroeconomic and Fiscal Framework (*Marco Presupuestario a Medio Plazo*) should make more explicit the policy assumptions underlying its projections, and clearly identify the financial impact of new measures and policy priorities. No-policy change expenditure estimates should be elaborated by line ministries, on the basis on a common methodology and a set of macroeconomic assumptions, and discussed bilaterally with the MOEF prior to the communication of ministerial ceilings. Furthermore, the allocation of these ceilings should also be informed by an assessment of macroeconomic and specific fiscal risks. Improving the definition of budgetary programs would also contribute to the accuracy of baseline expenditure projections. In the absence of this approach, budgetary appropriations may prove insufficient and induce either large virements or spending outside the budget.

Table A4.2. Fiscal Deficit Adjustments
(In percent of GDP)

	2015	2016	2017	2018
Central Government				
Reported balance	-3.7	-3.8	-3.1	-2.8
Adjusted balance	-4.1	-4.1	-3.6	-3.6
Consolidated NFPS				
Reported balance	-2.3	-1.8	-1.9	-2.0
Adjusted balance	-2.4	-2.0	-2.2	-3.2

Source: MEF and IMF staff calculations.

- ***Weak capital budgeting.*** The importance of enhancing multi-annual budgeting is epitomized by investment projects. Absent comprehensive information on their multi-annual costs, there is a risk of projects being discontinued or arrears accumulating. Implementing this approach can be facilitated by a centralized register of public investment projects, which is regularly maintained and contains their estimated completion dates and executed amounts.

- ***Highly centralized procedures for commitment authorization***. These procedures, centralized in the *Contraloría*, are not automated, slow down budget execution, and might favor some dysfunctionalities, such as the late presentation of commitments or the authorization of some operations after the end of the fiscal year for which they were appropriated.

- ***Remaining difficulties in the identification of payments***. Currently some of the payments are channeled through *fondos rotativos,* or revolving funds transferred by the Treasury to Ministries for emergency situations or the implementation of specific programs. These have an ad-hoc nature and sometimes cause payment identification problems, for being made from individual accounts in the BNP. Past TA missions have recommended the electronic allocation of monthly payment limits (*cuota de pago*) by the Treasury based on uniform criteria for all ministries. This would allow to channel all payments through the General Fund and facilitate their identification. The government has been working to develop this system for some years, but implementation is lagging. Relatedly, the MEF has made substantial progress towards a full TSA implementation, but still some accounts remain outside it (less than 10 percent of total balances as at October 2019). The government should finalize this process as a priority and avoid payments through cheques.

- ***The structure of budget execution reports***. Budget execution reports can be an effective tool for a timely detection of large floating debt stocks and the accumulation of arrears. These reports should capture, for each main budgetary item, appropriations, commitments, floating debt, payments and unencumbered amounts. This would facilitate the interpretation of execution information and the appropriation in next year's budget of committed and non-disbursed amounts. Currently execution information is presented at a highly aggregated level and does not clearly differentiate between these concepts.

6. Improved multiannual budgeting and fiscal transparency warrants the comprehensive disclosure of multi-year costs of public investment. Payment deferrals in public investment are particularly relevant for turnkey projects and PPP operations, where the bulk of disbursements are deferred until the delivery of the asset or even the long run. For this reason, budget documentation and the Fiscal Strategy Document (*Marco Presupuestario a Medio-Plazo*) should reflect in their annexes cash disbursement projections by year for existing and new turnkey and PPP projects undertaken by NFPS units. Likewise, all contingent liabilities generated by PPP operations (guarantees, early termination-related obligations, etc.) should be disclosed in budget documentation, together with the government's maximum exposure to these risks.

Appendix I. Written Communication

REPÚBLICA DE PANAMÁ
GOBIERNO NACIONAL

MINISTERIO DE ECONOMÍA Y FINANZAS
Despacho del Ministro

January 5, 2021
MEF-2021-203

Mme. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC. 20431
United States

Dear Madame Georgieva:

1. Panama has benefited from strong economic fundamentals, having experienced the longest and fastest expansion in Latin America with an average annual growth of 6 percent in the last 25 years. The country reached high-income status in 2017 and enjoys the highest per capita income in Latin America. We have used IMF-supported programs in the past to advance some of the public policies that contributed to the successful economic performance of the Panamanian economy. These arrangements provided timely insurance against external risks, helped strengthen fiscal and external buffers in a challenging external environment, and sent positive signals to market participants.

2. Prior to the global outbreak of COVID-19, Panama's economy slowed in 2018–19 with growth reaching 3 percent in 2019. Inflation slid below zero for most of the year due to soft demand, while credit growth decelerated. Slower regional growth contributed to the growth deceleration through sluggish tourism. In addition, the FATF placed Panama on its grey list in June 2019, citing deficiencies in the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime, its effectiveness and the related legal framework.

3. In light of the COVID-19 pandemic, Panama's outlook in the short-term has deteriorated significantly. Despite decisive mitigation measures, the number of infections in Panama has been one of the highest in the region amid high population density in the Panama City-Colón metropolitan corridor and a relatively high share of population over 65. The implementation of containment measures—including a mandatory curfew and suspension of certain commercial activities, mass gatherings and international flights—significantly reduced economic activity.

At the same time, external trade declined, including the Canal traffic. In 2020, Panama's real GDP could contract by 9 percent, with the current account deficit widening to over 7 percent of GDP (from 5¼ percent of GDP in 2019) due to shortfalls in tourism and re-exports from the free trade zone. Meanwhile, containment costs and a drop in revenue may increase the fiscal deficit to 9 percent of GDP (from the original budget target of 2.75 percent of GDP), thereby surpassing the limit established under the Social and Fiscal Responsibility Law (SFRL). In 2021, economic growth is expected to rebound to 4 percent as the health emergency subsides and the situation normalizes, with the current account deficit falling to 6.25 percent of GDP as exports recover and the fiscal deficit also falling to 7.5 percent of GDP as tax collections improve with a rebound in activity and expenditure pressures ease. These projections are subject to a large degree of uncertainty, as elsewhere in the world.

4. To mobilize essential COVID-19-related health expenditure and support to the vulnerable population, we sought support from multilateral institutions. Notably, on April 16, the IMF provided much-needed emergency financial assistance under the Rapid Financing Instrument (RFI) of about US$513.5 million to meet our urgent balance of payment needs stemming from the pandemic.

5. Given the severity and persistence of the global COVID-19 shock, the deterioration in external demand conditions, and mounting potential pressures on the balance of payments and public finances, we are requesting IMF support for our public policy agenda in the form of a 24-month Precautionary and Liquidity Line (PLL) arrangement in the amount of SDR 1.884 billion (500 percent of quota, or approximately US$2.6 billion), of which SDR 0.942 billion (250 percent of quota) would be available during the first year. The PLL arrangement will serve as an insurance against extreme adverse risks related to the pandemic. As with most IMF arrangements used in the past, we intend to treat this facility as precautionary.

6. The immediate priority is to contain the spread of the novel coronavirus, minimize the human loss and support the consumption needs of the vulnerable population. Over the longer horizon, the objectives supported by the new arrangement would aim to speed up the pace of our public policy agenda to promote stronger, more inclusive growth while enhancing macroeconomic resilience and the robustness and integrity of the financial system. To this end, we aim to focus on policy areas that would benefit from further strengthening, including: (i) the AML/CFT regime; (ii) financial stability; (iii) public financial management, and (iv) data adequacy. In addition, we plan to strengthen the fiscal responsibility law to preserve fiscal and debt sustainability. As a result, we aim at boosting growth, reinvigorate business confidence, and exiting the FATF grey list as soon as possible. We remain committed to maintain sound economic policies and to respond appropriately to shocks that may arise.

7. With the aim of enhancing Panama's financial integrity and exiting the FATF list of jurisdictions with strategic deficiencies, we adopted an action plan supported by the FATF which addresses remaining deficiencies in our AML/CFT regime. Specifically, we committed to:

- Strengthen our understanding of the national terrorist financing risks and sectoral ML/TF risks and improve national policies to mitigate these risks.

- Proactively take action to identify unlicensed money remitters and ensure effective, proportionate, and dissuasive sanctions against AML/CFT violations, and demonstrate that supervision of designated nonfinancial businesses and professionals is applied based on the understanding of its risks.

- Ensure adequate verification, and update of and timely access to beneficial ownership information, establish an effective mechanism to monitor the activities of offshore entities and define and implement specific measures to prevent the misuse of nominee shareholders and directors, considering existing risks.

- Increase the use of our Financial Intelligence Unit for ML investigations, demonstrating the country's ability to investigate and prosecute ML involving foreign tax crimes as predicate offense and to provide constructive and timely international cooperation with such offences.

The Panamanian Government has made the completion of the Action Plan a top priority and has devoted the necessary resources to do so. In this context, Panama is working alongside a group of private advisors that includes a former FATF Executive Secretary, a former GAFILAT Undersecretary and a former FATF representative of the Canadian Government, in order to implement the necessary actions to achieve our goal of exiting permanently the FATF grey list. Particularly, the Panamanian Government will work swiftly on:

- Developing an action plan for the implementation of the Unified Registry that would centralize the information on legal persons including ultimate beneficial ownership in accordance with Law 129, 2020.

- Taking the necessary actions in order to ensure that information to be included in the beneficial ownership registry is accurate and timely updates as possible.

8. To support the economy in these challenging times and safeguard financial stability, we have launched the Fund for Economic Stimulus with the dual objectives of providing liquidity to banks in times of need and extending credit to support the economy. In particular, given Panama is a fully dollarized economy with no central bank, creating a liquidity facility for banks would cushion our financial sector from unanticipated external shocks—including global shocks from the COVID-19 pandemic—by providing relief to solvent banks during episodes of liquidity shortages. This facility has been established as a trust with the Ministry of Economy and Finance acting as trustor and the National Bank of Panama as trustee. Regarding the objective of providing liquidity, the Superintendent of Banks, in its role as regulator, will previously issue its "non objection" with respect to the banks' request for temporary liquidity facilities.

9. Our policy agenda also includes enhancing multi-annual budgeting, expenditure controls and fiscal reporting, all of them critical areas to enhance governance, increase fiscal transparency, and prevent the build-up of domestic arrears in the future (as we encountered when we assumed office in July 2019). To this end, our government has requested Technical Assistance (TA) for reinforcing Public Financial Management practices in key areas and elaborating a work plan based on the findings and recommendations of the mission. Our ultimate objectives are: (i) enhancing the

estimation, update and disclosure of multi-annual costs of capital projects; (ii) assessing the effectiveness of current procedures for registry and re-allocating budgetary appropriations across financial years; (iii) ensuring timely recording and disclosure of commitments and accrued expenditure, in budget execution reports and financial statements, for all of types of contracts; and (iv) completion of the Treasury Single Account and execution of all payments by electronic means. We are committed to follow best procurement practices, including that government contracts be regularly published online, along the names of the winning companies and their beneficial owners according to the dispositions of the Public Procurement Law No. 22 of 2006, modified by Law 153 of May 8, 2020.

10. As regards strengthening the statistical infrastructure, we hosted an IMF mission to update the Reports on the Observance of Standards and Codes (ROSC) in early 2020 and will adopt its recommendations in the updated National Statistics Plan 2020–24, with emphasis in the following areas:

- First, we aim to modernize the National Institute of Statistics and Census (INEC), and increase INEC's resources. We intend to establish a National Statistical Coordination Committee by May 2021 (structural benchmark), which will meet twice annually with INEC serving as a secretariat and overseeing the operational aspects of the Committee's work.

- Second, we plan to subscribe to IMF's Special Data Dissemination Standard (SDDS) by 2022 by enhancing the coverage, periodicity, and timeliness of data reporting. In particular, we intend to: (i) publish the Data Template on International Reserves and Foreign Currency Liquidity on the National Summary Data page (NSDP) with assistance from the Fund by September 2021 (structural benchmark); (ii) resume quarterly publication at INEC of the Fiscal Operations of Central Government (CG) and General Government (GG),which are elaborated by the Ministry of Economy and Finance, adding detailed financing data by March 2022 (structural benchmark); (iii) publish metadata for SDDS related data categories on the National Summary Data Page (NDSP) and a draft of an Advance Release Calendar by December 2021; and (iv) improve periodicity of labor market indicators (employment, unemployment and wages/earning) in line with SDDS requirement moving from semi-annual to quarterly periodicity by March 2022.

- Third, we intend to rebase Panama National Accounts to 2018 and adopt the 2008 SNA conceptual framework by June 2022.

11. Sound macroeconomic policies and an efficient financial system are essential to support our public policy agenda, reduce fiscal and external vulnerabilities and generate fiscal buffers to bolster growth potential and absorb shocks. In terms of fiscal policy, our fiscal management has been prudent in the past as we managed to reduce public debt from about 60 percent of GDP in 2005 to around 40 percent of GDP in 2019, supported by a fiscal rule introduced in 2008. Going forward, we have raised the ambition of our fiscal objectives and, in view of medium-term consolidation needs, set a deficit objective of 1.5 percent of GDP by 2025 by means of an amendment of the Law of Social Fiscal Responsibility. Our Medium-Term Fiscal Framework will be updated by the end of 2020 consistently with this new objective. In order to facilitate compliance with these objectives, while fostering the efficiency and inclusiveness of revenues and expenditures, improvements of tax and

customs administrations will be stepped-up, improvements in the quality of public spending will be implemented, and Panama's tax expenditures will be reviewed, taking into account the analysis of recent IMF technical assistance. In addition, we will gradually realign current spending with social needs—including by investing more in education— and improving its effectiveness. We will prioritize public investments with high social return, while diversifying those investments geographically.

12. To ensure adequate liquidity provision to support the financial system and Panama's public accounts, we will continue maintaining indicative targets (that arise from the financial management) on national government liquidity and official banks' liquidity buffers, based on clearly specified targets. We will continue monitoring the data necessary to verify regular compliance with these targets at the end of each review period.

13. Panama's banking sector is stable, well-capitalized and solvent, and we continue to strengthen the financial sector policy framework, consistent with Basel III prudential regulations and the recommendations from the 2011 Financial Sector Stability Assessment. We are committed to strengthening and adapting the regulatory framework of the financial system in line with international standards, and we are requesting technical assistance to the IMF to continue improving our regulatory framework.

14. As a member of the IMF, we will be presenting relevant information of our economic and policy developments within the framework of this letter and the Fund's Articles of Agreement. We are creating working groups with Fund staff to review advances in the different policy areas mentioned before ahead of the semi-annual reviews (expected to be completed by no later than July 18, 2021, January 18, 2022, and July 18, 2022, assuming the approval of the PLL by the IMF Executive Board on January 19, 2021). In line with our policies, we will also observe the standard criteria on trade and exchange restrictions, bilateral payment agreements, multiple currency practices and the non-accumulation of payment arrears on the external debt in the context of our dollarization regime.

15. We believe that the policies contained in this communication are adequate for achieving the economic goals supported by the PLL, and we are committed to taking additional measures that may be necessary to attain these goals. We will appreciate the IMF's technical support on the adoption of these measures. The continued strengthening of the economy's resilience should position Panama well for achieving the objectives of the program, once the exogenous risks to which the economy is exposed by the COVID-19 shock have significantly declined. On behalf of the government of Panama, we extend our gratitude for the continued support we have received from the Fund toward the success of our economic policies in the current global environment.

Héctor E. Alexander H.

Minister of Economy and Finance

Table 1. Panama: Quantitative Indicative Targets

	March 31 2021	September 30 2021	March 31 2022
National Government deposits 1/	1,000	1,000	1,000
Official Banks' liquidity buffers 2/	30	30	30

Source: IMF staff estimates.
1/ Refers to National Government deposits at the Banco Nacional de Panama (BNP), measured in millions of U.S. dollars.
2/ Defined as the ratio of liquid assets to net deposits as per Superintendency of Banks' Guidelines. Official banks comprise Banco Nacional de Panama and Caja de Ahorros. Official banks have maintained liquidity buffers significantly higher than the legal requirement and the indicative target. These buffers are expected to continue at those levels.

Table 2. Panama: Structural Benchmarks

	Measure	Timing
Data Adequacy		
A.	Establish a National Statistical Council (NCS) that meets twice annually with members from INEC, CG, MEF, NBP, SBP, private and academic sectors, who are appointed by the Comptroller with INEC serving as a secretariat of the NCS, overseeing the operational aspects of the council's work.	End-May 2021
B.	Publish the Data Template on International Reserves and Foreign Currency Liquidity on the National Summary Data page (NSDP) with assistance from the Fund.	End-September 2021
C.	Resume quarterly publication of the Fiscal Operations of Central Government (CG) and General Government (GG), which are elaborated by the Ministry of Economy and Finance, adding detailed financing data, at the National Institute of Statistics (INEC).	End-March 2022

Attachment I. Technical Appendix

1. Under the first year of the PLL arrangement, quantitative indicative targets as defined in Table 1 of our written communication will be set for end-March 2021, end-September 2021, and end-March 2022. They include:

- **Floor on the level of the National Government liquidity coverage**, as defined in Table 1, at a minimum of US$1,000 million, computed as deposits of the national government at Banco Nacional de Panama (BNP). National Government includes the Central Government and other public institutions. Central Government is defined as per Law 34/2008 of Social Fiscal Responsibility Law and subsequent amendments, and shall always comprise the National Assembly, Contraloria, line ministries, the Supreme Court, the Public Prosecutor's Office and the Electoral Court, as well as other units classified within the central government in the last approved State's budget. National Government deposits at the BNP will be taken directly from the detailed balance sheet of the BNP, under the item "National Government Deposits", as it is submitted to the Fund.

- **Floor on the official (state-owned) banks' liquidity buffers**, as defined in Table 1, calculated as an end-of-period ratio of the liquid assets up to 186 days to the total net deposits up to 186 days, expressed in percent and measured at end of the last completed quarter.

  - Total balance of liquid assets up to 186 days in the official banks is defined according to the liquidity report from the Superintendency of Banks of Panama (SBP), and includes a sum of the (i) legal tender in Panama; (ii) deposits in banks in Panama; (iii) deposits in banks abroad; (iv) securities (including Treasury Bills issued by the state with maturities no longer than a year, liabilities of foreign private and government agencies with AAA long-term rating, and investment grade liabilities); (v) bank liabilities payable in Panama up to 186 days; (vi) flow of debenture payments payable up to 186 days; and (vii) other liquid assets, as authorized by the SBP[1].

  - Total balance of the net deposits up to 186 days in the official banks are defined as a sum of private deposits, bank deposits, and deposits of other financial institutions, as determined by the liquidity report from the SBP.

2. As has always been the case, the Government of Panama will continue paying all its external obligations on time and with no delays. The policy of the government has also been to pay domestic obligations on a timely manner, including commercial loans, treasury bills, notes and bonds. For the purpose of the arrangement, the payment arrears are defined as external debt-service obligations (principal and interest) that have not been paid at the time that are due as

[1] Definitions of each individual components are set in the Article 75 of the Panama's Banking Law of 2008 (Executive Decree 52 from April 8, 2008).

specified in the contractual agreements, on central government and central govenrement-guaranteed debt. Overdue debt and debt-service obligations that are in dispute will not be considered as external payment arrears.

3. Timing of reviews. Assuming the approval of this arrangement by the IMF Executive Board on January 19, 2021, the reviews are expected to be completed by no later than July 18, 2021 for the first review, January 18, 2022 for the second review, and July 18, 2022 for the third review.

PANAMA

January 5, 2021

ASSESSMENT OF THE RISKS TO THE FUND AND THE FUND'S LIQUIDITY POSITION

EXECUTIVE SUMMARY

The supplement assesses the risks to the Fund arising from Panama's request for a two-year arrangement under the Precautionary and Liquidity Line (PLL) and its effects on the Fund's liquidity position, in accordance with the policy on exceptional access. The proposed access of SDR 1,884 million (500 percent of quota) exceeds the cumulative access limit under the General Resources Account (GRA), and the scheduled potential purchases would also exceed annual access limits during each year of the arrangement. The authorities intend to treat the proposed PLL arrangement as precautionary. Panama has prior outstanding credit to the Fund of SDR 376.8 million (100 percent of quota) arising from the May 2020 purchase under the Rapid Financing Instrument (RFI) to address urgent financing needs caused by the COVID-19 pandemic.

Key Findings and Issues

- The proposed PLL arrangement will have a moderate impact on Fund liquidity. Upon approval, the Fund's Forward Commitment Capacity would decline by about 1.2 percent.
- If Panama were to make the first purchase at the approval of the proposed PLL arrangement, the GRA credit concentration among the top five borrowers would decline slightly whereas the already high Fund exposure to countries in the Western Hemisphere would moderately increase.
- If Panama were to draw on the proposed arrangement in full, Fund exposure to Panama would peak at 14.1 percent of the current level of the Fund's precautionary balances.
- Panama's capacity to repay is adequate under an adverse scenario assuming that it draws the proposed arrangement in full.
- While risks to the program are tilted to the downside, overall risks to the Fund and the Fund's liquidity position are moderate. Risks from the Fund's potential credit exposure to Panama are mitigated by several factors, including adequate government liquidity buffers and the country's continued market access even in the current high-risk environment, and its strong macroeconomic policy framework and sound institutions.

Approved By
Andrew Tweedie and Martin Čihák

Prepared by the Finance and Strategy, Policy, and Review Departments (in consultation with other departments). The main contributor is Mwanza Nkusu (FIN), with inputs from Kubi Johnson (FIN) and Luiza Antoun de Almeida (SPR).

CONTENTS

INTRODUCTION

1. This note assesses the risks to the Fund arising from Panama's request for a two-year arrangement under the Precautionary and Liquidity Line (PLL) and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.[1] The arrangement would cover a 24-month period beginning January 19, 2021, with access in an amount up to SDR 1,884 million (500 percent of quota) available in two or more purchases. Of this access, an amount equivalent to SDR 942 million (250 percent of quota) would be available in the first year of the arrangement and the balance of SDR 942 million (250 percent of quota) would be made available at the beginning of the second year, subject to the completion of the relevant six-monthly reviews. The authorities have indicated that they intend to treat the arrangement as precautionary.

BACKGROUND

2. Since 1965, the Fund has had 20 arrangements for Panama over a period of more than three decades during which Panama transformed its economy and maintained a strong record of meeting its obligations to the Fund. The eight most recent of the 20 Fund arrangements, predominantly standby arrangements (SBAs), were in place over the period 1980 to the early 2000s (Table 1). As noted in the accompanying staff report, the authorities consider that Fund arrangements supported reform agendas that underpinned Panama's successful economic performance over a two-decade period. The previous Fund arrangement for Panama was an SBA approved in June 2000, which the authorities treated as precautionary until it expired at end-March 2002. Panama had no outstanding credit due to the Fund for the eleven years preceding the COVID-19 pandemic.

3. Prior to the COVID-19 global shock, Panama was on an impressive economic growth trajectory underpinned by prudent macroeconomic management. As discussed in the main staff report, Panama was the fastest growing economy in Latin America over the previous 25 years, with real GDP growth averaging 6 percent annually, though it weakened in the last two years. With Panama's dollarized economy, prudent macroeconomic management, underpinned by a fiscal rule introduced in 2008, had fostered a reduction in public debt from about 60 percent of GDP in 2005 to an average of 36½ percent over the period 2009–17.

4. The COVID-19 pandemic has caused significant economic disruptions and challenges to Panama. In May 2020, Panama purchased SDR 376.8 million (100 percent of quota) under the Rapid Financing Instrument (RFI) to cover emergency financing needs arising from the disruptions and health challenges caused by the COVID-19 pandemic. With the outlook subject to heightened COVID pandemic-related uncertainty, the proposed PLL arrangement, which the authorities intend

[1] See paragraph 5 of Decision No 14064-(08/18), adopted 2/22/2008, as amended, and *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy* (3/5/03).

to treat as precautionary, will help insure against extreme adverse risks. Panama does not have an actual balance of payments need.

5. Panama's public debt is moderate relative to recent exceptional access cases.[2] The public debt-to-GDP ratio has ticked up in the past two years as a result of slower economic growth and larger gross financing needs, to an estimated 41 percent of GDP by end-2019. Under the baseline, it is projected to increase further to almost 54 percent of GDP by end-2020, mainly as a result of the larger financing needs caused by the economic disruptions of the COVID pandemic shock. The 2020 public debt level would exceed the median of recent exceptional access cases by 7 percentage points of GDP (Figure 1, Panel D).

6. Panama's total external debt-to-GDP is high, with most of the debt owed by the private sector (Table 2). The total external debt-to-GDP ratio increased from almost 150 percent in 2017 to 157 percent by end-2019. Under the baseline, it is projected to increase sharply, reaching 194 percent of GDP at end-2020 (Table 2). This level of external indebtedness is nearly 136 percentage points of GDP above the median of recent exceptional access cases (Figure 1, Panel A).[3] The private sector owes most of Panama's total and short-term external debt. At 36 percent of GDP as of end-2019, public sector external debt accounts for only about one-fifth of Panama's external debt. The public sector's share of short-term external debt stood at less than a quarter of a percent at end-2019 or 0.1 percent of GDP. Short-term debt, almost entirely owed by the private sector, averaged just under 60 percent of GDP during 2017–19 and stood at 55 percent of GDP at end-2019, representing around 35 percent of total external debt.

7. Reflecting the large share of short-term external debt, Panama's external debt service is high. Panama's total external debt service for 2019 is estimated at around 68 percent of GDP and projected at 72 percent of GDP in 2020 under the baseline. In line with the predominant share of liabilities of the private sector in total short-term external debt, debt service obligations of the public sector in 2019 were estimated at only 2⅓ percent of GDP out of the 68 percent of GDP total external debt service for 2019. External debt service is more than twice as large as exports of goods and services and is the largest among recent exceptional access cases (Figure 1, Panel C). This high debt service ratio reflects the large share of banks' external debt, including deposits against which the banking system as a whole holds a large reserve buffer.

[2] "Recent exceptional access cases" refers to exceptional access arrangements since September 2008.

[3] The large level of external debt mostly reflects the fact that Panama is an international financial center and local banks hold large deposits from non-resident banks. These deposits are an important and stable source of funding for bank loans.

THE NEW PRECAUTIONARY LIQUIDITY LINE—RISKS AND IMPACT ON FUND'S FINANCES

A. Risks to the Fund

8. Access under the proposed arrangement would exceed both annual and cumulative access limits and would be moderate on a number of indicators.

- If Panama made the first scheduled first purchase, its outstanding use of GRA resources would rise to SDR 1,318.8 million (350 percent of quota), taking into account 100 percent of quota from the May 2020 purchase under the RFI. If Panama purchased the full amount available under the proposed PLL arrangement, credit outstanding would peak at SDR 2,260.8 million (600 percent of quota) (Figure 2).

- At 600 percent of quota, the peak level of access would be below both the median and average peak exposures of recent exceptional access cases. In nominal terms, an overall access of SDR 2,260.8 million is far below the access of recent exceptional access programs (Figure 4, top panel).

9. If the full amount available under the proposed PLL arrangement were to be purchased under an adverse scenario, risks to Panama's capacity to repay the Fund would be moderate.

- Metrics of the Fund's peak exposure to Panama are generally modest compared with recent exceptional access cases. Fund exposure would peak at 5 percent of projected GDP, 2½ percent of total external debt, nearly 39 percent of gross international reserves, and about 28 percent of government revenue. Each of the four metrics is below the corresponding median of recent exceptional access cases (Table 3 and Figure 3a).

- Metrics of peak debt service on GRA credit would be broadly comparable to or below the corresponding medians of recent exceptional access cases (Table 3 and Figure 3a). Projected payment obligations to the Fund would peak in 2025 at SDR 950 million, representing 8.7 percent of projected government revenue. The peak of payment obligations to the Fund corresponds 25½ percent of total public external debt service, 13½ percent of gross international reserves, and about 4 percent of exports of goods and services. Three of these metrics, which are compared with those for recent exceptional access cases, are below their corresponding medians (Table 3 and Figure 3b).

- The peak total external debt service in percent of exports of goods and services would be the highest among recent exceptional cases. (Table 4 and Figure 3b). At almost 180 percent in 2021, peak total external debt service as a share of exports of goods and services is second only to the previous maximum peak of recent exceptional access cases, projected for Argentina's 2018 SBA. The relatively high ratio is driven mostly by the high level of the external debt service of the private sector, notably banks and also by the projected COVID pandemic-related sharp contraction in exports in 2020. This ratio is projected to decline gradually to about 115 percent at end-2026. The risk from the relatively high debt service ratio is mitigated by the fact that the banking system has ample liquidity buffers, with liquid assets covering nearly 60 percent of deposits. This is twice the minimum statutory requirement, which is 30 percent of deposits. However, should non-residents rapidly withdraw their deposits from Panama in an extreme shock scenario, banks' liquidity buffers could be eroded, possibly triggering a government intervention that could negatively affect Panama's capacity to repay the Fund.

- If the proposed arrangement were to be fully drawn, Panama's capacity to repay the Fund would remain adequate assuming steady program implementation and continued market access.

10. Enterprise risks arising from the proposed arrangement are relatively low. If the proposed arrangement were to be fully drawn, it would modestly increase risks associated with Fund lending, which are already significant in light of the COVID-19 pandemic. Panama's economic outlook is subject to significant downside risks, including the risks arising from weaknesses on AML/CFT issues. As noted in the staff report, absent meaningful progress in improving its AML/CFT framework, Panama's ongoing public listing by the FATF could have a potential adverse effect on correspondent banking relations and possible key credit channels, particularly if the FATF were to publicly consider elevating Panama to the list of high-risk jurisdictions (also referred to as black list) subject to a call for action. Panama's potential failure to implement FATF-recommended actions while being in a program relationship with the Fund could also pose reputational risk to the Fund. Moreover, the impact of possible countermeasures could, if Panama were to draw on the arrangement, weaken its capacity to repay the Fund. However, the risk of materialization of countermeasures is mitigated by the potential establishment of AML/CFT-related conditionality at the time of the first review under the PLL arrangement to ensure that the FATF action plan is fully implemented by the time of the second review as discussed in the staff report. Moreover, the credit risk is mitigated by Panama's adequate government liquidity buffers, the country's strong macroeconomic policy framework and sound institutions, its continued market access even in the current high-risk environment and despite the grey-listing, as well as its track record of servicing debt to the Fund.[4]

B. Impact on the Fund's Liquidity and Credit Exposure

11. The proposed PLL arrangement would have a moderate impact on the Fund's liquidity and potential risk exposure.

- The Fund's liquidity measured by the Forward Commitment Capacity (FCC), which stood at SDR 152.3 billion as of December 17, 2020, would decline by about 1.2 percent upon approval of the proposed PLL arrangement.

[4] So far, there is no evidence of higher borrowing costs on Panamanian public debt nor a reduction in the number of correspondent banking relationships since Panama was placed on the FATF grey list in June 2019.

- If Panama were to make the scheduled first purchase at the approval of the proposed arrangement, credit concentration among the five top borrowers, of which Panama would not be part, would slightly decline. The share of GRA credit to the top five borrowers would decline from 67.7 percent to 67 percent (Figure 4).

- If Panama were to draw on the arrangement in full, Fund exposure to Panama would peak at SDR 2,260.8 million, equivalent to 14.1 percent of the current level of the Fund's current precautionary balances. This compares with a peak Fund exposure to Ecuador (also a dollarized economy) of 38 percent of current precautionary balances after the approval of the recent arrangement under the Extended Fund Facility.

- If Panama were to accrue arrears on charges after fully drawing the proposed PLL arrangement, the Fund's burden sharing capacity would be insufficient. GRA charges for Panama, which are projected at SDR 27 million for 2021 and peak at SDR 58½ million in 2024 would significantly exceed the limited capacity of the Fund's burden sharing mechanism to absorb charges in arrears due to the low interest rate environment and borrowing by the Fund.

12. The approval of the proposed arrangement and Panama's first purchase would also moderately affect the regional concentration of GRA credit and commitments. The Fund's exposure to Western Hemisphere countries, which is already high, would rise further.

- On a credit outstanding basis, the share of GRA credit to countries of the Western Hemisphere would increase from 46.2 percent to 46.7 percent after Panama's first purchase.

- On a commitment basis, Fund exposure to the Western Hemisphere region—including the arrangements with Chile, Mexico, Colombia, and Peru under the Flexible Credit Line, as well as other significant exposures including the extended arrangement under the EFF for Ecuador—would increase from 67½ percent to about 68 percent of total GRA outstanding credit and undrawn balances under GRA active arrangements (Figure 5).

ASSESSMENT

13. The proposed PLL arrangement would have a manageable impact on the Fund's finances. It would cover a 24-month period with access in an amount of SDR 1,884 million (500 percent of quota). On approval of the proposed PLL arrangement, the Fund's liquidity position (FCC) would decline by about 1.2 percent. The Fund's overall liquidity position is expected to remain adequate after the approval of the proposed PLL arrangement. However, in view of highly elevated risks to global economic performance and financial stability at present and uncertainty over the scale and timing of new demand for Fund resources in the aftermath of the global COVID-19 pandemic, a close monitoring of the liquidity position is warranted.

14. Financial risks associated with the proposed arrangement are moderate. If Panama were to make the first scheduled purchase at the approval of the proposed arrangement, GRA credit exposure to Panama would represent 1½ percent of total GRA credit outstanding. Assuming that

Panama were to draw the proposed arrangement in full (500 percent of quota) indicators of capacity to repay the Fund under an adverse scenario suggest moderate credit risk to the Fund. Metrics of peak Fund exposure and debt service to the Fund would generally remain below or near the corresponding medians of recent exceptional access cases. Panama's overall external debt and public external debt are on the high side. But the high peak overall debt service in percent of exports, which is the highest among recent exceptional access cases, reflects mostly debt owed by the private sector. The risks from the Fund's potential credit exposure to Panama are mitigated by adequate government liquidity buffers, the country's strong macroeconomic policy framework and sound institutions, its continued market access even in the current high-risk environment, as well as its track record of servicing debt to the Fund. Moreover, the authorities intend to treat the proposed PLL arrangement as precautionary. Nonetheless, strong program implementation, including to strengthen the institutional framework and promptly implementing AML/CFT reforms that the authorities agreed with the FATF, would further mitigate risks to the Fund.

Table 1. Panama: IMF Financial Arrangements and Fund Exposure, 1980–2026

(in millions of SDRs)

Year	Type of New Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Fund Exposure 1/	
1980	Standby Arrangement	18-Apr-80	31-Dec-81	90.0	75.3	18.1	
1981						80.5	
1982	Standby Arrangement	28-Apr-82	27-Apr-83	29.7	0.0	76.1	
1983	Standby Arrangement	24-Jun-83	31-Dec-84	150.0	150.0	184.1	
1984						276.6	
1985	Standby Arrangement	15-Jul-85	31-Mar-87	90.0	90.0	283.4	
1986						288.6	
1987						243.9	
1988						243.8	
1989						243.2	
1990						191.3	
1991						150.7	
1992	Standby Arrangement	24-Feb-92	23-Sep-94	74.2	54.6	79.8	
1993						82.3	
1994						91.3	
1995	Standby Arrangement	29-Nov-95	31-Mar-97	84.3	84.3	74.4	
1996						91.0	
1997	Extended Fund Facility	10-Dec-97	20-Jun-00	120.0	40.0	105.4	
1998						125.5	
1999						108.3	
2000	Standby Arrangement	30-Jun-00	29-Mar-02	64.0	0.0	69.1	
2001						42.9	
2002						36.7	
2003						30.0	
2004						23.3	
2005						16.7	
2006						10.0	
2007						3.3	
2008						0	
2009						0	
:							
2020	Rapid Financing Instrument					*376.8*	
2021					*942*	*1,319*	2/
2022					*942*	*2,261*	2/
2023						*2,167*	2/
2024						*1,625*	2/
2025						*707*	2/
2026						*118*	2/

Source: IMF Finance Department.

1/ As of end December, unless otherwise stated.
2/ Figures including transactions under the proposed PLL arrangement are in italics. Fund exposure is derived assuming purchases are made as per schedule and Panama remains current on all its scheduled repurchases.

Table 2. Panama: External Debt Structure, 2015–20[1/]

	2015	2016	2017	2018	2019	2020 Proj.[2/]
	(In Millions of U.S. Dollars)					
Total External Debt	87,224	92,574	93,058	99,371	104,695	117,048
Long term	43,147	49,061	54,565	60,466	67,867	76,583
Private	27,710	32,314	36,278	40,009	43,724	47,355
Public	15,437	16,747	18,287	20,457	24,143	29,228
Short term	44,077	43,513	38,493	38,905	36,828	40,464
Private	43,865	43,359	38,391	38,787	36,748	40,384
Public	212	155	103	118	80	80
Memorandum items: public debt by creditors/instruments						
Total public external debt	15,649	16,901	18,390	20,575	24,223	29,308
Loans	5,271	5,514	5,912	6,337	6,681	8,203
Multilateral	4,158	4,564	5,104	5,636	6,060	7,681
Of which IMF	0	0	0	0	0	513
Bilateral	223	206	195	183	169	163
Commercial	890	744	613	518	452	360
Bonds	10,377	11,387	12,478	14,238	17,542	21,105
	(In Percent of GDP)					
Total External Debt	161.3	159.9	149.6	153.0	156.8	194.1
Long term	79.8	84.7	87.7	93.1	101.6	127.0
Private	51.2	55.8	58.3	61.6	65.5	78.5
Public	28.5	28.9	29.4	31.5	36.1	48.5
Short term	81.5	75.1	61.9	59.9	55.1	67.1
Private	81.1	74.9	61.7	59.7	55.0	67.0
Public	0.4	0.3	0.2	0.2	0.1	0.1
Memorandum items: public debt by creditors/instruments						
Total public external debt	28.9	29.2	29.6	31.7	36.3	48.6
Loans	9.7	9.5	9.5	9.8	10.0	13.6
Multilateral	7.7	7.9	8.2	8.7	9.1	12.7
Of which IMF	0.0	0.0	0.0	0.0	0.0	0.9
Bilateral	0.4	0.4	0.3	0.3	0.3	0.3
Commercial	1.6	1.3	1.0	0.8	0.7	0.6
Bonds	19.2	19.7	20.1	21.9	26.3	35.0

Sources: Panamanian authorities and IMF staff estimates.

1/ End of year unless otherwise indicated.
2/ Projections under the baseline.

Table 3. Panama: Capacity to Repay Indicators, 2020–26[1/ 2/]

	2020	2021	2022	2023	2024	2025	2026
Exposure and Repayments (In SDR millions)							
GRA credit to Panama	376.8	1,318.8	2,260.8	2,166.6	1,625.0	706.5	117.8
(In percent of quota)	(100.0)	(350.0)	(600.0)	(575.0)	(431.3)	(187.5)	(31.3)
Charges due on GRA credit	4.0	27.0	55.1	56.4	58.4	31.5	4.8
Repurchases under the PLL	0.0	0.0	0.0	0.0	353.3	824.3	588.8
Repurchases under RFI	0.0	0.0	0.0	94.2	188.4	94.2	0.0
Debt service due on GRA credit	4.0	27.0	55.1	150.6	600.1	949.9	593.6
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	197.1	205.6	209.0	205.9	201.7	197.3	195.7
External debt, public	52.1	59.7	63.0	62.4	60.7	58.7	58.5
GRA credit to Panama	0.9	3.2	5.3	4.8	3.3	1.4	0.2
Public external debt service	4.6	3.6	3.2	3.8	6.6	7.2	5.3
Debt service due on GRA credit	0.0	0.1	0.1	0.3	1.2	1.8	1.1
In percent of Gross International Reserves							
GRA credit to Panama	6.7	23.3	38.8	35.1	24.8	10.1	1.6
Debt service due on GRA credit	0.1	0.5	0.9	2.4	9.1	13.6	8.0
In percent of Exports of Goods and Services							
Total external debt service	210.8	179.9	166.3	149.1	148.5	134.5	114.8
Public external debt service	13.0	8.9	7.8	8.8	15.4	15.8	10.8
GRA credit to Panama	2.6	7.8	12.9	11.0	7.8	3.0	0.4
Debt service due on GRA credit	0.0	0.2	0.3	0.8	2.9	4.0	2.2
In percent of General Government Revenues							
Public external debt service	31.1	21.2	16.9	18.7	32.0	34.3	25.3
GRA credit to Panama	6.2	18.6	27.9	23.6	16.2	6.5	1.0
Debt service due on GRA credit	0.1	0.4	0.7	1.6	6.0	8.7	5.1
In percent of Total External Debt							
GRA credit to Panama	0.5	1.5	2.5	2.3	1.7	0.7	0.1
In percent of Total Public External Debt							
GRA credit to Panama	1.8	5.3	8.4	7.6	5.5	2.3	0.4
In percent of Total Public External Debt Service							
Debt service due on GRA credit	0.2	1.8	4.0	8.7	18.6	25.4	20.1

Sources: Panamanian Authorities, Finance Department, World Economic Outlook (WEO), and IMF Staff estimates.

1/ Assumes full drawings and macroeconomic indicators under an adverse scenario. The ratios of GRA Fund credit and debt service are based on the WEO's projected SDR-to-US dollar exchange rates.
2/ Includes GRA basic rate of charge, surcharges, service fees, and SDR charges.
3/ Staff projections for external debt, GDP, gross international reserves, government revenue, and exports of goods and services are based on an adverse scenario.

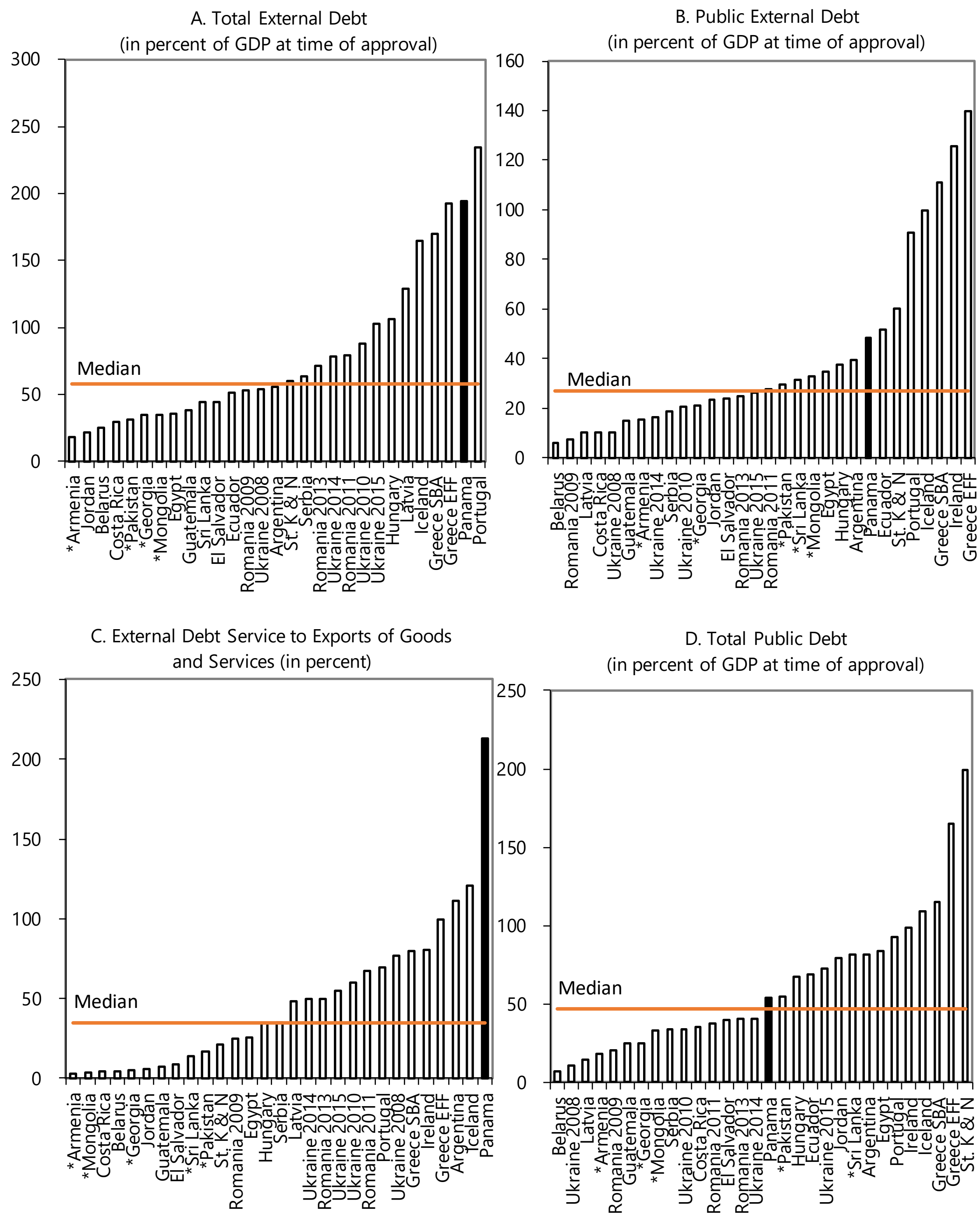
Table 4. Panama: Impact on GRA Finances

	As of 12/17/2020
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	152,315.0
FCC on approval 2/	150,431.0
(Change in percent of current one-year FCC)	-1.2
Prudential measures	
Fund GRA credit outstanding to Panama 3/	1,318.8
In percent of current precautionary balances	8.2
In percent of total GRA credit outstanding	1.4
Fund GRA credit outstanding to top five borrowers	
In percent of total GRA credit outstanding	67.7
In percent of total GRA credit outstanding including Panama's first purchase	67.0
Panama's annual GRA charges in percent of Fund's residual burden sharing capacity for 2020	158.9
Memorandum item	
Fund's precautionary balances (end-FY 2020)	16,000
Fund's residual burden-sharing capacity 4/	24.5

Sources: Finance Department and IMF Staff estimates.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include resources from currently unactivated lines of credit, including the New Arrangements to Borrow or bilateral commitments from members to boost IMF resources.
2/ Current FCC minus access under the proposed arrangement.
3/ Projected credit outstanding for Panama at time of approval of the proposed PLL based on the current repayment schedule and including first drawing.
4/ Burden-sharing capacity is calculated based on the floor for remuneration which, under current policies, is 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

Figure 1. Debt Ratios of Recent Exceptional Access Cases 1/ 2/

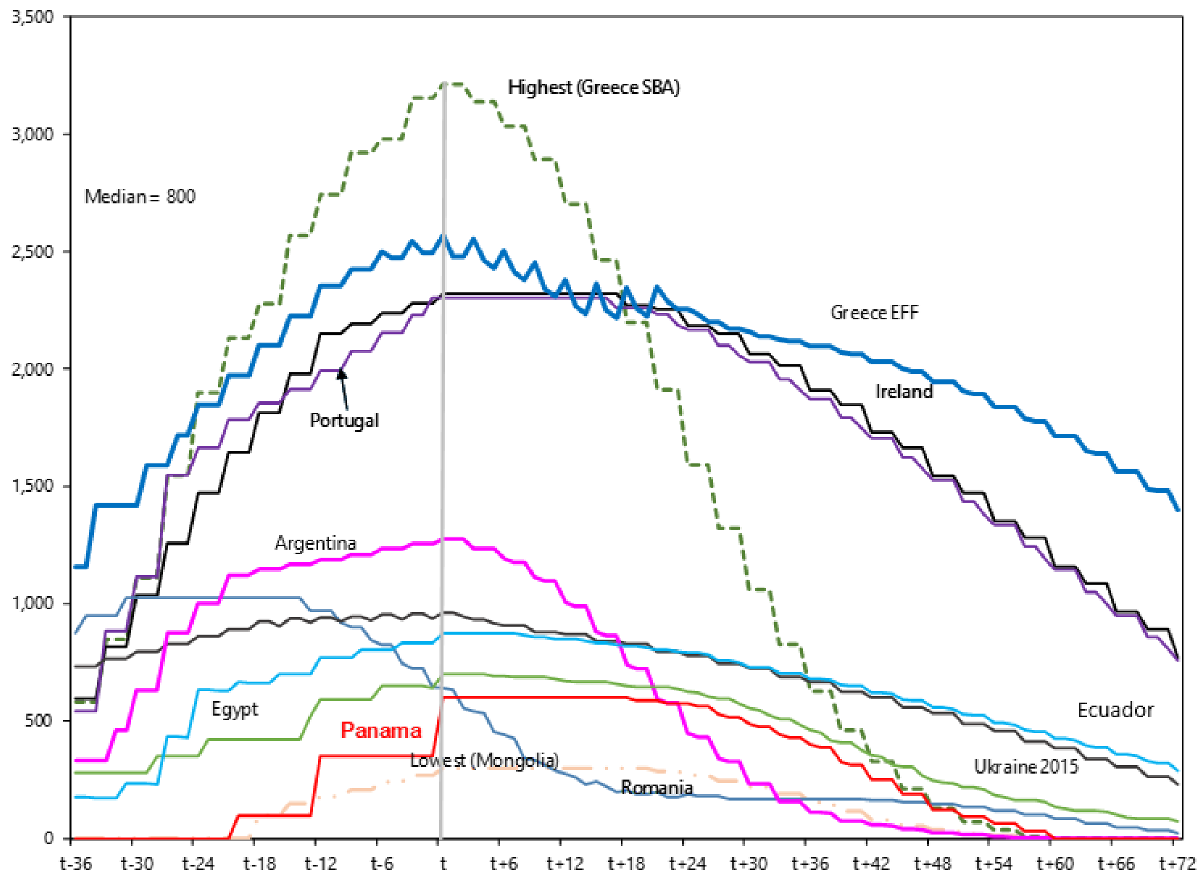


Source: Panamanian authorities and IMF staff estimates.

1/ Estimates as reported in relevant staff reports on Panama's request for a PLL arrangement. "Recent exceptional access cases" refers to exceptional access arrangements since September 2008.
2/ Asterisks indicate PRGT-eligible countries at the time of the program approval.

Figure 2. Credit Outstanding in the GRA around Peak Borrowing[1/ 2/]

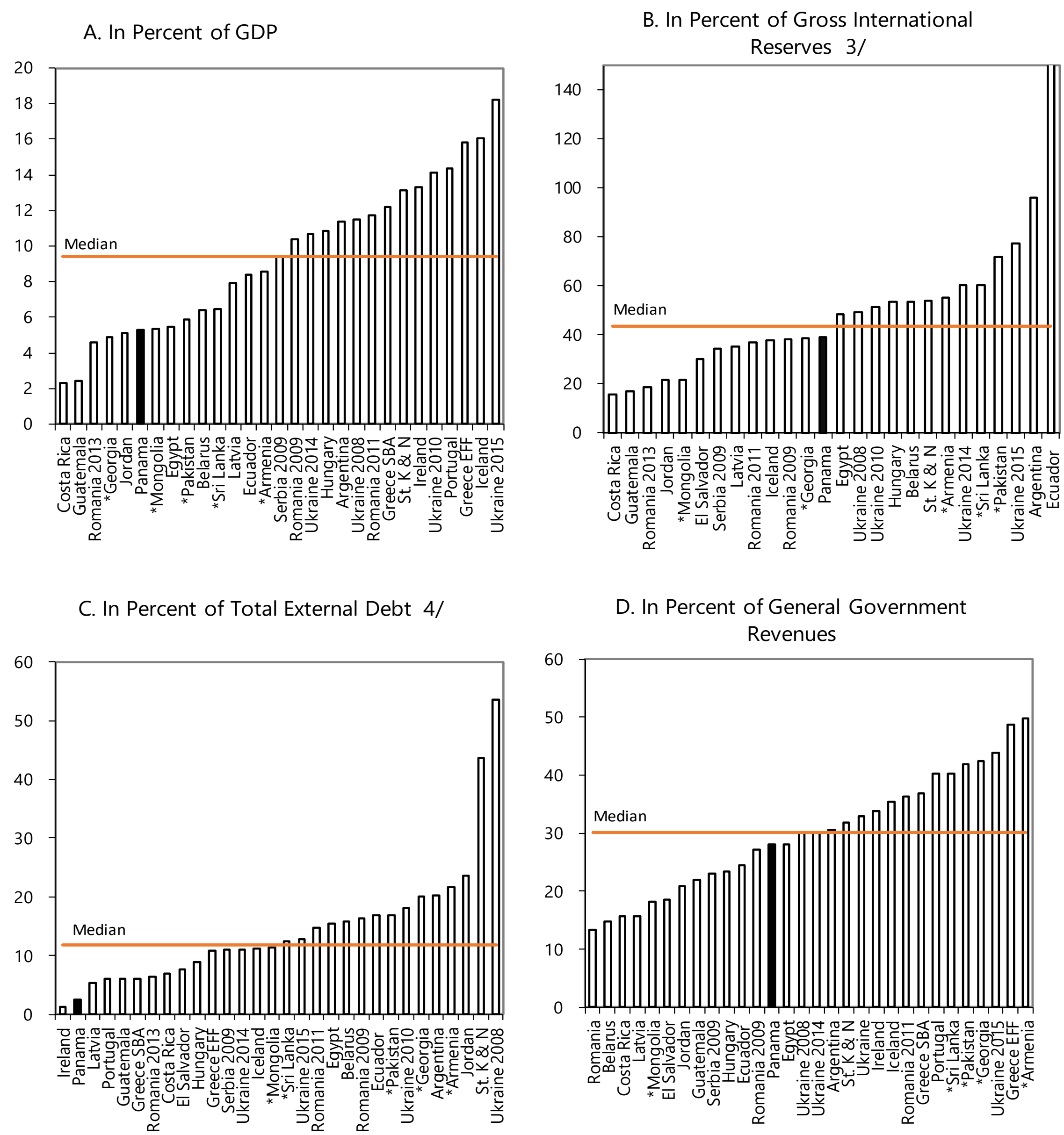
(in percent of quota)



Source: IMF Finance Department.

1/ Peak borrowing "t" is defined as the highest level of credit outstanding for a member on a given month.
2/ Based on quotas at the time of approval, i.e., pre-14th Review quotas for all countries except Argentina, Egypt, Ecuador, and Panama. Median and average credit outstanding at peak are 800 percent of quota and 892 percent of quota, respectively.

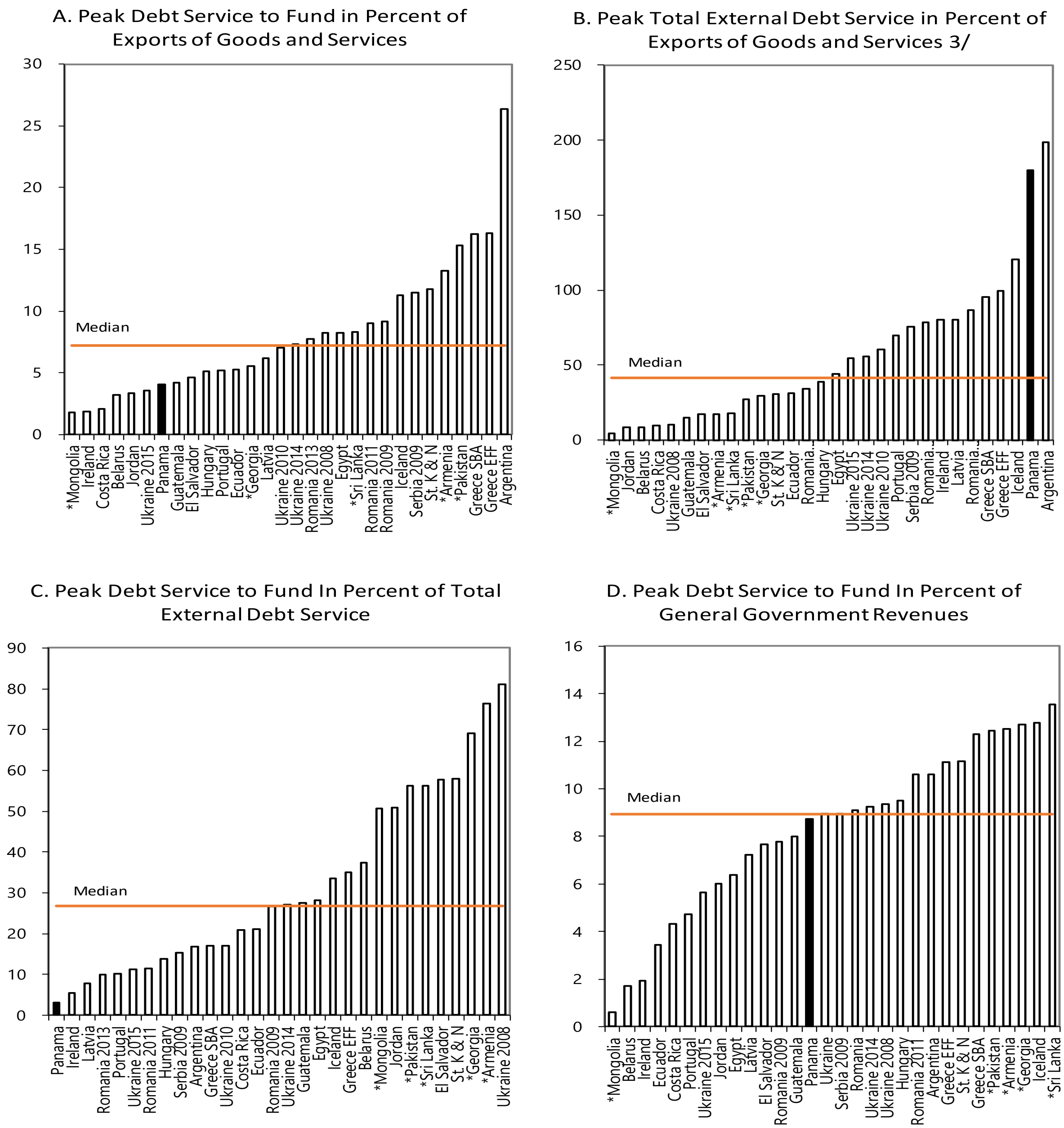
Figure 3a. Peak Fund Exposure Ratios for Exceptional Access Cases[1/ 2/]



Source: IMF staff estimates and World Economic Outlook.

1/ Estimates as reported in relevant staff reports on the request of exceptional access arrangements approved since September 2008.
2/ Asterisks indicate PRGT-eligible countries at the time of the program.
3/ Excluding arrangements with members belonging to the euro area at the time of the approval of the arrangement: Greece, Ireland, and Portugal.
4/ For arrangements of which total external debt (or debt service) ratio is not available, public external debt ratio is shown instead.

Figure 3b. Peak Debt Service Ratios for Exceptional Access Cases[1/ 2/]



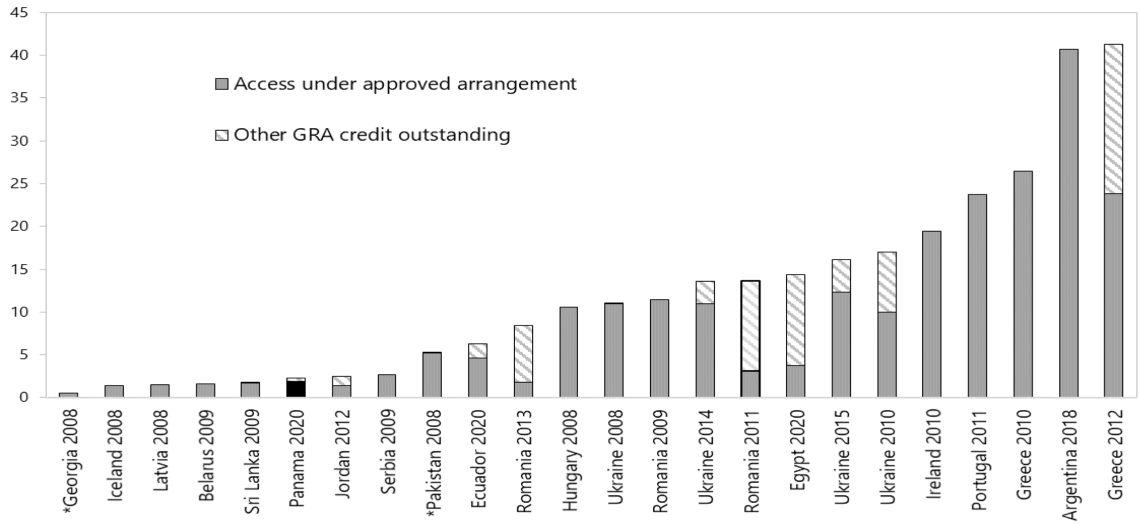
Source: IMF staff estimates and World Economic Outlook.

1/ Estimates as reported in relevant staff reports on the request of exceptional access arrangements approved since September 2008.
2/ Asterisks indicate PRGT-eligible countries at the time of the program. Georgia's debt service to the Fund includes one from PRGF loan.
3/ For arrangements of which total external debt (or debt service) ratio is not available, public external debt ratio is shown instead.

Figure 4. Exceptional Access Levels and Credit Concentration

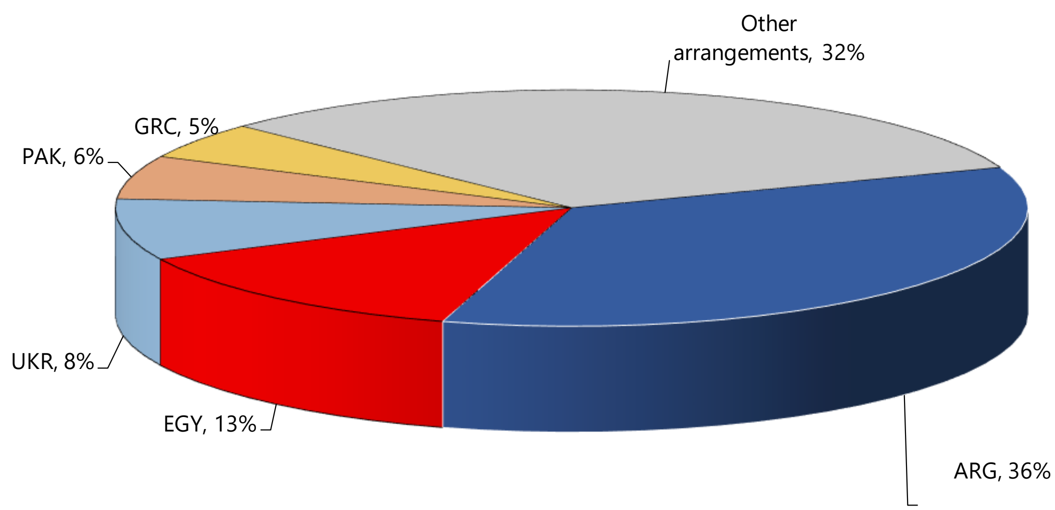
A. Total Access of Recent Exceptional Access Arrangements 1/

(in billions of SDR)



B. Credit Concentration of Fund GRA Exposure 2/

(as a percentage of total GRA credit outstanding)



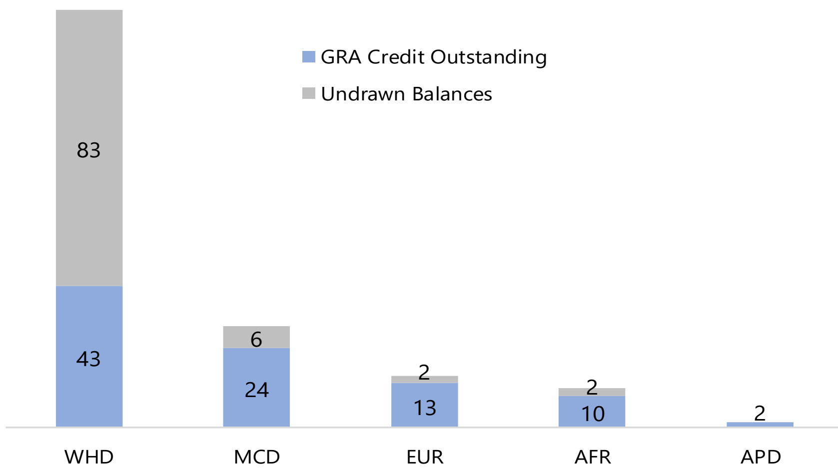
Source: IMF, Finance Department.

1/ Does not include FCL arrangements as well as arrangements with relatively low access in SDRs. Asterisks indicate countries that were PRGT-eligible at the time of approval.
2/ Total credit outstanding refers to credit outstanding as of December 17, 2020 plus Panama's scheduled first purchase under the proposed PLL arrangement.

Figure 5. Regional Concentration of GRA Lending Commitments 1/

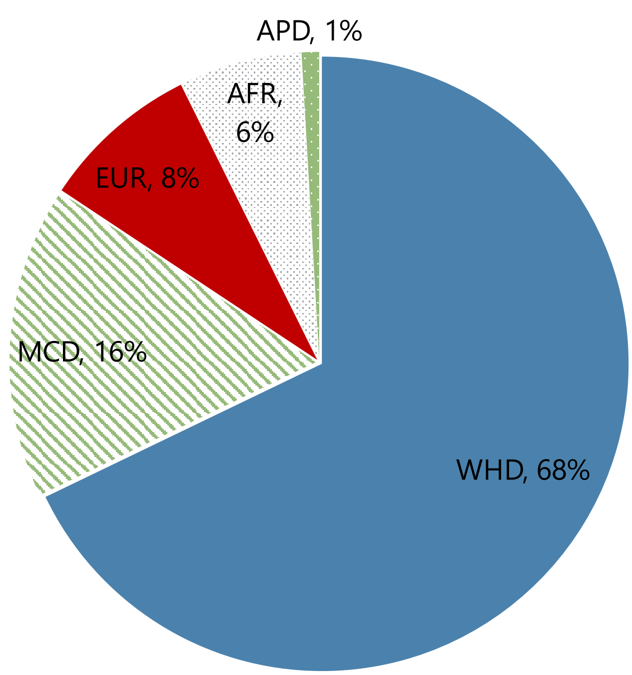
A. GRA Lending Commitments, including Proposed PLL Arrangement with Panama

(in billions SDRs)



B. Regional Concentration of GRA Lending Commitments, including Proposed PLL Arrangement with Panama

(in percent)



Source: IMF Finance Department.

1/ Lending commitments is the sum of credit outstanding and undrawn balances under active arrangements.

Statement by Mr. Bevilaqua, Executive Director for Panama,
Mr. Fuentes, Alternate Executive Director for Panama, and Mr. Maciá,
Advisor to the Executive Director for Panama
January 19, 2020

1. On behalf of our Panamanian authorities, we thank Executive Directors and Management for their continuing support to Panama, and Mr. Santos and his team for the excellent dialogue with the authorities. Until the COVID-19 pandemic, Panama had been one of the fastest growing economies in the world for two decades, supported by sound macroeconomic and financial policies. The pandemic, however, caused a sharp contraction in economic activity in 2020 and prospects for a recovery are subject to considerable uncertainty, as in many other countries. The authorities are requesting a Precautionary and Liquidity Line (PLL) arrangement to bolster their economic recovery efforts while they address outstanding vulnerabilities.

Recent developments

2. **In response to the COVID-19 pandemic, the authorities acted decisively implementing strong measures to protect lives and livelihoods.** As of January 11, 2021, the pandemic in Panama registered 281,353 cases and 4,500 deceased. Large budgetary resources have been reallocated to support the public health system to face the pandemic. Also, the Panama Solidarity Plan has been instrumental in providing food to vulnerable households and cash transfers to the unemployed, benefiting more than 1.7 million Panamanians. As announced by President Cortizo, social assistance programs will remain in place through mid-2021. Economic reopening had progressed steadily since September last year. However, a recent surge in new cases has forced the government to reinstate curfews and lockdowns during the holiday season and in early January. Despite these measures, the authorities expect a gradual acceleration of economic activity and increased dynamism in the labor market during 2021, as the pandemic is brought under control and vaccination progresses. The first lot of 40 thousand vaccines is expected to be delivered later this month.

3. **The 2020 recession was severe, driven by a sharp contraction in tourism and private construction.** The index of economic activity (IMAE) registered a reduction of 17.0 percent for the period January-October 2020. Unemployment reached 18.5 percent in August 2020, compared to 7.1 percent in 2019, primarily reflecting the substantial impact of the pandemic on small and medium enterprises (SMEs). Inflation remained subdued in 2020 and is expected to stay low even as domestic demand recovers. The external position has improved, reflecting the compound effect of lower international oil prices and higher copper exports, which have helped offset the fall in tourism receipts. For 2021, growth is expected to reach 4 percent supported by an accommodative policy stance and stronger activity in the private sector, as tourism gradually recovers and several mega-projects resume their activities.

Fiscal policy and public financial management (PFM)

4. **The fiscal accounts remain under pressure as authorities actively respond to the pandemic.** The overall fiscal deficit is expected to reach 9 percent in 2020 due to higher social expenditure and lower revenue collections caused by tax moratoriums and weak economic activity. As a result, the debt-to-GDP ratio is expected to reach 53.8 percent in 2020, and 59.4 percent in 2021, from 41.0 percent in 2019. Still, public debt would remain sustainable and the government's capacity to honor its financial commitments adequate. With the massive exogenous shock, the National Assembly has authorized easing the targets in the Social and Fiscal Responsibility Law (SFRL) to create further fiscal space for critical social spending and help reactivate the economy. Fiscal consolidation under the SFRL has been reset to gradually converge to a new (anchor) deficit of 1.5 percent of GDP by 2025. Notwithstanding these necessary amendments, the authorities remain fully committed to the SFRL as a key instrument for fiscal prudence, debt reduction and medium-term fiscal sustainability.

5. **The authorities are taking strong actions to improve PFM systems and avoid arrears accumulation.** The government is fully aware of the need to reform PFM to address weaknesses in debt reporting, off-budget expenditures and public project management. In the context of the PLL arrangement, the authorities intend to bolster PFM, including by implementing a multi-annual budget framework, reinforcing procurement practices and performing fiscal reporting on an accrual basis. The scheduled FAD technical assistance mission should provide a medium-term roadmap for PFM reform to enhance governance and transparency in budget management.

Financial sector and market access

6. **The financial sector remains strong and well-capitalized under Basel III principles.** NPLs remain stable at 2.0 percent and, notwithstanding the loan moratorium, the temporary increase in provisioning is not expected to affect solvency and liquidity indicators, and should support financial stability. The capital adequacy ratio (CAR) stood at 16.25 percent at end-September 2020, twice the regulatory standard, and system liquidity stood at 64.0 percent of total deposits at end-November. Moreover, the government has operationalized a US$1.0 billion Fund for Economic Stimulus (FES) to provide liquidity to banks and credit assistance for economic recovery buttressed by resources from the Rapid Financing Instrument (RFI) and Banco Nacional de Panama (BNP). This is crucial to safeguard financial stability and support resilience in the banking system. In order to enhance the regulatory and supervisory framework, the SBP has requested a multi-topic technical assistance from MCM to reinforce macroprudential policies and risk assessment and strengthen supervisory capacity and systemic risk monitoring.

7. **Credit rating agencies have reaffirmed Panama's investment grade based on the country's strong macroeconomic fundamentals and solid fiscal framework**. Panama has a long tradition of access to capital markets at very low costs with an excellent track record of servicing its debt obligations. Since achieving investment grade status in 2010, sovereign bond spreads for Panama have been much lower than in most countries in the region. Accordingly, in August 2020, BNP issued a 10-year US$1.0 billion bond at an annual yield of 2.25 percent, and in the following month the government issued a US$2.25 billion global bond, in two tranches of respectively US$1.25 billion maturing in 2032 at 2.25 percent coupon and a US$1.0 billion maturing in 2060 carrying a 3.87 percent coupon.

AML/CFT regulations and transparency

8. **The regulation and supervision of non-financial obligated subjects (NFBP) has been strengthened in accordance with the FATF action plan.** The implemented measures include the criminalization of tax evasion, penalization of illegal money-remitters, and creation of a single registry for offshore companies. These actions have been complemented by strengthening the Financial Intelligence Unit's investigative and prosecution capabilities. Furthermore, the Ministry of Economy and Finance (MEF) has taken steps to reinforce its AML/CFT technical staff to support the implementation of the action plan moving forward. Progress achieved thus far is expected to set the stage to address FATF's recommendations. In the meantime, authorities remain fully committed to achieving a delisting from FATF's grey list as soon as feasible.

9. **Quality and timeliness of macroeconomic statistics continues to improve.** In May 2020, the STA completed a ROSC assessment on the National Institute of Statistics and Census (INEC). The authorities plan to move forward with the modernization of the INEC and claim full ownership of the proposed ROSC's roadmap to strengthen and restructure INDEC. Structural benchmarks under the PLL include the creation of the National Statistics Coordination Committee, publication of the data template on international reserves, and publication of fiscal operations of central and general government data on a quarterly basis. Subscribing to SDDS standards by the completion of the PLL arrangement is a commitment that would enhance data coverage, periodicity and timeliness.

Final remarks

10. **The authorities consider the PLL arrangement as critical to supporting the country's macroeconomic strategy to overcome the impact of the COVID-19 pandemic**. Access to this facility will provide an effective insurance to help Panama recover amid the extreme uncertainty caused by the pandemic and expedite efforts to strengthen the macroeconomic policy framework and implement institutional reforms to meet international financial standards. Authorities approach the program to be implemented under the PLL arrangement

with full commitment, ownership, and determination. The authorities intend to treat the arrangement as precautionary. Should adverse conditions require drawing under the PLL, the country exhibits an adequate capacity to repay the Fund.