INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/173

PANAMA

July 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PANAMA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Panama, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 14, 2021 consideration of the staff report that concluded the Article IV consultation with Panama.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 14, 2021, following discussions that ended on April 30, 2021, with the officials of Panama on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 24, 2021.
- An **Informational Annex** prepared by the IMF staff.
- 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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Washington, D.C.

PRESS RELEASE

PR 21/179

IMF Executive Board Concludes 2021 Article IV Consultation with Panama

FOR IMMEDIATE RELEASE

Washington, DC – **June 16, 2021:** On June 14, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.[1]

Panama's economy contracted sharply in 2020 against the backdrop of reduced mobility and measures to address the COVID-19 pandemic, along with the global recession. Real GDP growth contracted by an unprecedented 17.9 percent in 2020, and the unemployment rate rose sharply to 18½ percent in September 2020. A sharp loss of revenues due to the lockdown and associated demand effects also precipitated a marked deterioration in the fiscal position, while COVID-related spending in health and social programs was broadly offset by a reorientation of other expenditure. The nonfinancial public sector fiscal deficit swelled to about 10 percent of GDP, but remained in line with the amended fiscal rule. The external current account improved to a surplus of 2⅓ percent of GDP in 2020, on the back of a sharp contraction in imports, lower oil prices, as well as increased copper exports and resilient canal revenues. The financial sector remained stable, well capitalized, and liquid despite the large pandemic shock and moratorium on servicing bank loans. Panama remains on the Financial Action Task Force (FATF) grey list. While the FATF acknowledged the actions taken by the authorities in improving the AML/CFT regime in the recent February 2021 Plenary, progress was not sufficient to remove Panama from the list of countries with strategic deficiencies. The FATF noted that the timelines for implementing all items of the FATF action plan had expired and encouraged Panama to address remaining deficiencies as soon as possible.

While a strong recovery is expected for 2021, the balance of risks remains tilted to the downside. Growth is projected to recover to 12 percent in 2021 and converge to its potential of about 5 percent over the medium-term. However, the economic outlook continues to be subject to an unusual degree of uncertainty arising from the impact of the pandemic. Domestic downside risks include delays in addressing the items contained in the FATF's Action plan and improving the effectiveness of the AML/CFT regime and tax transparency frameworks; increase in NPLs from the moratorium on servicing bank loans; setbacks in fiscal consolidation which jeopardizes market confidence. External risks include new pandemic waves, and continued weaknesses in global trade curtailing traffic flow and revenue from the Canal. In addition, natural disasters and extreme climatic events could lead to loss of lives and livelihoods, and disrupt canal activity, agriculture, and tourism.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors broadly agreed with the thrust of the staff appraisal. Panama experienced a pronounced economic contraction in 2020 amid stringent containment measures and mobility restrictions to tackle the COVID-19 pandemic. A rebound in the global economy and supportive macroeconomic policies are expected to underpin a strong recovery in 2021. Directors commended the authorities' commitment to protecting the health and lives of Panamanians through a vaccination program. They emphasized the need to remain cautious as global uncertainties remain, particularly from the emergence of new COVID-19 strains.

Directors underscored the importance of adhering to the fiscal rule to ensure debt sustainability in the medium term. The envisaged post-pandemic fiscal consolidation effort should be accompanied by strengthening medium-term planning. Directors highlighted the need to strengthen the fiscal framework to improve the credibility of the fiscal strategy and refine the public financial management framework to bolster transparency and prevent the resurfacing of arrears.

Panama's banking system remained resilient during the pandemic, and is generally well-regulated. However, the financial system is still vulnerable to unanticipated shocks. Tight supervision and monitoring are needed to safeguard stability. Directors stressed the need for the regulatory forbearance granted on loans following the pandemic to be restricted and phased out, reinforced by a supervisory action plan and close monitoring. The *ad hoc* provisioning requirement on modified loans should continually be recalibrated to evolving circumstances. Given the large share of modified loans, a risk-focused loan portfolio examination of all banks, including an assessment of fundamental asset quality, would help assess banks' credit exposures and capital buffers.

Directors emphasized the importance of improving the financial integrity framework. Exiting the FATF grey list must remain a priority, including by expediently addressing the remaining deficiencies in the AML/CFT regulatory framework. Efforts to further enhance tax transparency should continue, in close cooperation with the European Union.

Directors called for structural reforms to enhance competitiveness and growth potential through improvements in the business climate, strengthening policies related to labor mobility, governance and institutional capacity, enhancing innovation and technological sophistication in key industries, and deepening financial inclusion. There is also a need to upgrade workforce skill levels, streamline the insolvency framework and improve the functioning of the judicial system to remain an attractive destination for doing business. Directors welcomed the long-term goals of enhancing the efficiency of spending, particularly in health, education, and social areas, including improving the living conditions of indigenous populations.

It is expected that the next Article IV consultation with Panama will be conducted on the standard 12-month cycle.

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

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2020)	4.3	Poverty line (percent, 2017)	20.7
Population growth rate (percent, 2020)	1.4	Adult literacy rate (percent, 2018)	95.4
Life expectancy at birth (years, 2018)	78.3	GDP per capita (US$, 2020)	12,373
Total unemployment rate (Sep, 2020)	18.5	IMF Quota (SDR, million)	376.8

				Est.	Projections	
	2017	2018	2019	2020	2021	2022
				(Percent change)		
Production and prices						
Real GDP (2007 prices)	5.6	3.6	3.0	-17.9	12.0	5.0
Consumer price index (average)	0.9	0.8	-0.4	-1.6	0.2	1.1
Consumer price index (end-of-year)	0.5	0.2	-0.1	-1.6	0.5	2.0
Output gap (% of potential)	2.4	4.4	7.3	-14.2	-6.3	-4.3
Demand components (at constant prices)						
Public consumption	6.4	7.7	4.5	19.1	6.2	-11.2
Private consumption	3.1	2.3	3.6	-15.7	12.3	4.5
Public investment 1/	-20.7	6.9	-1.6	-19.7	4.0	3.0
Private investment	14.9	-0.4	-2.8	-40.0	33.7	12.4
Exports	5.0	5.1	-0.1	-28.3	15.3	11.0
Imports	4.3	4.1	-3.3	-34.0	34.0	6.5
Financial sector						
Private sector credit	6.5	4.5	2.4	-2.6	12.3	6.1
Broad money	5.2	2.8	2.3	9.5	15.2	7.1
Average deposit rate	1.6	1.8	2.1	1.9	1.6	1.6
Average lending rate	7.9	7.7	7.9	7.8	6.2	6.2
				(In percent of GDP)		
Saving-investment balance						
Gross domestic investment	41.7	41.5	39.3	28.5	32.5	34.3
Public sector	5.9	6.2	6.0	5.3	5.0	4.9
Private sector	35.8	35.3	33.2	23.2	27.6	29.5
Gross national saving	35.8	33.8	34.3	30.9	29.1	31.0
Public sector	4.2	4.2	2.7	-4.1	-2.8	1.2
Private sector	31.6	29.6	31.6	35.0	31.9	29.8
Public finances 1/						
Revenue and grants	22.0	22.0	20.9	21.8	22.6	23.1
Expenditure	24.2	24.9	24.1	30.7	29.3	26.4
Current, including interest	17.0	17.2	17.6	25.3	24.4	21.6
Capital	6.9	6.6	5.8	5.3	5.0	4.9
Overall balance, including ACP	-2.2	-2.9	-3.2	-8.9	-6.7	-3.3
Overall balance, excluding ACP	-2.2	-3.2	-3.6	-10.1	-7.4	-4.0
Total public debt						
Debt of the Non-financial public sector 2/	35.3	37.3	42.2	64.0	62.9	62.5
External	28.7	30.6	35.3	55.1	54.2	54.4
Domestic	6.6	6.7	6.9	8.9	8.7	8.1
Debt of ACP	4.4	4.2	3.8	4.3	3.5	2.9
Other 3/	3.4	4.2	4.1	5.2	4.6	4.4
External sector						
Current account	-5.9	-7.6	-5.0	2.3	-3.4	-3.3
Net exports from Colon Free Zone	3.0	2.5	2.7	3.2	2.7	2.8
Net oil imports	3.8	4.4	3.8	1.6	2.2	2.1
Net foreign direct investment inflows	6.9	7.6	5.5	1.2	4.0	6.4
External Debt	149.6	153.0	156.8	201.9	186.3	185.3
Memorandum items:						
GDP (in millions of US$)	62,203	64,928	66,788	52,938	59,447	63,084

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 2017–18.
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.

INTERNATIONAL MONETARY FUND

PANAMA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 24, 2021

KEY ISSUES

Background. After over two decades of unprecedented economic expansion, Panama's economy contracted sharply in 2020 amidst challenges from the COVID-19 pandemic. As conditions rapidly deteriorated, Panama requested financial support under the Rapid Financing Instrument (RFI) for 100 percent of quota equivalent to US$0.5 billion (SDR 0.4 billion) to address immediate balance of payments needs, which the IMF Executive Board approved on April 15, 2020. Subsequently, uncertainties magnified, and Panama requested a two-year arrangement under the Precautionary and Liquidity Line (PLL) for 500 percent of quota, equivalent to US$2.7 billion (SDR 1.9 billion), as insurance against extreme external shocks, which was approved by the IMF Executive Board on January 19, 2021.

Outlook and Risks. The economy is expected to rebound by 12 percent in 2021. However, the balance of risks remains tilted to the downside and subject to unusual uncertainties relating to the pandemic. External risks include an acceleration of de-globalization which could weaken global trade and curtail the recovery in the Panama Canal's traffic flow and revenue. Domestic risks include setbacks in addressing the remaining items in the FATF Action Plan in order to exit the grey list, delays in fiscal consolidation, and a prolonged pandemic that could exacerbate socio-economic hardship and derail economic policies and the recovery.

Policy Advice. The policy agenda should focus on supporting the recovery of the economy and intensifying the vaccination of the population. To that end, fiscal consolidation is taking place only gradually following the revised fiscal responsibility law, while the financial system maintains adequate liquidity to finance the economic expansion. The temporary forbearance measures should be phased out once the pandemic recedes. Measures to promptly exit the FATF's grey list will support confidence and Panama's status as a regional financial center. In the medium term, intensifying structural reforms to improve competitiveness, reduce poverty and inequality, and address climate risks will support healthy and inclusive growth, as well as preserve Panama's competitive advantage as an attractive destination for business.

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

Discussions were held virtually during April 19–30, 2021. The mission comprised Alejandro Santos (head), Julian Chow, Marina Rousset, Paola Aliperti (all WHD), Alberto Soler (FAD), Luiza Antoun de Almeida (SPR), Torsten Wezel (MCM), José Daniel Rodríguez-Delgado (STA), and Francisco Figueroa (LEG), with support from Madina Toshmuhamedova (WHD). Alfredo Macia (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 and private sector representatives.

CONTENTS

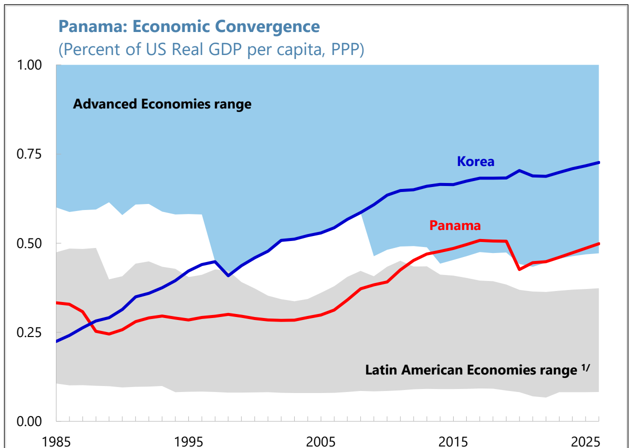
ANNEXES

Acronyms

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BASEL III	International Regulatory Framework for Banks
BNP	Banco Nacional de Panamá (National Bank of Panama)
CFZ	Colon Free Zone
CIT	Corporate Income Tax
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CRS	Common Reporting Standards
DRS	Disaster Resilience Strategy
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
e-GDDS	Enhanced General Data Dissemination System
FATF	Financial Action Task Force
FES	Fund for Economic Stimulus
GAFILAT	Latin America Anti-Money Laundering Group
GFDRR	Global Facility for Disaster Reduction and Recovery
FDI	Foreign Direct Investment
INEC	National Institute of Statistics and Census
IO	Immediate Outcome
LCR	Liquidity Coverage Ratio
LOLR	Lender of Last Resort
LP	Liquidity Program
MEF	Ministry of Economy and Finance of Panama
ML/FT Risks	Money Laundering and Financing of Terrorism Risks
MLI	Multilateral Instrument on Base Erosion and Profit Shifting
NEER	Nominal Effective Exchange Rate
NFPS	Non-Financial Public Sector
NIIP	Net International Investment Position
NPLs	Non-performing Loans
NSFR	Net Stable Funding Ratio
PLL	Precautionary and Liquidity Line
PPP	Purchasing Power Parity
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
RFI	Rapid Financing Instrument
SBP	Superintendency of Banks
SDSS	Special Data Dissemination Standard
SECMCA	Central America Monetary Council
SFRL	Social and Fiscal Responsibility Law
SP	Stimulus Program
SWF	Sovereign Wealth Fund
TA	Technical Assistance

STRONG FUNDAMENTALS PRE-PANDEMIC

1. **After over two decades of record high growth, Panama's economy contracted sharply in 2020 amidst challenges triggered by the global COVID-19 pandemic.** 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. The high-growth episode was propelled by an investment boom, which included the expansion of the Panama Canal, the construction of one of the largest copper mines in the world, and a construction boom that erected some of the tallest skyscrapers in Latin America. Panama reached high-income status in 2017, according to the World Bank classification methodology, and enjoys the highest per capita income in Latin America, rapidly reducing the gap with advanced economies (see Annex V).[1] Social outcomes also improved significantly over the last few decades.[2] However, the economy faced an unprecedented shock stemming from the 2020 global economic recession and lockdown which affected trade and domestic economic activities as a consequence of the COVID-19 pandemic.



Source: World Economic Outlook and IMF staff calculations.
1/ Excluding Panama.

2. **The IMF Executive Board approved Panama's request for a two-year arrangement under the Precautionary and Liquidity Line (PLL) on January 19, 2021.** Given the significant downside risks to the outlook, the PLL (amounting to 500 percent of quota, equivalent to US$2.7 billion) serves as insurance against extreme external shocks. Panama also benefitted from financial support under the Rapid Financing Instrument (RFI) (amounting to 100 percent of quota, equivalent to US$0.5 billion) approved by the IMF Executive Board on April 15, 2020.[3]

THE SHOCK OF A CENTURY

3. **Panama has been severely affected by the COVID-19 pandemic.** However, the authorities' resolute containment and vaccination efforts have mitigated the infection rate. Measures to contain virus contagion had adversely affected economic activity. While at some point Panama had one of the highest COVID fatality rates in the world (despite a relatively robust healthcare system and a decisive response from the authorities) due to a large service sector based

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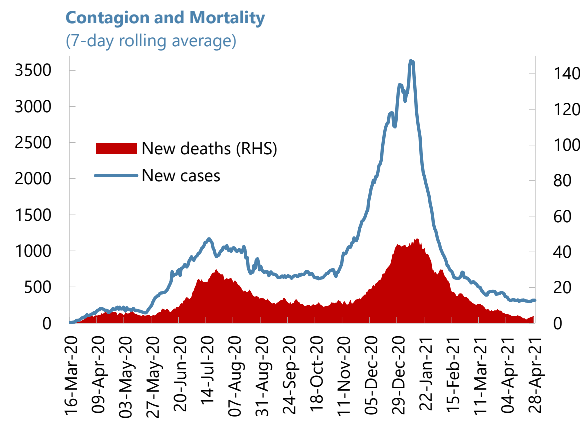
[1] See "Panama—Economic Quantum Leap", (2019) *Diálogo a Fondo* IMF.

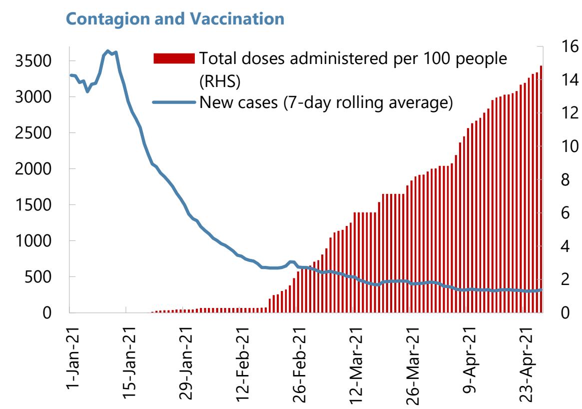
[2] According to World Bank calculations, extreme poverty (at US$1.9/day, PPP) declined to 1.7 percent before the pandemic (a reduction of over 85 percent since 2000), while general poverty (at US$5.5/day, PPP) declined to 12.6 percent before the pandemic (a fall of about 65 percent since 2000). See Selected Issues Paper (2020), IMF.

[3] The RFI resources have been earmarked to the Fund for Economic Stimulus (FES) to support bank liquidity (similar to a dual lender of last resort and credit facility). As of mid-May 2021, no bank has used the facility.

on human contact (i.e., retail, construction, tourism), the pandemic was effectively contained at the end of the first quarter of 2021 as control measures intensified and the vaccine rollout began (Annex VI). Vaccination started in January 2021 and reached 15 doses administered per 100 people at end-April 2021, reducing significantly the number of new cases and fatalities.

COVID-19 Indicators





Source: "Our World in Data" database and IMF staff calculations.

4. **Climate change-related natural disasters also led to a loss of human lives and damage to agricultural production.** Hurricane Eta and tropical storm Iota hit Panama on November 5 and November 17, 2020 respectively, causing floods and landslides that affected a large part of the country's agricultural production. While these natural disasters created significant human dislocation, economic losses were contained mainly to the agricultural sector. The authorities declared a state of emergency and allocated US$100 million to support the affected population.

5. **The economy contracted sharply in 2020 against the backdrop of reduced mobility and containment measures, along with the global recession.** Following a moderation of growth to 3.0 percent in 2019, the economy virtually stagnated in Q1-2020 (growing only at ½ percent, y/y), and contracted sharply in Q2-2020 (declining 38¼ percent, y/y) at the peak of the first wave of the pandemic. Following the slump, the economy recovered vigorously in the second half of 2020 but not enough to compensate the fall in the first half (with GDP falling 23½ percent, y/y in Q3-2020 and 11 percent, y/y in Q4-2020). Real GDP fell by 17.9 percent in 2020, the largest economic contraction in recorded history. Construction and tourism were among the most affected activities (falling over ½), while mining was booming (expanding by ⅓). The contraction in construction and commerce account for about ⅔ of

Real GDP Growth in 2020
(In percent/percentage points)

	Growth Rate	Contri-bution	Structure
Real GDP	**-17.9**	**-17.9**	**100.0**
Construction	-51.9	-8.4	46.8
Commerce	-19.4	-3.4	19.2
Real estate	-15.5	-2.0	11.2
Tourism	-55.8	-1.2	6.8
Manufacturing	-22.0	-1.1	6.1
Transportation	-6.2	-0.9	4.9
Other services	-46.2	-0.7	4.1
Mining	34.1	0.8	-4.6
Other sectors	-3.5	-1.0	5.5

Source: INEC and IMF staff calculations.

the fall in real GDP in 2020. The monthly indicator of economic activity fell 9¾ percent (y/y) in February 2021. Amid the recession, the unemployment rate more than doubled from 7 percent in August 2019 to 18½ percent in September 2020; most of the increase in unemployment were furloughed workers (Annex XI).

6. **Inflation was in negative territory but picked up recently.** Following relative price stability in 2019, consumer prices gradually fell in 2020 and inflation remained below zero throughout the year amid falling transportation prices. After dropping by as much as 2.5 percent (y/y) in May 2020, headline inflation closed the year at -1.6 percent (y/y) (similar to core inflation). More recently, prices picked up, with headline inflation reaching 1.7 percent (y/y) in April 2021 (due to supply shocks in transportation), while core inflation remained subdued at -1.3 percent (y/y).

7. **While the fiscal position deteriorated markedly, it was in line with the amended fiscal rule.** The NFPS fiscal deficit climbed from 3½ percent of GDP in 2019 to 10 percent of GDP in 2020. Most of the deviation from the originally budgeted deficit of 2¾ percent of GDP was due to automatic stabilizers on the revenue side, while on the expenditure side, COVID-19 related spending (about 3 percent of GDP) was broadly offset by cuts in capital expenditure (about 2 percent of GDP) and other current spending (about 1 percent of GDP). In essence, the authorities implemented the same level of spending (in nominal terms) as envisaged in the 2020 budget (but altered significantly its composition to attend the COVID-19 emergency), and the whole deficit overrun was due to a sharp revenue shortfall. The 2020 fiscal outcome was in line with Social and Fiscal Responsibility Law (SFRL) as amended in October 2020, which sets deficit objectives between 9 and 10½ percent of GDP in 2020, with a gradual fiscal consolidation path until the NFPS deficit reaches 1½ percent of GDP from 2025 onwards (Annex VII). NFPS debt rose from 42¼ percent of GDP in 2019 to 64 percent of GDP in 2020. About half of the increase reflects the higher fiscal deficit, while the other half reflects the GDP drop and the strong buildup of public sector deposits. The tax amnesty (on tax liabilities accrued until June 2019), was extended until December 2021. In February 2021, the government announced measures to reduce penalties.

Budget Execution 2020

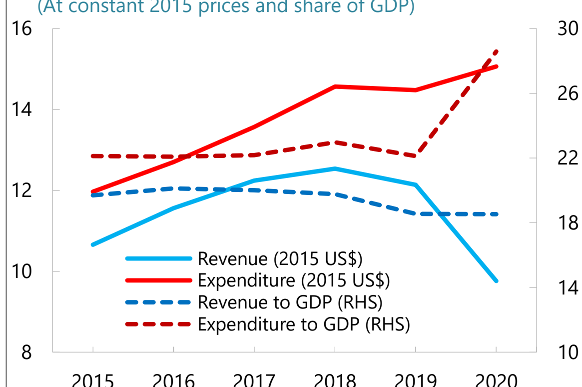
(In billions of U.S. dollars)

	Budget	Actual	Δ
Revenues	**13.1**	**9.8**	**-3.3**
Expenditures	**15.1**	**15.1**	**0.0**
Primary current spending	9.9	11.0	1.1
Non-COVID related	9.9	9.5	-0.5
COVID-related	-	1.6	1.6
Panama Solidario	-	1.1	1.1
Health and security	-	0.3	0.3
Electricity subsidy	-	0.2	0.2
Interest payments	1.5	1.4	-0.1
Capital expenditure	3.7	2.7	-1.0
Fiscal Deficit	**-2.0**	**-5.3**	**-3.3**

Source: MEF and IMF staff calculations.

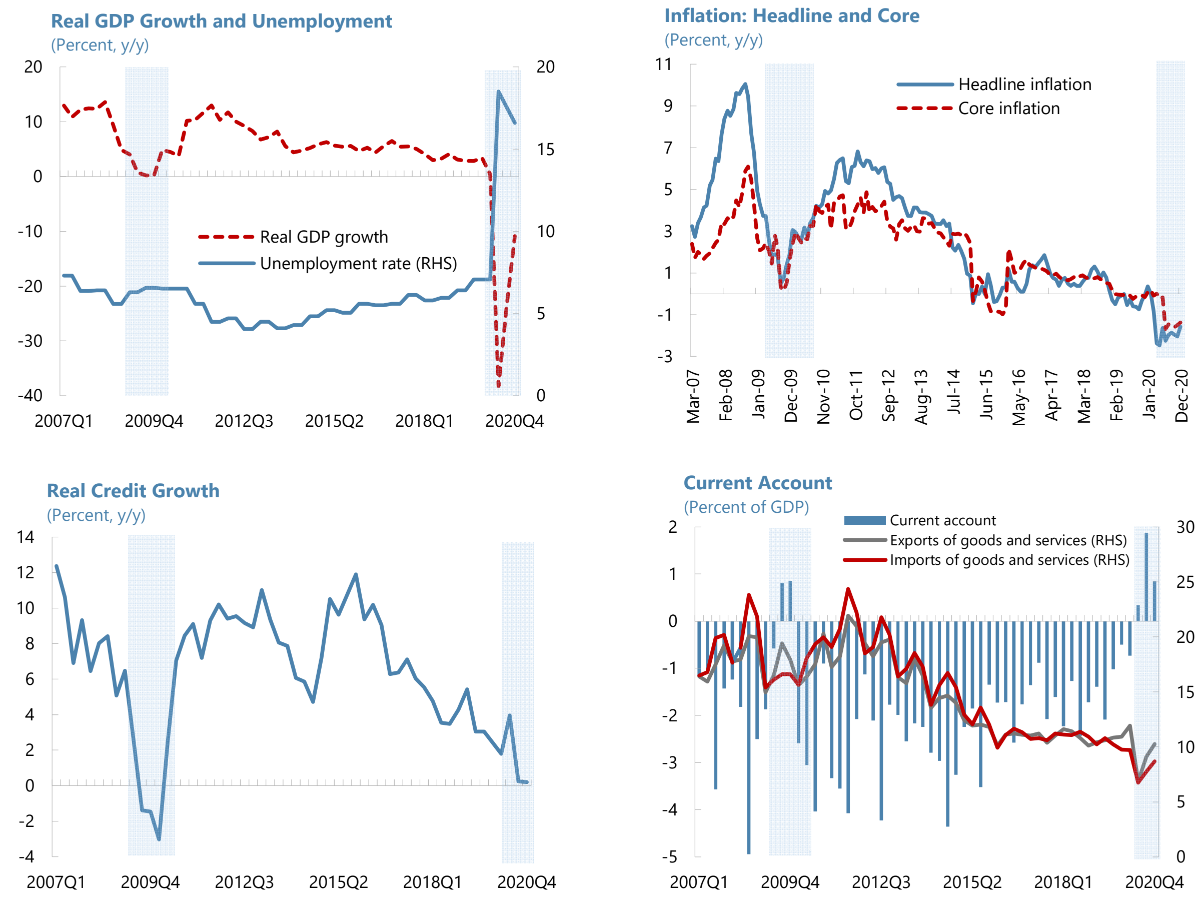
NFPS Revenue and expenditure

(At constant 2015 prices and share of GDP)



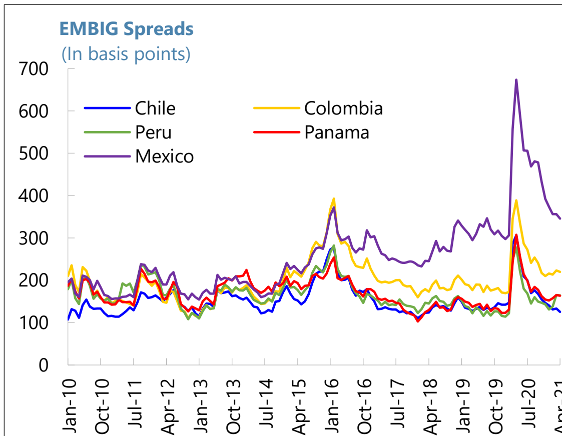
Source: MEF and IMF staff calculations

Business Cycle: Unprecedented Shock



Sources: INEC, SBP and IMF staff calculations.

8. The impact of the large pandemic shock and a moratorium on servicing bank loans has been limited thus far.[4] The government and the banking community agreed on a temporary moratorium on servicing bank loans, originally through end-2020 and then (de facto) extended to mid-2021, in the form of voluntary loan restructuring, grace periods, and in some cases interest rate reduction. As a preventive measure, the authorities established a Fund for Economic Stimulus (FES) in August 2020, resembling a lender of last resort (LOLR) facility, to safeguard financial

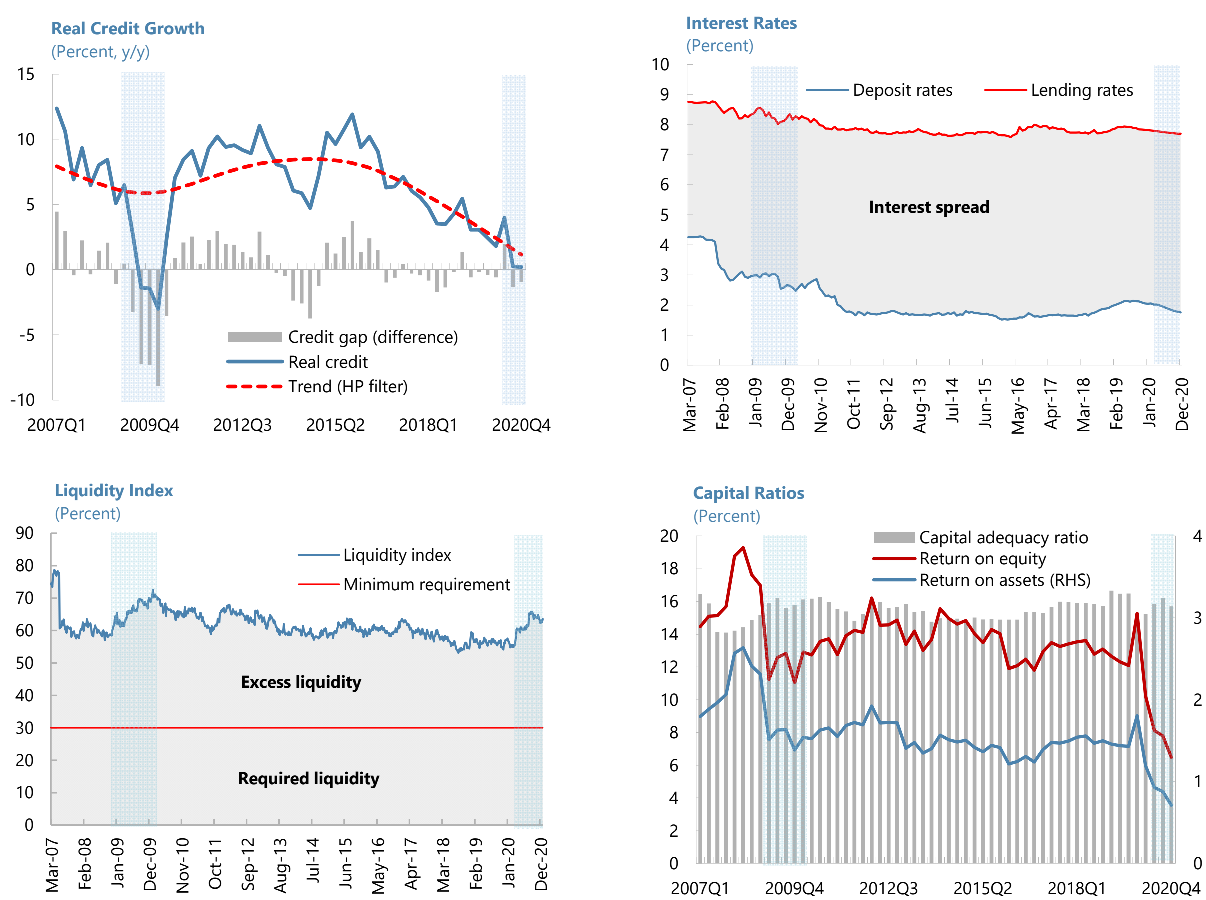


Source: Bloomberg.

[4] Panama does not have a central bank or a monetary authority. The national currency of Panama is the balboa, but it is issued in the form of coins only. The exchange rate has been fixed one-to-one to the U.S. dollar since 1904. In practice, Panama uses the U.S. dollar as its currency.

stability by providing timely liquidity and credit in times of financial stress.[5] As of mid-May 2021, liquidity under the FES has not been drawn by any bank, underscoring the continued resilience of the banking sector. Bank loans declined only 2.2 percent in 2020 driven by lower credit to the corporate sector. Deposits grew 8.1 percent in 2020, largely driven by large build-up in government deposits. Banks increased their capital adequacy ratio to 15.7 percent at end-2020 (from 15.2 at end-2019). Liquidity in the banking sector remained high with liquid assets covering 64 percent of deposits as of end-February 2021. To ease banks' financial position, the Superintendency of Banks (SBP) allowed using dynamic provisions amounting to US$1.3 billion (about 2 percent of GDP); only five banks used such provisions and for smaller amounts than allowed.

Credit Cycle: Resilience under Stress



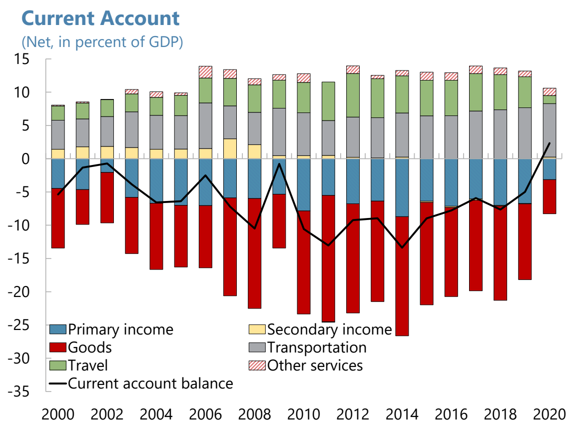
Source: SBP and IMF staff calculations.

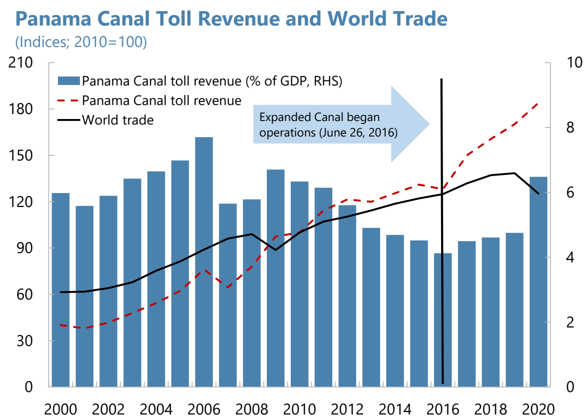
[5] The FES is fully operational since August 2020. A first-time safeguards assessment of the BNP was completed in September 2020. The BNP has implemented most of the recommendations. In particular, the criteria for selection and appointment of external auditors have been strengthened and investment practices were enhanced through revised policy and governance arrangements. Work continues to reinforce internal audit and expedite finalization of the legal framework for implementing the FES, the approval of which is now delayed to accommodate further consultation among internal stakeholders.

9. The external position improved temporarily in 2020, mainly due to the economic downturn. The current account balance switched to a surplus of 2¼ percent of GDP in 2020 (from a deficit of 5 percent of GDP in 2019) on the back of a sharp contraction in imports, lower oil prices, as well as increased copper exports and resilient canal and CFZ revenues. The current account surplus and other capital inflows led to a buildup of external buffers. The external position is assessed to be moderately stronger than the level implied by fundamentals and desirable policy settings. Sovereign spreads are below the average of emerging economies with similar credit rating.

10. Panama remains on the Financial Action Task Force (FATF) grey list. In the recent February 2021 plenary, the FATF acknowledged the steps taken by Panama towards improving the effectiveness of its AML/CFT regime although the progress was not sufficient to remove Panama from the list of countries with strategic deficiencies. Panama reiterated its commitment to continue implementing its action plan agreed upon with the FATF at the time of the grey listing in June 2019. The next FATF plenary is scheduled for late-June 2021.[6]

External Sector Indicators





Sources: INEC and IMF staff calculations.

UNUSUAL UNCERTAINTY TO THE OUTLOOK

11. Economic activity is projected to recover in 2021. Output growth is projected to rebound to 12 percent in 2021 as economic activities recover boosted by the vaccination rollout and supported by full-scale copper production, a recovery in private investment, and a large carryover effect.[7] Over the medium term, growth is expected to stabilize at its potential annual rate of

[6] The EU added Panama to its list of non-cooperative jurisdictions for tax purposes in February 2020, citing non-compliance with global transparency criteria, notably shortcomings in its tax information exchanges.

[7] The sharp economic recovery of the second half of 2020 implies that the real GDP of the last quarter of 2020 is about 8 percent higher than the average for the year (on a seasonally adjusted basis).

5 percent. Inflation is expected to moderate to ½ percent (y/y) by end-2021 as supply shocks unwind and stabilize at 2 percent over the medium term. Meanwhile, the external position is projected to deteriorate temporarily in 2021 to a current account deficit of about 3½ percent of GDP, driven by higher pent-up demand for imported durable goods, followed by stronger export receipts in the medium term, reducing the current account deficit to 2½ percent of GDP by 2026.

12. The fiscal balance is expected to improve significantly in 2021 as automatic stabilizers increase revenues and expenditures are contained. The 2021 budget is in line with a reduction of the NFPS deficit to almost 7½ percent of GDP consistent with the SFRL. The deficit reduction is driven by a rebound in revenues (1¼ percent of GDP), as well as a moderation of spending (1½ percent of GDP). The composition of expenditures was amended in early 2021 to reprioritize spending by 1¼ percent of GDP towards the purchase of vaccines and social programs while reducing other spending (COVID spending could amount to over 2 percent of GDP in 2021). NFPS debt will come down below 63 percent of GDP in 2021 (from 64 percent the year before), mainly due to robust growth. Further reductions in the deficit until 2025 would be supported by a recovery in tax revenues, improvements in tax administration, the withdrawal of the stimulus measures implemented during the pandemic, and a moderation of expenditure growth over the medium term.

13. The balance of risks remains tilted to the downside. The economic outlook continues to be subjected to an unusual degree of uncertainty arising from the possible more contagious mutations of the COVID-19 virus and the effectiveness of vaccines. Specifically:

- ***New wave of the pandemic.*** While the expectation is for increasing vaccination and a rapid recovery, the situation could become less positive, triggering a new wave of the pandemic.

- ***Escalation of external risks.*** A worsening of the COVID-19 pandemic could lead to disruption of global trade and capital flows, negatively impacting the activity of Canal and logistics sectors.

- ***FATF grey list.*** A lack of meaningful progress in improving the effectiveness of its AML/CFT framework could potentially expose Panama to countermeasures that may affect correspondent banking relationships.

- ***Security and climate risks.*** Cyberattacks could bring significant disruptions, while more climate-change related natural disasters could adversely affect Canal activity, agriculture, and tourism.

Medium-Term Macroeconomic Outlook

	2016	2017	2018	2019	Est. 2020	Projections 2021	2022	2023	2024	2025	2026
	(In percent)										
Macroeconomic Developments											
Real GDP growth	5.0	5.6	3.6	3.0	-17.9	12.0	5.0	5.0	5.0	5.0	5.0
Output gap	0.0	2.4	4.4	7.3	-14.2	-6.3	-4.3	-2.3	-0.3	0.0	0.0
CPI inflation (average)	0.7	0.9	0.8	-0.4	-1.6	0.2	1.1	2.0	2.0	2.0	2.0
Private credit growth	8.4	6.5	4.5	2.4	-2.6	12.3	6.1	7.1	7.1	7.1	7.1
	(In percent of GDP)										
Fiscal Accounts											
Overall balance	-2.0	-2.2	-3.2	-3.6	-10.1	-7.4	-4.0	-3.0	-2.0	-1.5	-1.5
Structural primary balance	-0.4	-1.0	-2.3	-3.2	-4.7	-3.3	-0.8	-0.3	0.2	0.5	0.4
Public debt (gross) 1/	35.3	35.3	37.3	42.2	64.0	62.9	62.5	61.7	60.2	58.3	56.4
Public debt (net) 2/	20.5	23.1	26.0	29.1	41.2	44.0	45.5	45.5	44.5	43.1	41.7
External Sector											
Current account balance	-7.8	-5.9	-7.6	-5.0	2.3	-3.4	-3.3	-3.1	-2.8	-2.6	-2.5
Foreign direct investment	-7.9	-6.9	-7.6	-5.5	-1.2	-4.0	-6.4	-7.0	-6.9	-7.1	-7.1

Sources: Ministry of Economy and Finance; INEC; SBP; and IMF staff calculations.
1/ Non-Financial Public Sector (NFPS) as defined in Law 31 of 2011.
2/ NFPS gross debt minus deposits at the National Bank (BNP) and financial assets at Panama's Savings Fund.

Authorities' Views

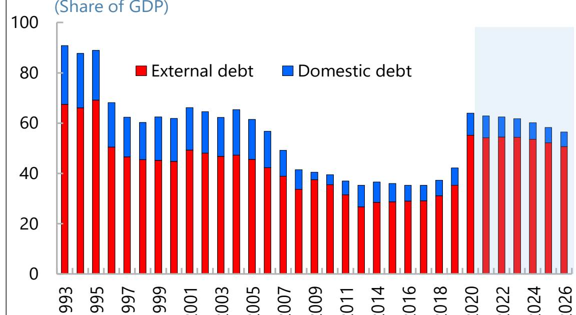
14. **The authorities broadly agreed with staff's views on the outlook and risks.** They were cautiously optimistic about the outlook for 2021 and beyond, despite the uncertainties from possible more contagious mutations of the COVID-19 virus which could dampen the effectiveness of vaccines and derail economic recovery. However, they remain firmly positive on medium-term growth prospects, underpinned by full scale copper production, Canal traffic volume and revenue, and a recovery in private investment and tourism. They are cognizant of the importance of exiting the FATF grey list and supporting fiscal consolidation. Further, they remain resolute in taking measures to tackle cybersecurity and climate risks. The authorities also agreed with staff's assessment of public debt sustainability and external stability.

OPPORTUNITY TO FORTIFY POLICY FRAMEWORKS

A. Adhering to the Modified Fiscal Rule to Cement Debt Sustainability

15. **The modified fiscal rule accommodates the pandemic shock, preventing a pro-cyclical stance in the short run, while ensuring debt sustainability in the long run.** The priority in the short term is to conduct a speedy vaccination campaign of the population. The underlying reason for the deterioration in the fiscal position in 2020 was the sharp reduction in revenues due to the use of automatic stabilizers. The unwinding of the shock as the pandemic recedes will produce an economic rebound and a strengthening of revenues, improving the fiscal position. The deficit

Public Debt
(Share of GDP)



Source: MEF and IMF staff calculations.

path set by the amended Social and Fiscal Responsibility Law (SFRL) provides flexibility to allow the gradual recovery of the revenue loss, while expenditure growth will likely be below GDP growth to ensure the needed consolidation. Part of the expenditure moderation will be automatic as the large COVID-19 related spending fades with the pandemic in 2021-22, leaving room for some expansion in non-COVID-19 spending if growth is below expectations. To limit pro-cyclical adjustment, the authorities will focus on expenditure restrain on items with lower multipliers (i.e., untargeted subsidies) and favor expanding those items with higher multipliers (i.e., capital spending). Over time, the primary balance will be strengthened significantly, switching from a primary deficit of over 7¾ percent to GDP in 2020 to a primary surplus of ½ percent of GDP in 2025 (and beyond), which compares favorably with the medium-term debt-stabilizing primary deficit of 1¼ percent of GDP. This ensures that the public debt path is set on a downward trajectory from its peak of 64 percent of GDP in 2020.

16. Fiscal planning should play a prominent role in enabling compliance with the fiscal rule. Achieving the targeted deficit reduction will require some moderation in the growth of expenditures, as well as improvements in tax administration. The authorities should be prepared to take tax measures in the future if needed to ensure the observance of the fiscal rule. The medium-term fiscal framework should become an essential planning tool (expected for the 2022 budget) to facilitate compliance with the fiscal rule and quantify government estimates on the revenue and expenditure side. This framework should be based on sound revenue projections consistent with macroeconomic forecasts, a rigorous costing of ongoing projects, programs, new policy objectives, and make explicit the linkages between revenue policy, expenditure needs and deficit targets.

17. Tax policy measures 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. This is partly due to tax expenditure, estimated between 3 and 4 percent of GDP in 2016. This tax expenditure mostly benefits the highest income deciles, harms efficiency and could in most cases be replaced by targeted tax credits or transfers.[8] Additional revenues could be achieved by phasing out around ¼ of tax expenditures.[9] Furthermore, the production of detailed tax expenditure reports would enhance the transparency of the system and lay the ground for a reform roadmap. In addition, to cover the costs of spending priorities (i.e., education and health) and facilitate fiscal consolidation, some tax rates could be gradually adjusted in the medium term to raise revenues and increase progressivity.

18. While progress in the modernization of revenue administration has been made, there is room for further improvements. Staff estimates that by lowering the tax evasion ratio in Panama to the average level of countries with similar levels of income, tax collection could increase up to 2 percent of GDP. A modernization strategy for the tax authority (DGI) was designed in early 2020. Progress has been slow due to the pandemic but should be resumed later this year.

[8] In the case of the CIT, this is complicated by the proliferation of special regimes, exemptions, fixed fees and presumptive regimes.

[9] Particularly VAT exemptions which mostly benefit the highest deciles of income and tax deductions for individuals with several income sources.

The customs authority (ANA) developed a strategic plan that pursues operational improvements through digitalization, better infrastructures and capacity building. This plan is an important step, but adjustments will be needed, including in refining performance indicators, and reinforcing the transparency pillar.

19. Expenditure prioritization will need to factor social needs and the legacy of the COVID-19 crisis. Efforts need to be made to contain the growth of primary expenditure, to lower it as a share of GDP. This objective will be facilitated by the withdrawal of the COVID-19 expenditure in 2022 (some 2 percent of GDP), and is compatible with a reorientation of expenditure towards social and infrastructure spending. Public spending on education is one of the lowest in the region, along with enrollment rates in primary and secondary levels and expected years of schooling. The pandemic has highlighted the need to improve public health and support the most vulnerable sectors of the population, particularly low-skilled workers, or those with difficulties to adapt to structural changes in the labor market.[10]

20. Policy efforts would be needed 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 2005) is expected to deplete its reserves in the next few years. 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 in about two decades and going down thereafter.

21. The tax amnesty should be well managed to mitigate moral hazard. The latest amnesty bill was announced in February 2021 (following a number of amnesties and their extensions in recent years). As a side effect, the tax amnesty may reduce informality as informal workers may decide to become formal if they are not liable for previous tax obligations. Looking forward, it is important to consider that amnesties are unfair, and there is no empirical evidence that they can raise revenues in the long run. Careful communication emphasizing that the recent extension was the last one is necessary to contain public expectations of future tax amnesties that could weaken tax collection.

22. Once the medium-term deficit anchor is reached, the authorities could embed a safety margin for cyclical surprises. In the presence of negative growth or fiscal shocks, this strategy would avoid an excessive use of escape clauses, which are detrimental to the credibility of the fiscal rule. The calculation of this margin could take into consideration the historical volatility of GDP, the cyclical position of the economy, cyclical sensitivities of revenues and expenditures and the potential effects of macroeconomic and fiscal risks.[11]

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[10] The government approved new programs to address the COVID-19 crisis. 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.

[11] See Selected Issues Paper (2020), IMF.

23. The credibility of the fiscal strategy should be bolstered by a strengthening of public financial management practices. To avoid the resurfacing of arrears, the government has embarked on an action plan, to improve budget preparation, expenditure control and accounting practices. Progress is being monitored within a working group with IMF staff participation (see Annex VIII). Progress in the PFM framework should include improvements in the statistical and analytical content of fiscal reports (reflecting full accrual accounting and integrating timely information on COVID-19 spending), the presentation of NFPS consolidated financial statements, and the inclusion of fiscal risk statements in the Fiscal Strategy Report. A new law on Public Procurement (Law 153/2020) approved in September 2020 has made contracting processes more transparent, and the dedicated procurement website https://www.panamacompra.gob.pa/Inicio/#!/ now provides more comprehensive information on all types of contracts including those related to COVID-19. While the website provides information by contract on the name of the companies and their capital subscribers, the full information on beneficial owners is not always disclosed.[12] Transparency on the execution information of COVID-19 expenditure should be reinforced, and ex-post audits on it should be conducted and published.

Authorities' Views

24. The authorities are committed to fiscal discipline and are prepared to improve budgetary procedures. They are gearing their efforts towards ensuring compliance with the amended fiscal rule. To that end, they are working to develop a fiscal strategy based on enhanced revenue administration, the broadening of tax bases and the prioritization of expenditure allocations towards socially critical areas and infrastructure, while containing other spending. They also concur that this strategy should be reinforced by a robust multiannual budget framework with safeguards against arrears accumulation (including clearer sanctions). They are adopting an action plan for improving budget preparation and expenditure control and are in the process of drafting an Organic Budget Law to replace the current annual budget laws and enshrine a medium-term budget framework.

B. Financial Integrity as a Pillar of Institutional Strengthening

25. Panama has been on the Financial Action Task Force (FATF) grey list since June 2019.[13] While Panama has strengthened its legal framework, including by introducing legislation to criminalize tax evasion as a predicate offense to money laundering in 2019 , the FATF designated Panama as a "jurisdiction with strategic deficiencies" due to low levels of effectiveness identified in several immediate outcomes (IOs) on effectiveness. In response, the authorities agreed on an action

[12] For many (smaller) companies the names of the capital subscribers tend to be the same as the beneficial owner, however for other (larger) companies, it is not the case. Companies with contracts above US$500,000 are required to disclose the name of their beneficial owners to the government but the Supreme Court has ruled that the information cannot be publicly disclosed for privacy reasons. Nevertheless, the government can disclose the information on beneficial owners to the relevant agencies in case of a criminal investigation.

[13] As of February 2021, the FATF grey list includes 19 jurisdictions. FATF had placed Panama on the grey list before, from June 2014 to February 2016. Right after coming out of the grey list, the Mossack Fonseca scandal broke out in April 2016.

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) with the original timeline of implementing all the necessary reforms by September 2020 and January 2021.

26. The authorities need to promptly address the remaining items on the FATF action plan to exit the grey list. With the change of administration in July 2019, key staff with responsibility over AML/CFT issues changed, and Panama struggled to make progress in implementing the action plan as originally envisaged during the pandemic in 2020, and the agreed-upon deadlines have now expired. Nevertheless, Panama reaffirmed its commitment to implementing the remaining items in the action plan during the February 2021 FATF plenary meeting. The FATF urged the authorities to address their strategic deficiencies "as soon as possible".[14]

27. Panama has made important efforts to comply with international standards on business taxation. These include the recent ratification of the Multilateral Instrument on Base Erosion and Profit Shifting (MLI), and the implementation of the Common Reporting Standard (CRS) for automatic exchange of information. In compliance with its obligations under the CRS the government mandated financial institutions to report all relevant fiscal information to the authorities of a list of 66 countries (including the EU 27), effective September 30, 2020, while non-automatic exchanges of information are held with another 161 jurisdictions. The government has also amended various special regimes which were considered harmful by the EU. Despite this progress, in February 2021 the EU decided to keep Panama on the blacklist of non-cooperative jurisdictions for tax purposes. This reflects the fact that the Global Forum on Transparency and Exchange of Information for Tax Purposes has not yet rated Panama as "largely compliant" with the Exchange of Information on Request, with the latest review published in 2019 assessing practices in force in 2018.

28. However, outside the amended regimes, the Panamanian Tax Code is still largely based on the principle of territoriality. This prevents the authorities to tax active and passive income sources that have not been taxed abroad. The authorities are encouraged to gradually move towards a system of worldwide taxation of passive and some active incomes (such as services that residents offer online). This would allow Panama to adjust for the digitalization era and raise revenues.

Authorities' Views

29. Exiting the FATF grey list is a top priority for the Panamanian authorities, given the country's role as a regional financial center. The government hired international experts to help guide and coordinate their strategy to address the remaining action items on the FATF action plan as soon as possible, and is actively cooperating with GAFILAT, the regional arm of the FATF. The authorities indicated that they are making progress on all the Immediate Outcomes and their

[14] See Selected Issues Paper (2020) and (2019), IMF.

individual action items. The authorities are also pursuing an active communication strategy vis-à-vis the OECD and the EU on progress in the exchange of information for tax purposes, with a view to achieve a swift upgrading of the country's rating.

C. Reinforcing Resilience of the Financial Sector

30. Panama's banking system has remained resilient and well-regulated during the pandemic. Adapting the regulatory framework to the challenges of the COVID-19 shock has not been easy, especially in the context of the moratorium on servicing bank loans in effect through end-December 2020 and de facto extended in the period for further loan modification through end-June 2021. Despite these challenges, the regulatory capital adequacy ratio remained high, at 15.7 percent as of end-2020 (compared to 15.2 percent as of end-2019), against a minimum of 8 percent. Modified loans arising from such moratorium amounted to US$23 billion (40 percent of total loans). However, the impact of the modified loans on provisioning and capital adequacy is difficult to assess at this stage. While nonperforming loans have slightly increased, it is difficult to assess their eventual magnitude given the repayment deferments. Only after the end of the moratorium/modification (June 2021), a clearer picture of the financial condition of banks and their clients will emerge. The delinquency rate of domestic loans stood at 4.5 percent at end-March 2021, compared to 4.4 percent at end-2019. Against that background, an ad hoc regulatory requirement mandated banks to create a provision equivalent to 3 percent of the gross modified loan portfolio, helping to increase total loan-loss provision to 148 percent of NPL in 2020 (from 102 percent of NPL in 2019). Banks had made provision of 3.5 percent of the gross modified loan portfolio, on average. Higher provisioning and a decline in net interest margin led to a decline in returns on equity, to 6.5 percent in 2020 (from 15.3 percent in 2019).

31. The financial system is still vulnerable to unanticipated shocks. Banks face risks from exposures to the real estate sector which could translate into rising NPLs. Under an adverse scenario, particularly from a resurgence of the COVID-19 pandemic, bank liquidity could dry up (despite the creation of the FES in 2020). Corporations may also face difficulties rolling over external liabilities forcing them to run down deposits in the financial system to meet their external obligations. In addition, banks could face a sudden reversal in their external position if correspondent banking relationships were to be interrupted. An inter-sectoral balance sheet analysis shows that net claims from the external sector on banks (mostly foreign deposits) amounted to 2.5 percent of GDP in 2019 (Annex IX), indicating that large-scale deposit withdrawals by foreigners could adversely affect liquidity in the banking system. A recent stress test by the SBP which assumed a slow recovery in 2021 showed that the delinquency rate could increase to 14.8 percent and an additional provisioning of 6 to 7 percent of the gross modified loan portfolio could be required for loans under the moratorium. The average capital adequacy ratio could decline to 13 percent (from 15.7 percent at end-2020). Smaller banks (with assets of up to US$1 billion) are most affected, but their capital adequacy ratio, on average, would remain above the regulatory threshold.[15]

[15] See Selected Issues Paper (2020), IMF.

32. The financial system should remain under tight supervision. Given the large share of modified loans, a risk-focused loan portfolio examination of all banks, including an assessment of fundamental asset quality, once the pandemic recedes would help assess banks' credit exposures and capital buffers. The SBP's resolute commitment in adhering to Basel III supervisory standards is commendable. Staff encourages the authorities to continue phasing-in the Basel III liquidity coverage ratio (LCR), and implement the net stable funding ratio (NSFR), once the COVID crisis is over.[16] At the same time, the SBP should further strengthen its capacity to effectively conduct AML/CFT supervision, systemic risk monitoring and stress testing, and put in place robust cybersecurity and fintech regulatory frameworks to bolster confidence in the financial system and foster innovation, mitigate current and future risks, and support CBRs.

33. Phasing out debt relief measures is necessary as the pandemic recedes. To provide relief to borrowers affected by the pandemic, the authorities established a formal moratorium on servicing bank loans until December 31, 2020, and allowed an extended period of loan modification through June 30, 2021, to all physical and legal persons economically affected by the national emergency. Considering the elevated credit risk from restructured exposures in view of still-high unemployment (which may lead to increasing NPLs), the SBP has advised banks to be prepared to increase their provisioning beyond the required level during normal times**.** They see merit in reestablishing the entrenched culture of loan repayment by clients and proper provisioning by banks but remain vigilant to deal with special cases to safeguard financial stability. Some banks are building additional buffers by increasing their ad hoc provisioning on modified loans.

34. Developing macroprudential tools and further upgrading the regulatory framework will mitigate a build-up of vulnerabilities. To fortify financial stability post-pandemic, the authorities could formalize a crisis management plan, implement key Basel III capital conservation buffers, introduce additional capital requirements for systemically important banks, and expand the macroprudential policy toolkit.[17] The authorities are in the process of drafting a bill on banking resolution for troubled banks (with the support of IMF technical assistance). The regulatory-supervisory approach for 2021–23 will focus on implementing the capital conservation buffer, treatment of interest rate risk in the banking book, enhancing stress testing and the Internal Capital Adequacy and Assessment (ICAAP) process, and corporate governance.[18]

Authorities' Views

35. The authorities concurred that the financial system remains sound and are committed to continuing their efforts to fortify the regulatory oversight. They expressed concerns that 2021 will remain challenging despite the availability of COVID-19 vaccines. As such, they

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[16] Panama implemented Basel III capital adequacy rules in 2018. However, the capital conservation buffer and the countercyclical buffer have not yet been adopted.

[17] See Selected Issues Paper, (2020), IMF.

[18] Three IMF technical assistance missions have been scheduled for 2021 covering Basel III standards and supervisory-regulatory practices, risk assessment and stress testing, and macroprudential policy framework and tools.

stressed the importance for banks to continually adjust their stress testing and provisioning models to ensure that risks are adequately captured and reflected in capital positions. Further, they highlighted that intensive supervision and monitoring of banks, particularly on the health of the modified loans, will continue along with internal stress tests. They also indicated that the loan moratorium following the onset of the pandemic is not expected to be extended beyond June 30, 2021. Additionally, they are collaborating with other member countries to develop a national and regional crisis management plan. The authorities reiterated their commitment to implement additional macroprudential policies, where necessary, to safeguard financial stability. They have plans to implement the Basel III capital conservation buffer.

D. Improving Statistics

36. Panama has a sound macroeconomic statistical system that could be further strengthened in some areas. Key macroeconomic data programs will benefit from further consultation with users and communication across data producing agencies. Completing the updates to the national accounts benchmark and CPI weights will support better surveillance and benefit data users.

37. Additional investment would help improve Panama's data dissemination practices to subscribe to the Special Data Dissemination Standard (SDDS) and support surveillance. Panama having access to capital markets makes more relevant the SDDS goal to guide countries in the dissemination of economic and financial data to the public. Building on Panama's dissemination experience with the e-GDDS (since 2000) some improvements in timeliness and periodicity as well as coverage of a few data categories will support Panama's subscription.

Authorities' Views

38. The authorities have embraced the recommendations of the ROSC and are committed to statistical improvement, including subscription to the SDDS by 2022. 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), increasing INEC resources, and strengthening of the National Statistical Council to improve coordination and oversee the statistical reform. With increased efforts and resources, Panama should meet SDDS requirements by 2022. Resource planning will be critical to tackle these plans in a timely manner in addition to the ongoing Census and GDP rebasing.

STAFF APPRAISAL

39. The economy is poised to rebound strongly in 2021. The recovery will be broad-based and supported by full-scale copper production and higher private demand. Key risks include delays in addressing the FATF recommendations and improving the AML/CFT and tax transparency frameworks; increase in NPLs prompted by the loan moratorium; setbacks in fiscal consolidation which jeopardizes market confidence and sovereign credit rating; and re-emergence of the pandemic triggered by new virus strains or short effectiveness of vaccines.

40. Sustained fiscal discipline is required to keep public debt on a downward trajectory. Staff welcomes the recently amended fiscal rule which enshrines a path of gradual fiscal consolidation towards a medium-term deficit anchor of 1½ percent of GDP and provides a margin for countercyclical policies in the short run. Adherence to this path would keep public debt on a sustainable path, with a steady decline of debt to GDP from its peak in 2020 (64 percent of GDP) to 56½ percent in 2026.

41. Strengthening the fiscal framework is essential to improving the credibility of the fiscal strategy. Action on the PFM front should aim to prevent the resurfacing of arrears and bolster fiscal transparency. Staff welcomes the authorities' commitment to implement an action plan to enhance budgeting, expenditure control and accounting practices. Staff assigns great importance to the publication of the time series of fiscal balances adjusted by past unrecorded and accrued arrears, as well as the associated liabilities.

42. Exiting the FATF grey list must remain a priority. Staff reiterated the need to expediently address the remaining deficiencies in the action plan to further strengthen the effectiveness of Panama's AML/CFT regulatory framework identified by the FATF. Specifically, priority commitments include addressing national and sectoral ML/TF risks, supervision, and sanctions against AML/CFT violations, verification and update of beneficial ownership information of legal persons and arrangements, and investigation and prosecution of ML involving foreign tax crimes.

43. The financial sector remains resilient, but tight supervision and monitoring are needed to safeguard stability. The regulatory forbearance granted on loans following the pandemic should be restricted to categories set out explicitly and phased out, with a supervisory action plan and close monitoring. The ad hoc provisioning requirement on modified loans should continually be recalibrated in line with evolving circumstances. A risk-focused loan portfolio examination of all banks, including an assessment of fundamental asset quality, once the pandemic recedes would help assess banks' credit exposures and capital buffers, given the large share of modified loans.

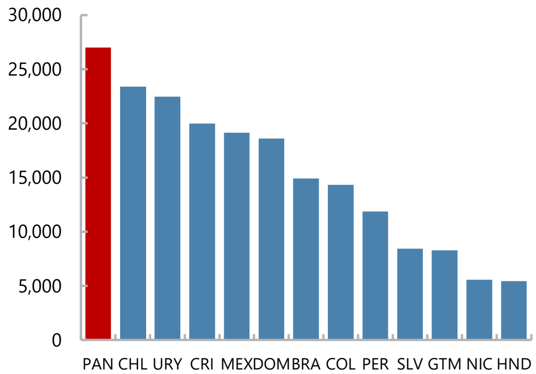
44. Addressing social inequities with budgetary resources is urgent. Staff supports the government's long-term goals of enhancing the efficiency of spending, particularly in health education and social areas, and prioritizing country-appropriate and fiscally-sustainable strategies to reduce inequality, improve living conditions in the *comarcas* (areas inhabited by indigenous populations), and enhance women's economic opportunities.

45. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 1. Panama: Socio-Economic Indicators

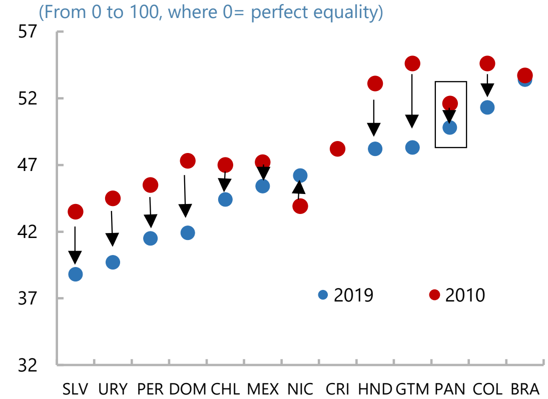
Per capita income is the highest in Latin America…

PPP GDP Per Capita, 2020 1/
(In PPP dollars)



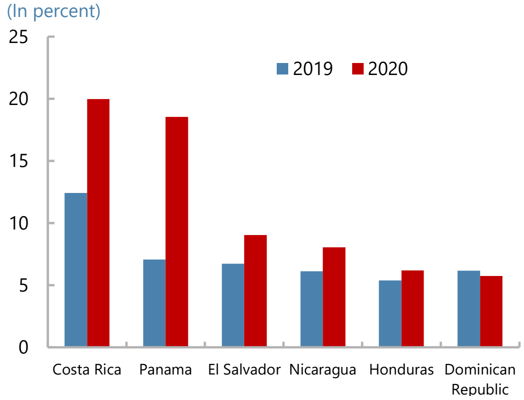
…but inequality remains high relative to regional peers.

GINI Index 2/
(From 0 to 100, where 0= perfect equality)



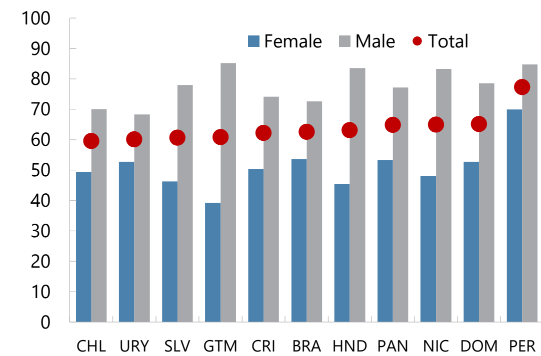
Unemployment has increased drastically due to the pandemic.

Unemployment Rate
(In percent)



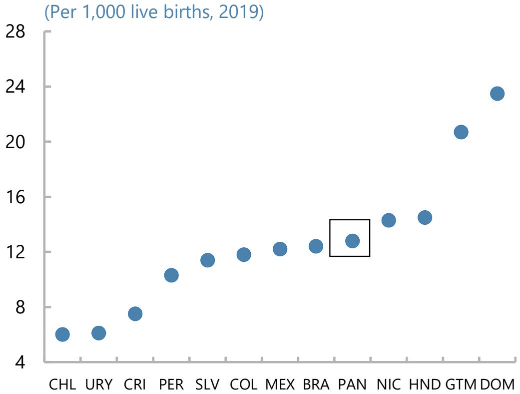
Pre-pandemic, labor force participation rates were in line with regional peers.

Labor Force Participation 3/
(In percent of population ages 15+, 2019)



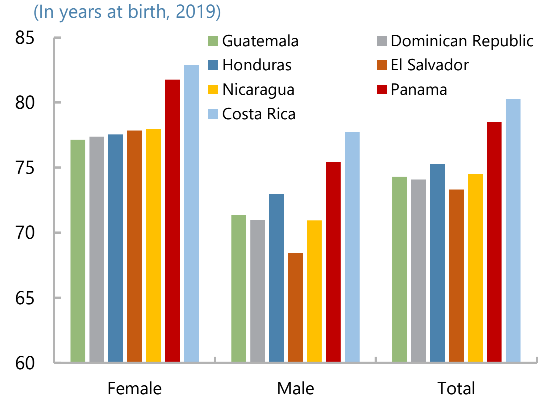
Infant mortality is comparable to regional peers, but…

Infant Mortality Rate
(Per 1,000 live births, 2019)



…life expectancy is higher than in most comparator countries.

Life Expectancy
(In years at birth, 2019)

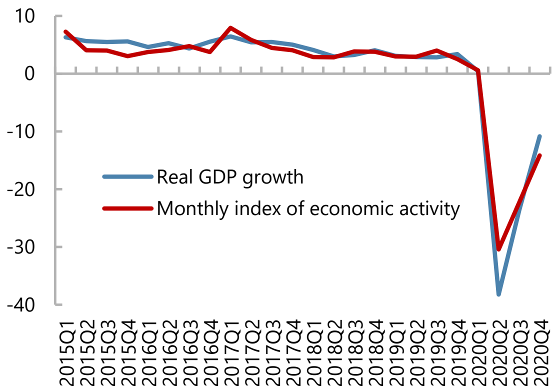


Sources: World Economic Outlook, World Bank, World Development Indicators, and IMF staff calculations.
1/ LA6 (Brazil (BRA), Chile (CHL), Colombia (COL), Mexico (MEX), Peru (PER) and Uruguay (URY)) and CAPDR (Costa Rica (CRI), Honduras (HND), Nicaragua (NIC), El Salvador (SLV), Dominican Republic (DOM), Guatemala (GTM), and Panama (PAN)).
2/ For 2010, data for NIC, CHL and BRA is from 2009 and GTM is from 2006. For 2019, NIC and GTM is from 2014, CHL to 2017 and MEX to 2018.
3/ Data for GTM is from 2017 and for NIC is from 2014.

Figure 2. Panama: Real Sector Developments

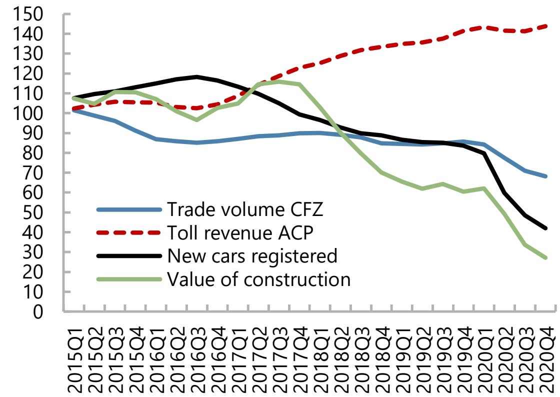
The economic contraction was sharp and especially drastic in Q2-2020

Economic Activity
(Percent; year-over-year)



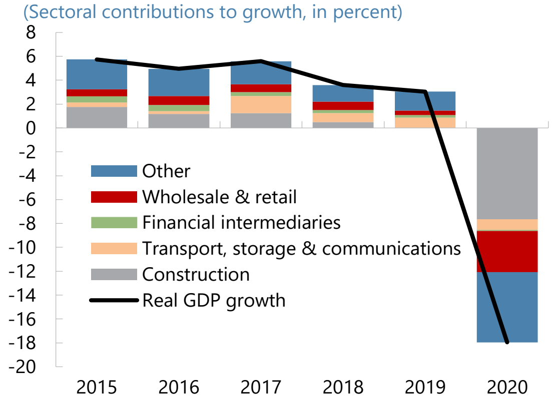
...amid plummeting construction sector activity and continued weakness in the CFZ.

High-Frequency Indicators [1/]
(Index 2014Q1=100)



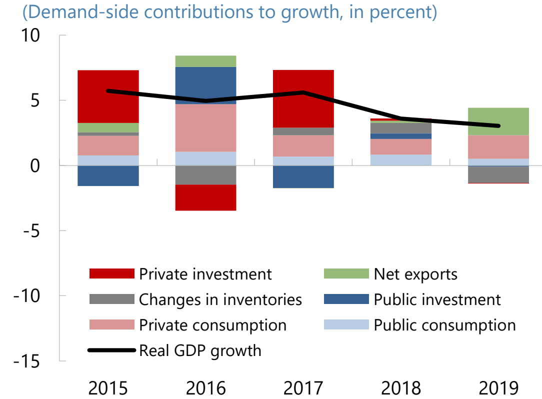
All sectors (but mining) experienced a contraction in 2020, with construction contributing the most.

Real GDP Growth
(Sectoral contributions to growth, in percent)



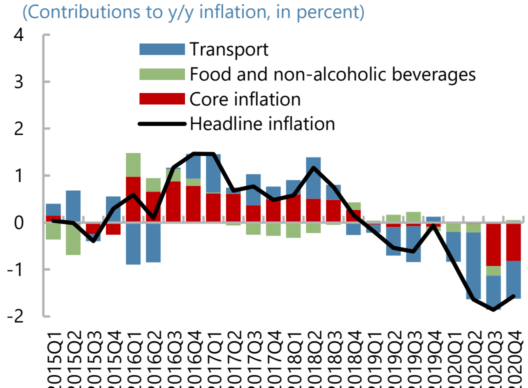
Before the pandemic, investment was already weak, with consumption and exports propelling growth.

Real GDP Growth
(Demand-side contributions to growth, in percent)



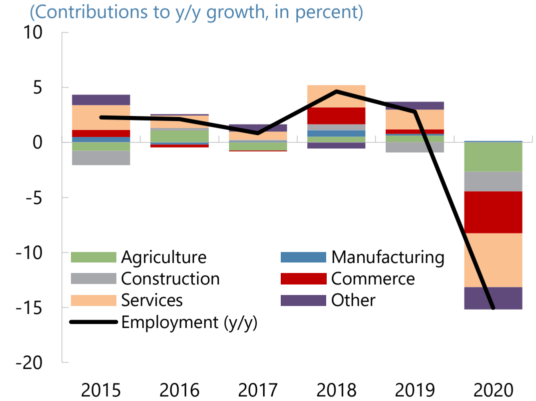
Prices were soft in 2020, reflecting weak demand.

Inflation
(Contributions to y/y inflation, in percent)



Employment growth has collapsed, with the services sector being affected the most.

Employment Growth
(Contributions to y/y growth, in percent)

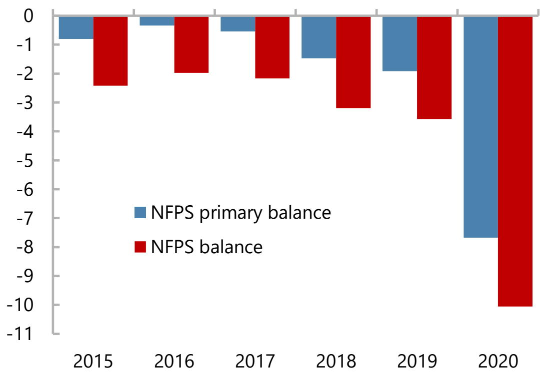


Sources: National authorities and IMF staff calculations.
1/ 4-quarter moving averages. Zona Libre de Colon (ZLC) measured in gross metric tons.

Figure 3. Panama: Fiscal Developments

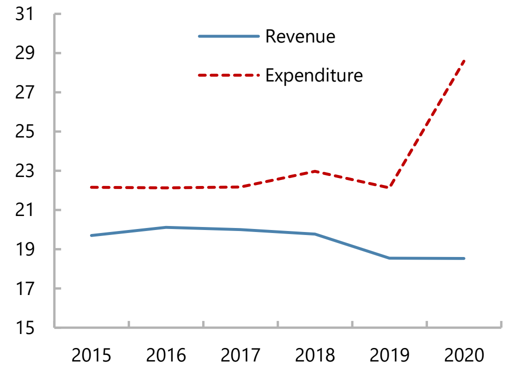
The fiscal deficit sharply rose as a result of the pandemic …

Fiscal Balances 1/
(In percent of GDP)



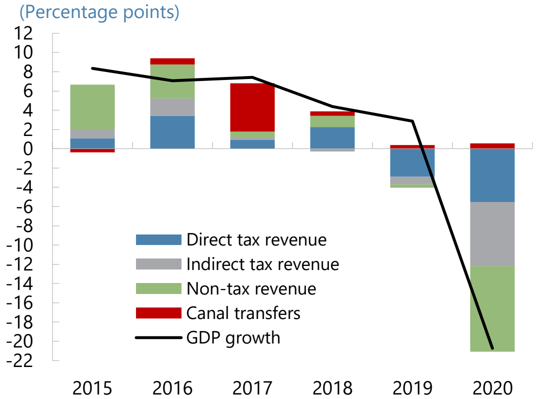
… reflecting strong denominator effects on the expenditure side and a loss of revenue.

Revenue and Expenditure 1/
(In percent of GDP)



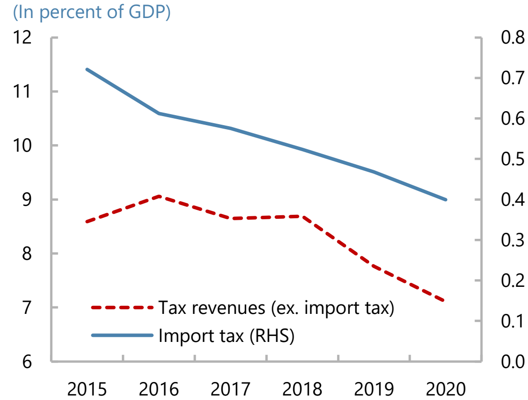
Low tax revenue explains most of the revenue decline…

Revenue Contribution 2/
(Percentage points)



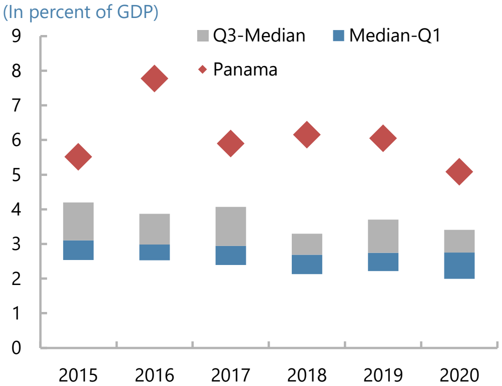
…and challenges in tax and customs administration, and tax exceptions continue to affect tax and tariff collection.

Tax Revenues
(In percent of GDP)



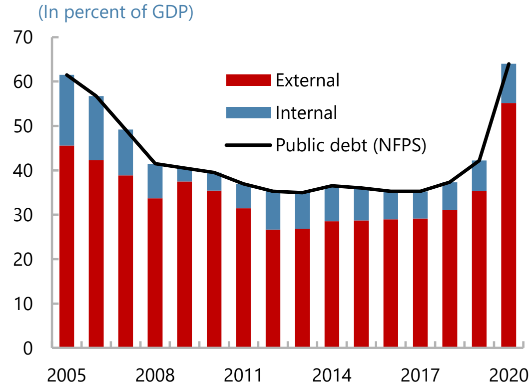
Public investment had to be moderated to accommodate COVID related spending.

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



Public debt increased by more than 20 percent of GDP, reflecting higher deficit and the denominator effect.

Public Debt
(In percent of GDP)

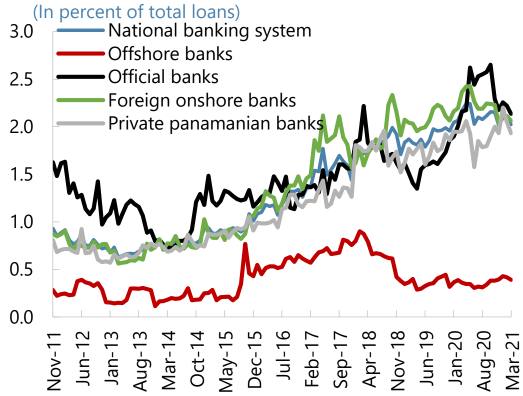


Sources: National Authorities, World Economic Outlook and IMF staff calculations.
1/ Non-Financial Public Sector.
2/ Data refer to the Central Government.
3/ Countries in the chart are CAPDR (Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica, Panama and Dominican Republic) and LA6 (Brazil, Chile,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

Figure 4. Panama: Banking Sector Soundness

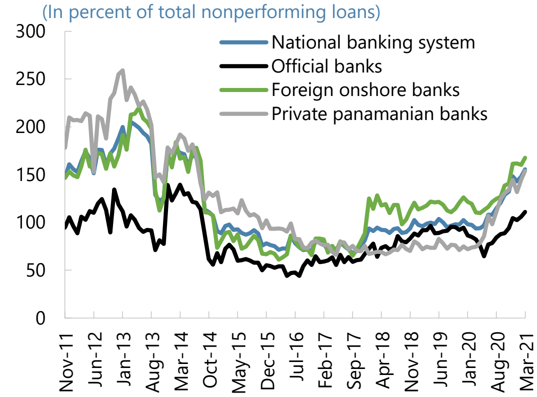
NPLs rose following weakness in the economy…

Nonperforming Loans
(In percent of total loans)



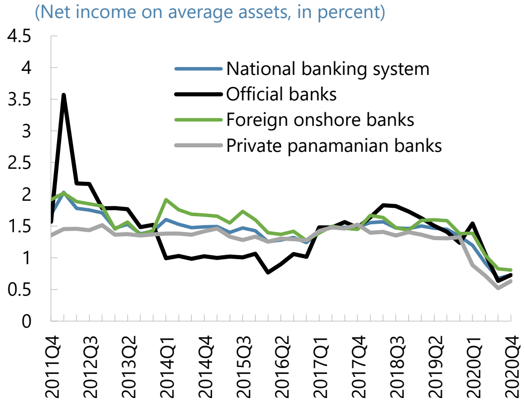
… loan-loss provisioning increased with the adoption of stricter provisioning requirements.

Provisioning
(In percent of total nonperforming loans)



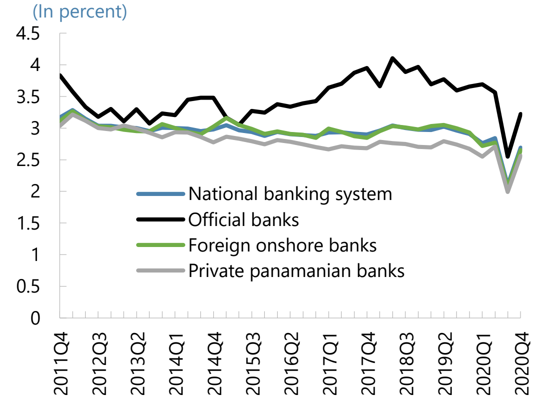
Profitability declined amidst challenging operating environment and higher provisioning…

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



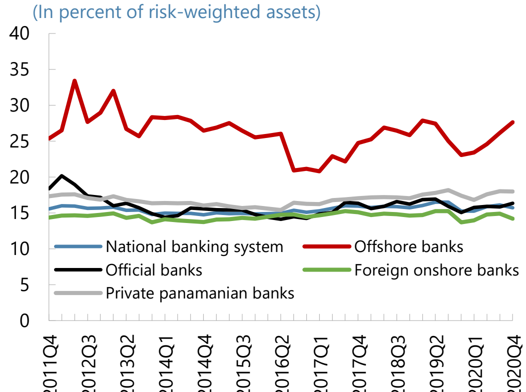
…while net interest margins declined slightly.

Net Interest Margin
(In percent)



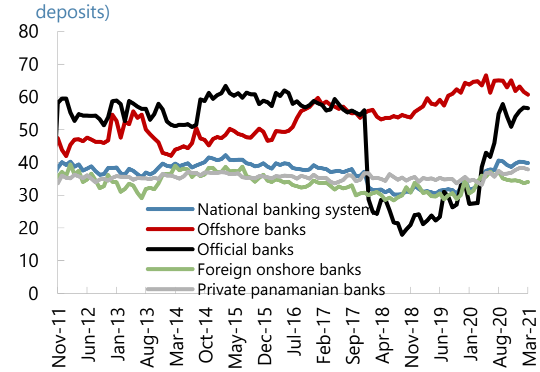
Banks' capital adequacy remains above regulatory minimum.

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



.. while liquidity increased and remained ample.

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

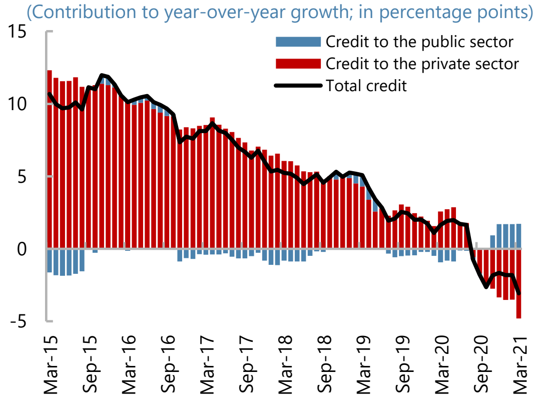


Sources: SBP and IMF staff calculations.

Figure 5. Panama: Macrofinancial Developments

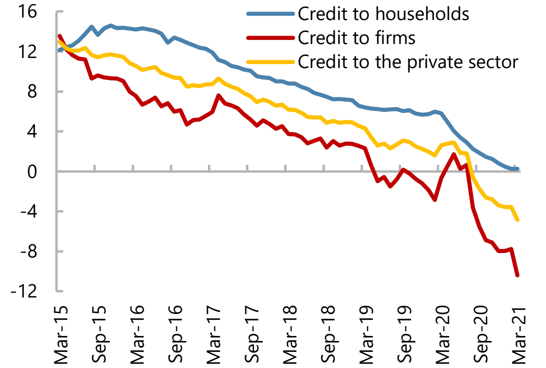
Credit growth slowed significantly in 2020, driven mostly by weak lending to the private sector …

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



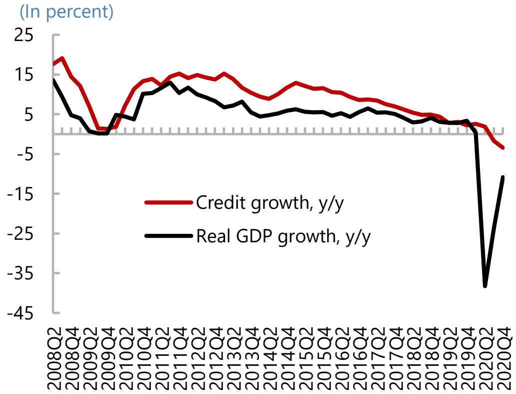
…particularly lending to nonfinancial corporates.

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



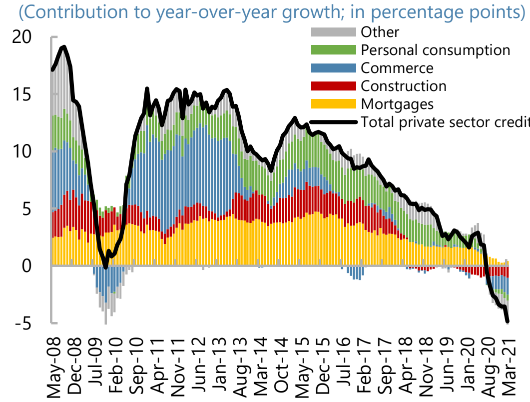
Private sector credit continued to evolve in line with the deterioration in economic activity…

Growth of Credit to the Private Sector
(In percent)



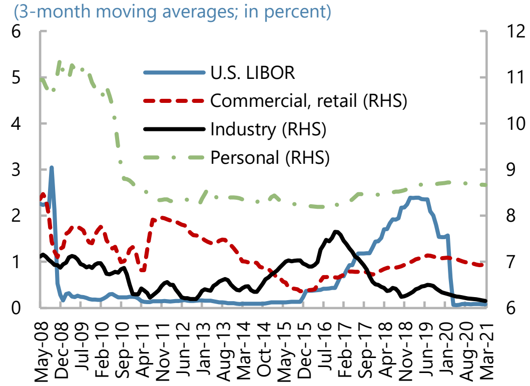
… the credit deceleration in 2020 was largely driven by commerce and construction.

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



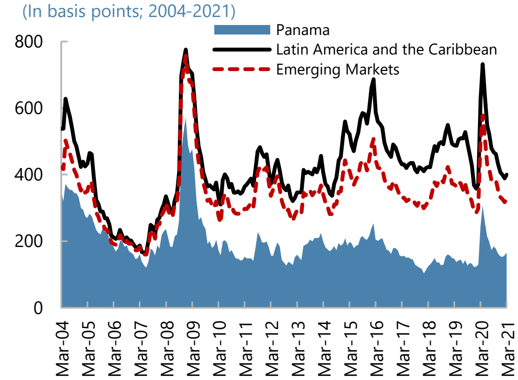
Domestic interest rates declined slightly…

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



…while sovereign spreads remained among the lowest in the region.

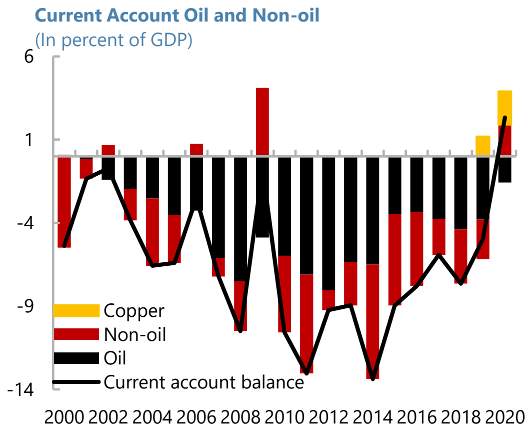
EMBIG Spreads
(In basis points; 2004-2021)



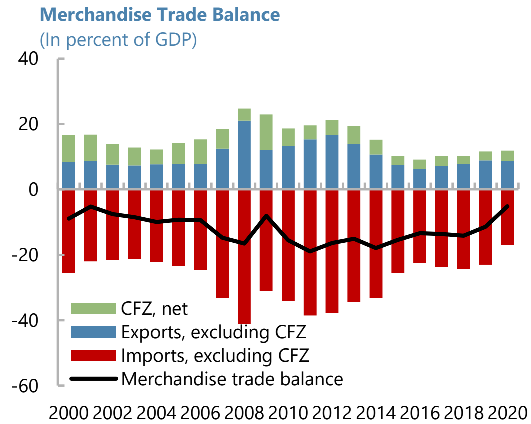
Sources: SBP, INEC, U.S. Federal Reserve, Bloomberg and IMF staff calculations.

Figure 6. Panama: External Sector Developments

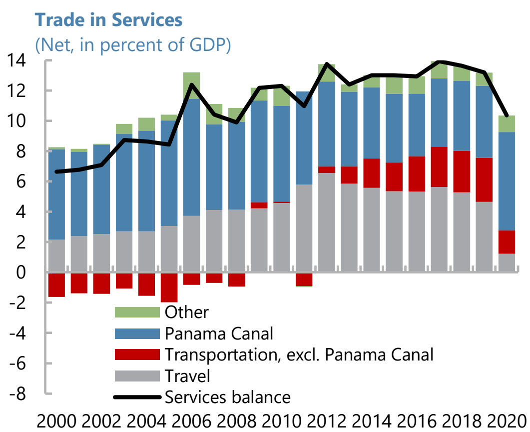
The CA deficit has improved considerably, on the back of higher copper exports and lower oil prices…



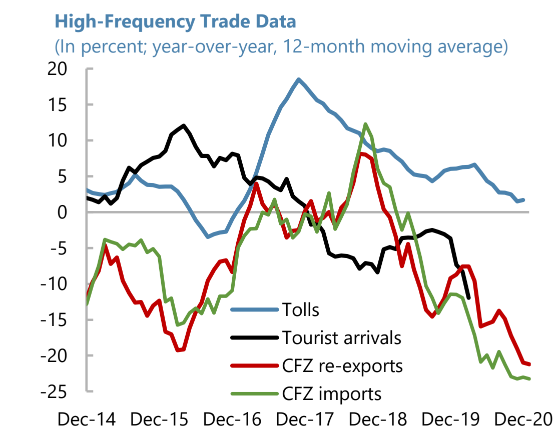
…which reduced the merchandise trade deficit.



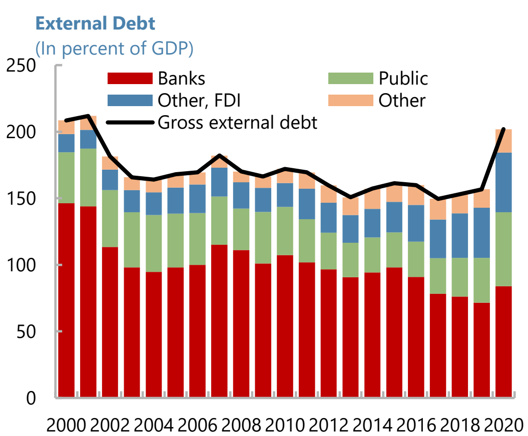
Weak tourism and air travel reduced service exports, …



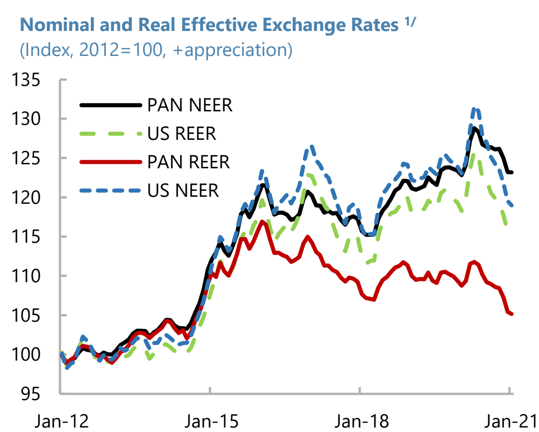
… while the canal revenue remained resilient, and the decline in CFZ re-exports was offset by a decline in imports.



External debt ticked up amid high public debt issuance and a GDP denominator effect.



The REER depreciated in 2020 relative to 2019, amid low inflation in Panama relative to peers.



Sources: IMF World Economic Outlook; INEC and IMF staff calculations.
1/ Panama's NEER and REER exclude Venezuela.

Table 1. Panama: Selected Economic and Social Indicators, 2016–26

Population (millions, 2020)	4.3	Poverty line (percent, 2017)	20.7
Population growth rate (percent, 2020)	1.4	Adult literacy rate (percent, 2018)	95.4
Life expectancy at birth (years, 2018)	78.3	GDP per capita (US$, 2020)	12,373
Total unemployment rate (Sep, 2020)	18.5	IMF Quota (SDR, million)	376.8

					Est.	Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					(Percent change)						
Production and prices											
Real GDP (2007 prices)	**5.0**	**5.6**	**3.6**	**3.0**	**-17.9**	**12.0**	**5.0**	**5.0**	**5.0**	**5.0**	**5.0**
Consumer price index (average)	0.7	0.9	0.8	-0.4	-1.6	0.2	1.1	2.0	2.0	2.0	2.0
Consumer price index (end-of-year)	1.5	0.5	0.2	-0.1	-1.6	0.5	2.0	2.0	2.0	2.0	2.0
Output gap (% of potential)	0.0	2.4	4.4	7.3	-14.2	-6.3	-4.3	-2.3	-0.3	0.0	0.0
Demand components (at constant prices)											
Public consumption	**10.1**	**6.4**	**7.7**	**4.5**	**19.1**	**6.2**	**-11.2**	**-0.6**	**-0.1**	**0.4**	**3.3**
Private consumption	7.1	3.1	2.3	3.6	-15.7	12.3	4.5	2.8	4.0	4.8	4.5
Public investment 1/	49.0	-20.7	6.9	-1.6	-19.7	4.0	3.0	12.3	6.1	2.7	4.1
Private investment	-5.5	14.9	-0.4	-2.8	-40.0	33.7	12.4	6.8	7.1	6.2	6.7
Exports	-4.3	5.0	5.1	-0.1	-28.3	15.3	11.0	9.3	7.5	8.4	7.0
Imports	-4.8	4.3	4.1	-3.3	-34.0	34.0	6.5	6.9	5.7	6.9	8.6
Financial sector											
Private sector credit	**8.4**	**6.5**	**4.5**	**2.4**	**-2.6**	**12.3**	**6.1**	**7.1**	**7.1**	**7.1**	**7.1**
Broad money	4.2	5.2	2.8	2.3	9.5	15.2	7.1	8.1	8.2	8.2	8.2
Average deposit rate	1.6	1.6	1.8	2.1	1.9	1.6	1.6	1.6	1.6	2.0	2.0
Average lending rate	7.8	7.9	7.7	7.9	7.8	6.2	6.2	6.2	6.2	6.6	6.6
					(In percent of GDP)						
Saving-investment balance											
Gross domestic investment	**40.5**	**41.7**	**41.5**	**39.3**	**28.5**	**32.5**	**34.3**	**35.1**	**35.8**	**36.0**	**36.4**
Public sector	7.8	5.9	6.2	6.0	5.3	5.0	4.9	5.2	5.3	5.1	5.1
Private sector	32.7	35.8	35.3	33.2	23.2	27.6	29.5	29.9	30.5	30.8	31.3
Gross national saving	32.7	35.8	33.8	34.3	30.9	29.1	31.0	32.1	33.0	33.4	33.9
Public sector	3.9	4.2	4.2	2.7	-4.1	-2.8	1.2	1.9	2.7	3.5	3.9
Private sector	28.8	31.6	29.6	31.6	35.0	31.9	29.8	30.2	30.3	29.9	30.0
Public finances 1/											
Revenue and grants	**22.6**	**22.0**	**22.0**	**20.9**	**21.8**	**22.6**	**23.1**	**23.7**	**24.1**	**24.2**	**24.2**
Expenditure	24.8	24.2	24.9	24.1	30.7	29.3	26.4	26.3	25.8	25.2	25.0
Current, including interest	16.7	17.0	17.2	17.6	25.3	24.4	21.6	21.1	20.5	20.1	19.9
Capital	8.0	6.9	6.6	5.8	5.3	5.0	4.9	5.2	5.3	5.1	5.1
Overall balance, including ACP	-2.2	-2.2	-2.9	-3.2	-8.9	-6.7	-3.3	-2.6	-1.7	-1.1	-0.8
Overall balance, excluding ACP	-2.0	-2.2	-3.2	-3.6	-10.1	-7.4	-4.0	-3.0	-2.0	-1.5	-1.5
Total public debt											
Debt of Non-Financial Public Sector 2/	**35.3**	**35.3**	**37.3**	**42.2**	**64.0**	**62.9**	**62.5**	**61.7**	**60.2**	**58.3**	**56.4**
External	28.5	28.7	30.6	35.3	55.1	54.2	54.4	54.4	53.5	52.1	50.7
Domestic	6.8	6.6	6.7	6.9	8.9	8.7	8.1	7.3	6.7	6.1	5.7
Debt of ACP	4.7	4.4	4.2	3.8	4.3	3.5	2.9	2.4	1.9	1.5	1.1
Other 3/	3.8	3.4	4.2	4.1	5.2	4.6	4.4	4.1	3.8	3.5	3.3
External sector											
Current account	**-7.8**	**-5.9**	**-7.6**	**-5.0**	**2.3**	**-3.4**	**-3.3**	**-3.1**	**-2.8**	**-2.6**	**-2.5**
Net exports from Colon Free Zone	2.9	3.0	2.5	2.7	3.2	2.7	2.8	2.9	2.9	3.1	3.2
Net oil imports	3.4	3.8	4.4	3.8	1.6	2.2	2.1	1.9	1.9	1.8	1.8
Net foreign direct investment inflows	7.9	6.9	7.6	5.5	1.2	4.0	6.4	7.0	6.9	7.1	7.1
External Debt	159.9	149.6	153.0	156.8	201.9	186.3	185.3	182.7	178.8	176.8	175.2
Memorandum items:											
GDP (in millions of US$)	57,908	62,203	64,928	66,788	52,938	59,447	63,084	67,563	72,360	77,498	83,000

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, 2016–26 [1]
(In percent of GDP)

					Est.	Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Non-Financial Public Sector						
Revenues	**20.1**	**20.0**	**19.8**	**18.5**	**18.5**	**19.6**	**20.1**	**20.7**	**21.0**	**21.1**	**21.2**
Current revenue	20.1	20.0	19.8	18.6	18.6	19.2	20.2	20.6	21.0	21.1	21.2
Tax revenue	9.7	9.2	9.2	8.2	7.5	8.2	8.9	9.2	9.5	9.7	9.8
Nontax revenue	3.4	4.5	4.4	4.3	4.8	4.5	4.7	4.7	4.7	4.7	4.7
o/w: Panama Canal fees and dividends	1.8	2.6	2.6	2.6	3.5	3.0	3.1	3.1	3.1	3.1	3.1
Social security agency	5.8	5.7	5.6	5.6	5.8	5.8	5.7	5.7	5.7	5.7	5.7
Public enterprises' operating balance	0.1	0.0	0.0	0.0	-0.1	0.1	0.2	0.2	0.2	0.2	0.2
Other [2/]	1.0	0.5	0.5	0.5	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
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**	**22.2**	**23.0**	**22.1**	**28.6**	**27.0**	**24.2**	**23.7**	**23.0**	**22.7**	**22.7**
o/w COVID-19 related expenditure					3.0	2.2	0.0	0.0	0.0	0.0	0.0
Current primary expenditure	13.5	13.6	13.7	14.1	20.8	19.5	17.0	16.7	16.2	15.9	15.8
Central government [3/]	7.9	8.0	8.1	8.2	13.2	11.8	9.5	9.3	9.0	8.8	8.8
Rest of the general government	5.6	5.6	5.6	5.9	7.6	7.7	7.5	7.4	7.2	7.1	7.0
Social security agency	5.1	5.2	5.2	5.4	7.0	7.1	7.0	6.9	6.7	6.6	6.6
Decentralized agencies	0.4	0.4	0.4	0.4	0.6	0.6	0.5	0.5	0.5	0.4	0.4
Interest	1.7	1.7	1.8	1.9	2.7	3.1	2.6	2.5	2.4	2.3	2.1
Capital	6.7	6.5	6.3	5.5	5.1	4.3	4.5	4.5	4.5	4.6	4.8
Accrued spending [4/]	0.2	0.3	1.2	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance [5/]	**-2.0**	**-2.2**	**-3.2**	**-3.6**	**-10.1**	**-7.4**	**-4.0**	**-3.0**	**-2.0**	**-1.5**	**-1.5**
Net financing [6/]	**1.7**	**2.8**	**4.5**	**4.4**	**4.8**	**7.4**	**4.0**	**3.0**	**2.0**	**1.5**	**1.5**
External	2.1	2.1	3.1	5.1	10.5	4.3	3.4	3.6	2.7	2.1	2.0
Domestic	-0.5	0.8	1.4	-0.7	-5.7	3.1	0.7	-0.6	-0.7	-0.6	-0.5
					Panama Canal Authority (ACP)						
Revenue	**4.3**	**4.6**	**4.8**	**5.0**	**6.7**	**6.0**	**6.1**	**6.2**	**6.2**	**6.2**	**6.1**
Expenditure	**4.6**	**4.7**	**4.6**	**4.6**	**5.6**	**5.3**	**5.4**	**5.8**	**5.9**	**5.7**	**5.4**
Current primary expenditure	1.4	1.5	1.6	1.5	1.8	1.7	1.9	1.9	1.9	2.0	2.0
Transfers to the government	1.8	2.6	2.6	2.6	3.5	3.0	3.1	3.1	3.1	3.1	3.1
Interest payments	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	1.3	0.4	0.3	0.3	0.2	0.6	0.4	0.7	0.8	0.6	0.3
Overall balance	**-0.3**	**-0.1**	**0.2**	**0.4**	**1.2**	**0.6**	**0.7**	**0.4**	**0.3**	**0.5**	**0.7**
					Consolidated Non-Financial Public Sector						
Overall balance (incl. ACP)	**-2.2**	**-2.2**	**-2.9**	**-3.2**	**-8.9**	**-6.7**	**-3.3**	**-2.6**	**-1.7**	**-1.1**	**-0.8**
Memorandum items:											
Primary balance (excl. ACP)	-0.3	-0.5	-1.5	-1.9	-7.7	-4.5	-1.7	-0.8	0.1	0.5	0.4
Structural primary balance (excl. ACP) [7/]	-0.4	-1.0	-2.3	-3.2	-4.7	-3.3	-0.8	-0.3	0.2	0.5	0.4
Primary balance (incl. ACP)	-0.4	-0.4	-1.0	-1.2	-6.1	-3.6	-0.6	-0.1	0.6	1.2	1.3

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Official presentation excludes the operations of the ACP as it is not part of the NFPS.
2/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies.
3/ Different from Table 3 as it excludes the transfers to other agencies.
4/ 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 financing operations.
7/ Primary balance adjusted for the output gap.

Table 3. Panama: Summary Operations of the Central Government, 2016–26
(In percent of GDP)

					Est.	Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Revenues and grants	**13.3**	**14.0**	**13.9**	**12.7**	**12.5**	**13.3**	**13.9**	**14.2**	**14.5**	**14.7**	**14.7**
Current revenue	13.3	13.9	13.9	12.7	12.5	12.9	13.9	14.2	14.5	14.7	14.7
Taxes	9.7	9.2	9.2	8.2	7.5	8.2	8.9	9.2	9.5	9.7	9.8
Direct taxes	5.1	4.9	5.1	4.4	4.3	4.5	4.8	4.9	5.1	5.1	5.2
Income tax	4.6	4.4	4.6	4.0	3.9	4.1	4.3	4.4	4.6	4.6	4.7
Tax on wealth	0.5	0.5	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Indirect taxes	4.6	4.3	4.1	3.8	3.2	3.7	4.1	4.3	4.5	4.6	4.6
Import tax	0.6	0.6	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
ITBMS	2.6	2.5	2.3	2.2	1.8	2.1	2.3	2.5	2.7	2.7	2.7
Petroleum products	0.5	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Other tax on domestic transactions	0.9	0.8	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.8	0.9
Nontax revenue	3.6	4.7	4.6	4.5	5.0	4.7	4.9	5.0	5.0	5.0	5.0
Dividends	1.5	2.3	2.4	2.2	2.8	2.5	2.7	2.7	2.7	2.7	2.7
Of which : Panama Canal Authority	1.2	1.9	1.8	1.8	2.4	2.1	2.3	2.3	2.3	2.3	2.3
Panama Canal Authority: fees per ton 1/	0.7	0.7	0.8	0.8	1.0	0.8	0.8	0.9	0.9	0.9	0.9
Transfers from decentralized agencies	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other	0.9	1.2	1.0	1.0	0.8	1.1	1.1	1.1	1.1	1.1	1.1
Capital revenue	0.1	0.1	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0
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	**17.5**	**17.5**	**17.5**	**17.5**	**22.4**	**19.9**	**18.1**	**17.3**	**16.6**	**16.2**	**16.2**
o/w COVID-19 related expenditure					3.0	2.2	0.0	0.0	0.0	0.0	0.0
Current	10.7	10.9	11.0	11.3	17.2	16.3	13.8	13.0	12.4	11.9	11.7
Wages and salaries	4.3	4.6	4.7	4.8	6.3	5.7	5.6	5.4	5.2	5.0	5.0
Goods and services	1.3	1.4	1.2	1.2	1.7	1.4	1.2	1.2	1.2	1.1	1.1
Current expenditure of CSS	0.5	0.6	0.6	0.7	0.6	0.9	1.1	1.0	0.9	0.7	0.7
Transfers to public and private entities	2.8	2.7	2.7	2.8	6.0	5.2	3.2	2.9	2.8	2.7	2.7
Interest	1.7	1.7	1.8	1.9	2.7	3.1	2.6	2.5	2.4	2.3	2.1
Domestic	0.3	0.4	0.3	0.4	0.5	0.6	0.5	0.5	0.4	0.4	0.4
External	1.4	1.4	1.4	1.5	2.1	2.5	2.1	2.0	2.0	1.8	1.8
Capital	6.5	6.1	5.8	5.5	5.2	3.7	4.3	4.3	4.2	4.3	4.6
Accrued spending 2/	0.3	0.4	0.8	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings 3/	2.6	3.0	2.9	1.4	-4.7	-3.4	0.1	1.2	2.1	2.8	3.1
Overall balance 4/	**-4.1**	**-3.6**	**-3.7**	**-4.8**	**-9.9**	**-6.7**	**-4.2**	**-3.1**	**-2.1**	**-1.5**	**-1.5**
Financing (net) 5/	2.6	3.3	4.4	3.4	7.0	6.7	4.2	3.1	2.1	1.5	1.5
External	2.1	2.4	3.3	5.5	10.5	4.3	3.4	3.6	2.7	2.1	2.0
Of which : Multilateral lenders	1.2	1.5	1.4	1.2	4.7	2.8	1.3	1.2	1.1	1.0	1.0
Of which : Private creditors	1.7	2.4	2.7	4.9	9.0	4.1	2.9	3.7	4.5	3.9	3.3
Of which : Other lenders	-0.8	-1.5	-0.7	-0.7	-3.2	-2.7	-0.8	-1.3	-2.9	-2.8	-2.2
Domestic	0.5	0.9	1.0	-2.1	-3.4	2.4	0.9	-0.4	-0.6	-0.6	-0.5
Of which: Net credit from banks	-0.4	-0.3	0.5	-2.2	-3.4	1.3	1.0	0.3	0.1	0.0	0.0
Of which: Net credit from non-banks	0.6	0.8	-0.3	1.6	-0.1	1.0	-0.1	-0.2	-0.2	-0.1	0.0
Of which: Other lenders	0.3	0.4	0.8	-1.5	0.0	0.0	0.0	-0.5	-0.5	-0.5	-0.5
Memorandum items:											
Primary balance	-2.4	-1.8	-1.9	-2.9	-7.2	-3.5	-1.6	-0.6	0.2	0.7	0.6
GDP (in millions of US$)	57,908	62,203	64,928	66,788	52,938	59,447	63,084	67,563	72,360	77,498	83,000

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, 2016–26
(In percent of GDP)

	2016	2017	2018	2019	Est. 2020	Projections 2021	2022	2023	2024	2025	2026
Central Government											
Gross debt [1/]	39.0	39.6	42.3	47.6	70.8	68.9	68.2	67.1	65.2	62.9	60.8
of which: held by social security (CSS)	3.2	3.7	4.8	5.4	6.8	6.1	5.7	5.3	5.0	4.7	4.3
Domestic	9.8	10.1	10.6	10.9	13.9	13.2	12.3	11.3	10.4	9.6	9.0
of which: previously unrecorded	1.2	1.6	2.3	0.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
External	29.2	29.6	31.7	36.7	56.9	55.7	55.9	55.8	54.8	53.3	51.8
Financial assets	5.9	4.3	4.1	6.3	12.5	10.4	8.8	8.5	8.3	8.3	8.3
Deposits [2/]	3.4	1.9	1.9	3.9	8.3	5.6	4.3	3.8	3.4	3.2	3.0
Sovereign Wealth Fund [3/]	2.2	2.1	2.0	2.1	2.6	2.3	2.2	2.5	2.9	3.2	3.6
Loans	0.0	0.0	0.0	0.0	1.2	1.3	1.3	1.2	1.1	1.0	1.0
SDR holdings	0.3	0.3	0.3	0.3	0.3	1.1	1.1	1.0	0.9	0.9	0.8
Net debt	33.1	35.3	38.2	41.3	58.3	58.6	59.4	58.6	56.8	54.6	52.5
Non-Financial Public Sector											
Gross debt [1/]	35.3	35.3	37.3	42.2	64.0	62.9	62.5	61.7	60.2	58.3	56.4
of which: previously unrecorded	0.7	1.0	2.1	0.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial assets	14.8	12.2	11.3	13.1	22.8	18.9	17.0	16.2	15.7	15.2	14.7
Central government	5.9	4.3	4.1	6.3	12.5	10.4	8.8	8.5	8.3	8.3	8.3
Decentralized institutions (incl. CSS) [2/]	8.9	7.9	7.2	6.8	10.3	8.5	8.2	7.7	7.3	6.8	6.4
Net debt	20.5	23.1	26.0	29.1	41.2	44.0	45.5	45.5	44.5	43.1	41.7
Memorandum items:											
Net Debt as defined under SFRL [4/]	36.8	37.5	40.4	45.5	68.2	66.6	66.0	64.5	62.3	59.7	57.2

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$ 0.1 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, 2016–26 [1]

(In millions of U.S. dollars, unless otherwise stated)

					Est.	Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	(in millions of balboa at end of period)										
Net foreign assets	**3,974**	**1,752**	**542**	**2,547**	**10,727**	**10,898**	**12,665**	**13,507**	**14,398**	**15,347**	**16,357**
Short-term foreign assets, net	3,974	1,752	542	2,547	10,727	11,944	12,665	13,507	14,398	15,347	16,357
National Bank of Panama	4,331	2,957	2,218	3,646	8,485	9,531	10,116	10,836	11,607	12,432	13,317
Rest of banking system	-356	-1,204	-1,677	-1,099	2,242	2,413	2,550	2,671	2,792	2,914	3,040
Long-term foreign liabilities	0	0	0	0	0	0	0	0	0	0	0
Net domestic assets	**34,250**	**38,337**	**40,747**	**39,035**	**37,142**	**42,863**	**44,919**	**48,759**	**52,953**	**57,532**	**62,531**
Public sector (net credit)	-8,099	-7,425	-6,929	-9,431	-9,643	-9,631	-9,631	-9,631	-9,631	-9,631	-9,631
Central government (net credit)	-1,209	-505	-305	-1,507	-3,369	-3,357	-3,357	-3,357	-3,357	-3,357	-3,357
Rest of the public sector (net credit)	-6,890	-6,920	-6,624	-7,924	-6,273	-6,273	-6,273	-6,273	-6,273	-6,273	-6,273
Private sector credit	48,161	51,310	53,631	54,901	53,465	60,039	63,713	68,236	73,081	78,270	83,827
Private capital and surplus	-9,597	-10,390	-10,676	-11,384	-10,890	-12,229	-12,978	-13,899	-14,886	-15,943	-17,075
Other assets (net)	3,785	4,841	4,720	4,949	4,210	4,684	3,814	4,052	4,388	4,835	5,409
Liabilities to private sector	**38,546**	**40,565**	**41,690**	**42,631**	**46,667**	**53,761**	**57,584**	**62,266**	**67,351**	**72,878**	**78,888**
Total deposits	38,342	40,410	41,475	42,239	45,703	52,656	56,411	61,009	66,006	71,437	77,345
Demand deposits	8,226	8,337	8,710	7,892	9,100	10,673	11,860	13,295	14,904	16,707	18,729
Time deposits	20,493	21,796	22,368	23,849	24,264	27,830	29,533	31,630	33,875	36,280	38,856
Savings deposits	9,622	10,278	10,398	10,498	12,339	14,152	15,018	16,084	17,226	18,449	19,759
Bonds	204	155	215	392	964	1,105	1,173	1,256	1,345	1,441	1,543
Deposit as % of private sector credit	79.6	78.8	77.3	76.9	85.5	87.7	88.5	89.4	90.3	91.3	92.3
	(12-month change in relation to liabilities to the private sector at the beginning of the period)										
Net foreign assets	-2.8	-5.8	-3.0	4.8	19.2	0.4	3.3	1.5	1.4	1.4	1.4
Net domestic assets	7.3	10.6	5.9	-4.1	-4.4	12.3	3.8	6.7	6.7	6.8	6.9
Public sector credit (net)	-2.8	1.7	1.2	-6.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	10.1	8.2	5.7	3.0	-3.4	14.1	6.8	7.9	7.8	7.7	7.6
Private capital and surplus	2.0	2.1	0.7	1.7	-1.2	2.9	1.4	1.6	1.6	1.6	1.6
Other assets (net)	2.0	2.7	-0.3	0.5	-1.7	1.0	-1.6	0.4	0.5	0.7	0.8
Liabilities to the private sector	4.2	5.2	2.8	2.3	9.5	15.2	7.1	8.1	8.2	8.2	8.2
	(12-month percent change)										
Memorandum items:											
M2 [1/]	4.2	5.2	2.8	2.3	9.5	15.2	7.1	8.1	8.2	8.2	8.2
Net domestic assets	8.5	11.9	6.3	-4.2	-4.9	15.4	4.8	8.5	8.6	8.6	8.7
Public sector credit (gross)	-37.3	-10.1	21.3	2.6	39.8	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	8.4	6.5	4.5	2.4	-2.6	12.3	6.1	7.1	7.1	7.1	7.1
Share of demand deposits in total deposits (in percent)	21.5	20.6	21.0	18.7	19.9	20.3	21.0	21.8	22.6	23.4	24.2
	(In percent of GDP)										
Total deposits	66.2	65.0	63.9	63.2	86.3	88.6	89.4	90.3	91.2	92.2	93.2
Credit to private sector	83.2	82.5	82.6	82.2	101.0	101.0	101.0	101.0	101.0	101.0	101.0

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, 2015–20
(In percent, end-of-period)

	2015	2016	2017	2018	2019	2020
			(In percent)			
Core FSIs						
Regulatory capital to risk weighted assets	14.9	15.3	16.0	15.7	15.2	15.7
Non-performing loans net of provisions to capital	1.4	1.3	1.4	0.0	-0.3	-5.4
Non-performing loans to total gross loans	1.0	1.3	1.4	1.7	2.0	2.0
Return on assets	1.4	1.2	1.5	1.5	1.8	0.7
Return on equity	14.0	11.8	13.4	13.1	15.3	6.5
Interest margin to gross income	55.3	53.9	52.5	50.6	47.6	47.0
Non-interest expenses to gross income	50.1	50.0	46.9	46.4	47.7	48.6
Liquid assets to total assets	16.0	15.7	12.8	12.1	12.8	17.6
Liquid assets to short-term liabilities	39.9	39.3	33.9	34.8	37.0	47.0
Sectoral distribution of loans						
Domestic residents	74.6	77.5	80.7	81.2	81.7	82.0
Deposit takers	1.0	1.0	0.9	1.2	1.3	1.2
Central bank	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.2	2.8	2.6	2.8	2.6	2.4
General government	1.5	1.7	1.1	1.1	0.7	1.8
Nonfinancial corporations	36.4	36.3	37.8	36.7	35.8	34.0
Households	33.5	35.7	38.3	39.5	41.3	42.6
Nonresidents	25.4	22.5	19.3	18.8	18.3	18.0
Additional FSIs						
Capital to assets (leverage ratio)	10.2	11.4	12.5	12.5	12.7	11.8
Gross assets position in derivatives to capital	0.1	0.1	0.2	0.1	0.2	0.6
Gross liabilities position in derivatives to capital	0.8	1.3	0.9	0.7	0.4	0.4
Trading income to total income	0.0	0.0	0.0	0.0	0.0	0.0
Personnel expenses to total income	46.7	46.2	46.8	46.4	45.8	46.2
Customer deposits to total non-interbank loans	78.9	78.1	78.0	76.1	76.6	84.1

Sources: IMF Financial Soundness Indicators.

Table 7. Panama: Summary Balance of Payments, 2016–26
(In percent of GDP, unless otherwise stated)

	2016	2017	2018	2019	Est. 2020	Projections 2021	2022	2023	2024	2025	2026
					(In percent of GDP)						
Current account	**-7.8**	**-5.9**	**-7.6**	**-5.0**	**2.3**	**-3.4**	**-3.3**	**-3.1**	**-2.8**	**-2.6**	**-2.5**
Merchandise trade excluding Colón Free Zone, net	-16.3	-16.6	-16.7	-14.1	-8.3	-11.0	-11.3	-11.2	-11.3	-11.1	-11.2
Exports, f.o.b.	6.3	7.2	7.7	8.9	8.7	10.8	10.8	11.4	11.2	11.3	11.1
Of which: Copper	0.0	0.0	0.0	1.2	2.0	4.5	4.2	5.0	4.3	4.0	3.7
Of which: Gold	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.2
Imports, f.o.b.	22.5	23.7	24.4	23.0	17.0	21.7	22.2	22.6	22.5	22.3	22.3
Of which: Oil	5.4	6.8	8.1	7.5	3.2	4.4	4.1	3.8	3.6	3.4	3.3
Merchandise trade from Colón Free Zone, net	2.9	3.0	2.5	2.7	3.2	2.7	2.8	2.9	2.9	3.1	3.2
Re-exports, f.o.b.	16.1	15.1	15.0	13.0	13.3	13.4	13.2	13.3	13.3	14.1	14.8
Imports, f.o.b.	13.2	12.1	12.5	10.3	10.1	10.7	10.4	10.4	10.4	11.0	11.6
Services, net	12.9	13.9	13.6	13.2	10.4	10.8	12.2	13.2	13.7	13.9	13.9
Travel, net	5.3	5.6	5.3	4.7	1.2	1.7	3.4	4.0	4.4	4.4	4.4
Transportation, net	6.5	7.2	7.4	7.7	8.0	8.3	8.0	8.3	8.5	8.6	8.6
Of which: Canal	4.1	4.5	4.6	4.8	6.5	6.1	5.6	5.8	5.7	5.7	5.6
Other services, net	1.1	1.1	1.0	0.9	1.1	0.8	0.8	0.9	0.8	0.9	0.8
Income, net	-7.3	-6.2	-7.1	-6.8	-2.9	-6.0	-7.0	-7.9	-8.1	-8.5	-8.4
Primary, net	-7.1	-6.0	-7.0	-6.7	-3.2	-6.1	-6.9	-7.7	-7.9	-8.2	-8.1
Of which: Direct investment	-5.7	-4.5	-5.2	-5.1	-0.5	-3.3	-4.8	-5.8	-5.9	-6.2	-5.9
Secondary, net	-0.2	-0.2	-0.1	0.0	0.2	0.1	-0.1	-0.2	-0.2	-0.2	-0.3
Of which: Workers' remittances	-0.7	-0.6	-0.5	-0.5	-0.2	-0.4	-0.6	-0.7	-0.7	-0.7	-0.8
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	**-13.2**	**-9.4**	**-9.4**	**-7.1**	**1.8**	**-3.4**	**-3.3**	**-3.0**	**-2.8**	**-2.6**	**-2.5**
Foreign direct investment, net	-7.9	-6.9	-7.6	-5.5	-1.2	-4.0	-6.4	-7.0	-6.9	-7.1	-7.1
Of which: Reinvested earnings	-3.7	-2.9	-2.9	-3.4	0.9	-1.1	-2.4	-2.6	-2.7	-2.6	-2.8
Portfolio investment, net	-0.2	-1.1	-0.6	-4.8	-4.6	-1.1	-1.2	-1.2	-1.2	-1.1	-1.0
Financial derivatives, net	-0.1	0.0	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-6.1	0.2	-0.4	1.2	-2.9	0.0	3.4	4.1	4.3	4.5	4.5
Reserve assets, net	1.1	-1.6	-1.0	1.8	10.5	1.8	0.9	1.1	1.1	1.1	1.1
Net errors and omissions	**-5.5**	**-3.5**	**-1.8**	**-2.1**	**-0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:											
Exports of goods and services (annual percent change)	-3.3	7.7	5.1	0.1	-29.4	22.8	10.7	11.6	8.2	9.6	8.5
Imports of goods and services (annual percent change)	-6.9	5.8	7.2	-5.3	-36.4	33.5	8.1	8.9	7.0	8.6	8.6
Oil trade balance (percent of GDP)	-3.4	-3.8	-4.4	-3.8	-1.6	-2.2	-2.1	-1.9	-1.9	-1.8	-1.8

Sources: INEC; and IMF staff calculations.

Table 8. Panama: External Vulnerability Indicators, 2016–22
(In percent, unless otherwise specified)

	2016	2017	2018	2019	Est. 2020	Projections 2021	2022
Financial indicators							
Broad money (12-month percent change)	4.2	5.2	2.8	2.3	9.5	15.2	7.1
Private sector credit (12-month percent change)	8.4	6.5	4.5	2.4	-2.6	12.3	6.1
Deposit rate (6-month; in percent) 1/	1.7	1.8	1.8	2.2	2.0	1.8	1.8
External indicators							
Merchandise exports (12-month percent change)	-9.0	6.8	6.8	-0.7	-20.6	23.6	5.6
Merchandise imports (12-month percent change)	-8.2	7.7	7.5	-7.1	-35.6	34.3	6.8
Current account balance (in percent of GDP)	-7.8	-5.9	-7.6	-5.0	2.3	-3.4	-3.3
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)	-13.2	-9.4	-9.4	-7.1	1.8	-3.4	-3.3
Of which : direct investment	-1.2	-4.0	-6.4	-7.0	-6.9	-7.1	-7.1
Non-Financial Public Sector external debt (in percent of GDP)	28.5	28.7	30.6	35.3	55.1	54.2	54.4
In percent of exports of goods and services 2/	65.5	65.7	69.7	82.5	144.6	130.0	125.1
External interest payments							
In percent of exports of goods and services 2/	9.2	9.7	7.2	7.3	8.1	10.4	9.0
External amortization payments							
In percent of exports of goods and services 2/	185.9	172.9	146.5	147.9	205.7	159.2	142.8
REER, percent change (average) 6/	-8.3	-7.6	-1.2	1.0	0.0	…	…
Gross international reserves at end of period							
In millions of U.S. dollars 3/	4,745	3,788	3,149	4,375	9,936	10,982	11,566
In months of imports of goods and services	2.1	1.6	1.4	3.0	5.1	5.2	5.1
In percent of broad money 4/	12.3	9.3	7.6	10.3	21.3	20.4	20.1
In percent of short-term external debt 5/	10.9	9.8	8.1	11.9	27.9	30.5	33.4
Memorandum items:							
Nominal GDP	57,908	62,203	64,928	66,788	52,938	59,447	63,084
Exports of goods and services 2/	25,208	27,154	28,551	28,579	20,184	24,784	27,444
Imports of goods and services 2/	25,475	26,951	28,902	27,378	17,412	23,249	25,123

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.

Annex I. Implementation of Past IMF Policy Advice

The authorities' macroeconomic and financial policies remained broadly in line with past Fund advice in 2020, with appropriate adjustments for the COVID-19 shock. In particular, the authorities strengthened the credibility of their fiscal framework by amending the SFRL to accommodate the health spending and revenue shortfalls. They continue making progress on the FATF action plan. However, more needs to be done to strengthen Panama's tax collections, expenditure controls, fiscal transparency, and the effectiveness of the AML/CFT regime.

1. Fiscal Policy. It remains anchored in the SFRL, which was streamlined in October 2018 and further modified in response to the pandemic, in line with IMF's recommendations. A bill also created the fiscal council—an independent committee tasked with providing technical analysis of fiscal policy—following staff recommendations. However, members of the Council remain to be appointed, and the institution to be staffed and provided capacity development. Furthermore, measures to monitor fiscal risks and contingent liabilities are still in their early stages. The authorities are in the process of quantifying tax policy options recommended by IMF's Technical Assistance recommendations and formulating a medium-term revenue framework. Implementation of recent advice on revenue administration has started, but so far has been limited.

2. Financial Integrity and Tax Transparency. The authorities continue addressing the gaps identified in Panama's AML/CFT framework by the FATF and GAFILAT (its regional body for Latin America). Importantly, Panama criminalized tax evasion in 2019 and further enhanced its legislative framework in 2020, in line with staff advice and FATF requirements, although the pace of reforms was slowed by the onset of the pandemic. To exit the FATF grey list and strengthen its regulatory framework, Panama needs to demonstrate the effectiveness of its AML/CFT regime and urgently tackle the remaining items on the FATF action plan.

3. Financial Sector Reforms. Prudential regulations have been largely aligned to Basel III; the Basel III capital adequacy framework was implemented in 2018, and the LCR will be gradually phased-in in line with staff advice. A draft legislation to strengthen the bank resolution framework which will, among others, expedite the resolution process (taking into account the IMF's recommendations), has been submitted to the Cabinet for deliberation. When approved by the National Assembly, this framework will override the chapter on bank resolution in the Banking Law. Panama is also collaborating with other member countries of the Central America Monetary Council (SECMCA) to develop a national and regional crisis preparedness and management plan.

4. Structural Reforms. Amid the COVID-19 health crisis, reform implementation has been delayed, including in the areas of education, labor market flexibility, social safety nets, and infrastructure development. While the authorities agree with staff advice, implementation has been slow.

Annex II. Prospects and Risk Assessment Matrix[1]

<table>
<tr><th>Source of Risks</th><th>Relative Likelihood</th><th>Time Horizon</th><th colspan="2">Expected Impact</th><th>Policy Response</th></tr>
<tr><td colspan="6">External Risks</td></tr>
<tr><td>Unexpected Adverse Shifts in the COVID-19 Pandemic</td><td>Medium</td><td>ST</td><td>Medium</td><td>The COVID-19 pandemic prolongs and the disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and renewed lockdown, prompting further deterioration in economic activities and fueling financial vulnerabilities.</td><td>• Ensure adequate safety nets; build liquidity and fiscal buffers to safeguard macroeconomic stability.</td></tr>
<tr><td>Sharp Rise in Global Risk Premia Exposes Financial and Fiscal Vulnerabilities</td><td>Medium</td><td>ST</td><td>High</td><td>A market reassessment of Panama’s fundamentals, risks, and sovereign credit rating (e.g., in response to an unexpected adverse COVID-19 developments) could lead to spikes in credit spreads and trigger a reduction in capital inflows. In addition, higher risk premia could increase financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies could erode banks’ capital buffers. Higher interest rates resulting from a widening of credit spreads would lead to higher debt service and refinancing risks. In addition, a sovereign downgrade that places Panama below investment grade could jeopardize public external financing, leading to difficulties in raising global bonds and/or higher cost of issuance.</td><td>• Continue to deepen domestic financial markets and rebalance public sector financing to domestic sources.
• Consolidate public finances once the oedemic recedes to avoid a sudden, sharp increase in domestic rates and possible crowding out of private investment.
• Current account to adjust automatically through lower imports.
• Enhance crisis preparedness of Panama's regional financial center.</td></tr>
<tr><td>Accelerating De-globalization</td><td>Medium</td><td>ST, MT</td><td>High</td><td>Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.

Accelerating de-globalization would directly affect Panama through lower exports, FDI, and growth as slower growth or a decline in world trade would directly lower transits through the Panama Canal and reduce fiscal revenue. Moreover, lower growth in key trading partners would directly reduce exports and increased uncertainty triggered by escalating trade tensions could lead to increased financial market volatility with negative consequences on investment.</td><td>• Continue efforts to diversify key export markets.
• Advance structural reforms to improve productivity and strengthen competitiveness.</td></tr>
</table>

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

Source of Risks	Relative Likelihood	Time Horizon		Expected Impact	Policy Response
External Risks					
Cyber-attacks	Medium	ST, MT	Medium	Cyber-attacks on critical infrastructure, institutions, and financial systems trigger systemic financial instability or widespread disruptions in socio-economic activities and remote work arrangements.	• Improve legal, institutional and strategic frameworks, devise a centralized plan and common rules to combat cyberattacks more effectively. • Enhance risk monitoring and supervision of banking institutions to ensure that systems and process are in place to mitigate cyber-security risks.
Higher Frequency and Severity of Natural Disasters	Medium/ Low	ST, MT	Medium	Higher frequency and severity of natural disasters related to climate change could cause severe damages to lives, livelihoods, infrastructure, and economic activities in Panama. In the past, floods and draughts had disrupted Canal activity, tourism inflows, and agricultural production. A sequence of severe events in large economies could disrupts trade and reduce global GDP, prompting a recalibration of risk and growth prospects.	• Continue efforts to build resilience and limit disruptions caused by natural disasters, focusing on three areas: structural, financial, and post-disaster resilience. • Prepare a Disaster Resilience Strategy (DRS) based on a multi-year macro-fiscal framework, with input from stakeholders, to provide development partners with a comprehensive guide to the authorities' needs and plans, and to facilitate the coordination of their support.
Domestic Risks					
Setbacks in Improving the AML/CFT and Tax Transparency Frameworks	Medium	ST	High	Slowdown in implementing the FATF action plan or setbacks in the tax information exchange could lead to reputational damage, reduced external funding and access to international financial services, higher borrowing costs, and increased scrutiny of Panamanian entities.	• Promptly implement the FATF action plan on AML/CFT and the OECD tax transparency recommendations
Sharp Correction in Residential and Commercial Property Markets	Medium	ST, MT	High	A sharp correction in property prices could trigger adverse macro-financial spillovers in the economy, which could increase banks' NPLs.	• Strengthen monitoring of systemic risk. • Develop macroprudential policy framework and strengthen financial sector crisis preparedness.
Setbacks in Fiscal Consolidation Necessary to Return to the SFRL Limits	Low	MT	Medium	Should fiscal imbalances continue (due to not recovering revenues, increasing expenditure needs, or deficiencies in the tax and custom administration), the credibility of fiscal policy could deteriorate, damaging reputation, reducing market confidence, and leading to higher borrowing costs, impacting debt sustainability.	• Build fiscal buffers and commit to fiscal targets below the SFRL ceilings. • Reform tax and customs administration.

Source of Risks	Relative Likelihood	Time Horizon		Expected Impact	Policy Response
Widespread Social Discontent	**Low**	**ST, MT**	**Medium**	Social tensions could erupt as a prolonged pandemic results in socio-economic hardship, including unemployment, poverty, and shortages and higher prices of essentials, and exacerbates inequities. A materialization of this risk would derail economic recovery and reforms, leading to instability that could thwart external confidence and weaken medium-term domestic economic growth.	• Ensure the sufficiency of COVID-19 vaccines; carefully distribute and plan the vaccination programs across the country to ensure that the population is adequately immunized. • Ensure that heath care sufficiently reaches the vulnerable population and emergency facilities are adequate to save lives and tackle the pandemic. • Ensure that social welfare and transfer programs are well targeted and reaches the poor and those who are most in need. • Develop clear communication and engagement strategy with affected communities, taking into full consideration their direct and indirect distributional effects in policy decisions.

Annex III. External Sector Assessment

Overall Assessment: *The external position of Panama in 2020 is assessed to be moderately stronger than the level implied by fundamentals and desirable policies. The current account balance is estimated to have switched to a surplus of 2.3 percent of GDP in 2020 (from a deficit of 5.0 percent of GDP in 2019) on the back of a sharp contraction in imports, lower oil prices, and increased copper exports. The current account surplus together with strong portfolio and other investment inflows led to a buildup of reserves.*

Potential Policy Responses: *Panama's external stability remains closely dependent on continued financial stability and the global economic environment, particularly developments in global interest rates and world trade. Policy efforts should continue to focus on Panama's resilience to these risks by reducing vulnerability and building buffers.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The NIIP stood at -121 percent of GDP in 2020, down from -98 percent of GDP at the end of 2019. The decrease in the NIIP as a share of GDP was due to the lower GDP level, while the nominal level of the NIIP has increased slightly by 2 percent. Gross assets reached 155 percent of GDP in 2020 (from 119 percent of GDP at the end of 2019), of which the majority is accounted for by banks in the form of foreign deposits and loans (about 65 percent of GDP). The accumulation of gross international reserves in the order of 10 percent of GDP as well as banks' deposits were the main contributors for the increase in gross assets in 2020.

Gross liabilities reached 276 percent of GDP at the end of 2020 (from 217 percent of GDP in 2019), of which external debt is about 202 percent of GDP and non-debt FDI liabilities are about 75 percent of GDP. Banks account for the largest share of external debt (85 percent of GDP), followed by the government (50 percent of GDP), and FDI in the form of intracompany lending (45 percent of GDP). Banks' external debt is mostly in the form of deposits. Government bond issuance as well as bank deposits contributed to the increase in gross external debt in 2020.

Assessment. The banking sector alone accounts for about half of Panama's external debt, reflecting Panama's position as a financial hub and the dominance of its large private financial sector. A large bulk of banks' debt is in the form of deposits and the counterpart of banks' large gross external assets position. The NIIP is projected to improve over the medium term—due to higher net exports (particularly from the CFZ), canal receipts, tourism, as well as increased copper production. The ES model also suggests that the NIIP is sustainable under the baseline scenario, as it does not deteriorate in net present value terms.

2020 (% GDP)	***NIIP: -121.3***	***Gross Assets: 154.8***	***Debt Assets: 122.6***	***Gross Liabilities: 276.1***	***Debt Liabilities: 201.9***

Current Account

Background. The current account balance improved substantially from -5.0 percent of GDP in 2019 to 2.3 percent of GDP in 2020, as the decline in imports proved to be more accentuated than the decline in exports. Despite the significant decline in tourism receipts in 2020, exports were supported by a further increase in cooper production relative to 2019, as well as by relatively resilient revenues from the canal and Colon Free Zone. As the economy recovers, the current account balance is expected to deteriorate to about -3.5 percent of GDP in 2021 and then converge to –2.5 percent of GDP over the medium term as Panama expands its export capacity.

Assessment. The EBA CA model estimates a current account norm of -1.9 percent of GDP. After accounting for cyclical factors as well as COVID-related adjustment to the oil and tourism balance, the CA balance is adjusted from 2.3 to 0.6 percent of GDP. This leads to a current account gap of 2.5 percent of GDP, including a policy gap of 2.1 percent of GDP, given that Panama's fiscal balance deviation from its desirable level was smaller than the rest of the world's deviation. In this sense, the CA model assesses Panama's external position to be substantially stronger than the level implied by fundamentals and desirable policies. Overall, staff assesses Panama's external position to be

Model Estimates for 2020
(In percent of GDP)

	CA model
CA-Actual	**2.3**
Cyclical contributions (from model) (-)	2.0
COVID-19 adjustor (+) 1/	0.1
Additional temporary/statistical factors (+)	0.0
Natural disasters and conflicts (-)	-0.1
Adjusted CA	**0.6**
CA Norm (from model) 2/	**-1.9**
Adjustments to the norm (+)	0.0
Adjusted CA Norm	**-1.9**
CA Gap	**2.5**
o/w Relative policy gap	2.1
Elasticity	-0.31
REER Gap (in percent)	**-7.8**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (-1.6 percent of GDP) and on tourism (1.7 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

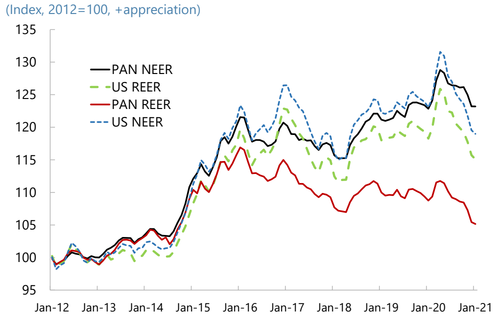
moderately stronger than the level implied by fundamentals and desirable policies, given the importance of the ES model to Panama with its large external debtor position and the assessment of the ES model that Panama's external position is broadly in line with fundamentals and desirable policies.

Real Exchange Rate

Background. The real effective exchange rate (REER) remained stable in 2020, depreciating by 0.5 percent on average relative to 2019, and by 1.6 percent relative to the 2017-19 average. Given dollarization, nominal effective exchange rate (NEER) appreciated by almost 3 percent on average in 2020 relative to 2019. However, low inflation in Panama relative to peers led to a slight REER depreciation.

Assessment. The EBA-lite CA model implies a REER undervaluation of 7.8 percent. Overall, given that the REER has not depreciated much since 2017, staff assesses the 2020 REER gap to be in the range of 0 to -8 percent.

Nominal and Real Effective Exchange Rates
(Index, 2012=100, +appreciation)



Source: IMF.

Capital and Financial Accounts: Flows and Policy Measures

Background. FDI inflows declined from 5.5 percent of GDP in 2019 to 1.2 percent of GDP in 2020, mainly due to lower reinvested earnings of large multinational companies. At the same time, portfolio investment inflows have increased due to large bond issuance by the government.

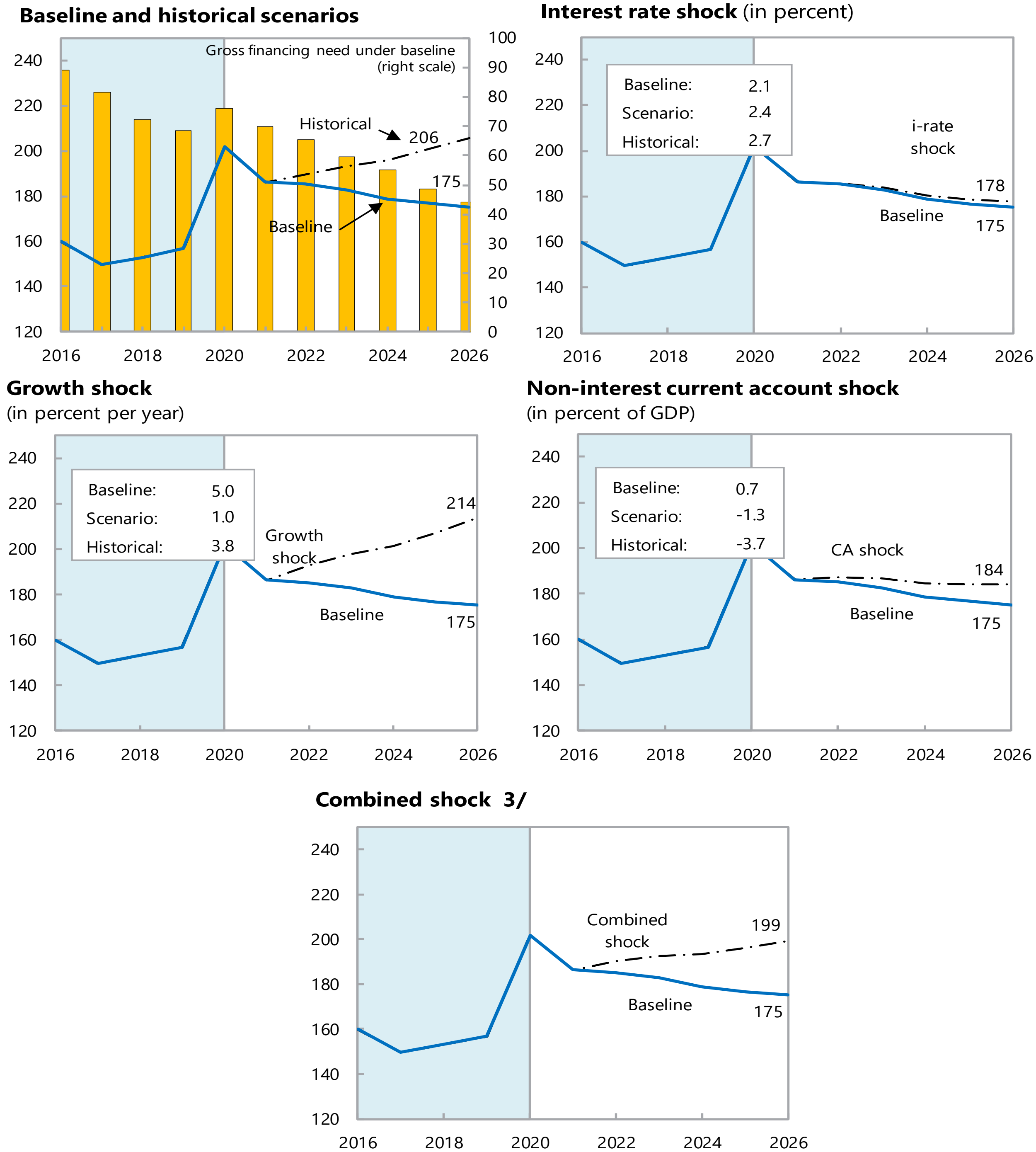
Assessment. Over the medium term, the current account deficit is expected to remain adequately financed by FDI. Panama's location as a maritime and air transportation hub as well as its position as a regional financial center paired with macroeconomic stability is expected to continue to attract substantial investment. Although the sustainability of the current account deficit continues to depend to some extent on the profitability of multinational companies and their continued reinvestment, any decline in FDI receipts would likely be offset by a reduction of outflows in the primary income account, limiting the overall impact on Panama's ability to finance imports.

FX Intervention and Reserves Level

Background. Panama is a fully dollarized economy and does not have its own currency or central bank. Given that the fiscal and banking sector liquidity needs drive the need for foreign currency reserves, the assessment of the reserve position needs to be based on individual traditional metrics, namely the adequacy of liquidity buffers to cover the external obligations of the government and banking sector. The standard ARA metric is inappropriate for Panama because of lack of control by the authorities over banks' foreign exchange liquidity. For statistical purposes, international reserves have 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. Net foreign assets of BNP increased from 5 percent of GDP in 2019 to 16 percent of GDP in 2020, mainly as a result of international bond issuance by the central government.

Assessment. Panama's reserve level is adequate. The central government deposit at commercial banks corresponded to 4.5 months of central government expenditures in 2020, well above the best practice of 1 month of expenditure. Panama has also a Sovereign Wealth Fund (SWF) 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. Liquid assets in the banking sector covered about 60 percent of deposits in 2020, nearly double the minimum statutory requirement of 30 percent. In addition, banks' short-term assets cover 3/4 of banks' short-term liabilities, reinforcing the high level of liquidity buffer in the banking sector.

Figure A3.1. 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 A3.1. External Debt Sustainability Framework, 2016–26

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020	10-Year Historical Average	10-Year Standard Deviation	2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	159.9	149.6	153.0	156.8	201.9			**186.3**	**185.3**	**182.7**	**178.8**	**176.8**	**175.2**	**-15.4**
2 Change in external debt	-1.4	-10.3	3.4	3.7	45.1			-15.6	-1.0	-2.5	-3.9	-2.0	-1.6	
3 Identified external debt-creating flows (4+8+9)	-10.7	-12.1	-6.2	-4.8	37.5			-22.2	-11.9	-12.6	-12.7	-12.8	-12.8	
4 Current account deficit, excluding interest payments	3.8	1.7	4.5	1.9	-5.4			-0.9	-0.6	-0.6	-0.7	-0.7	-0.8	
5 Deficit in balance of goods and services	0.5	-0.3	0.5	-1.8	-5.2			-2.6	-3.7	-4.8	-5.3	-5.9	-5.9	
6 Exports	43.5	43.7	44.0	42.8	38.1			41.7	43.5	45.3	45.8	46.9	47.5	
7 Imports	44.0	43.3	44.5	41.0	32.9			39.1	39.8	40.5	40.5	41.0	41.6	
8 Net non-debt creating capital inflows (negative)	-7.9	-6.9	-7.6	-5.5	-1.2			-4.0	-6.4	-7.0	-6.9	-7.1	-7.1	
9 Automatic debt dynamics 1/	-6.6	-6.8	-3.1	-1.1	44.1			-17.3	-4.9	-5.0	-5.1	-5.0	-4.9	
10 Contribution from nominal interest rate	4.0	4.2	3.2	3.1	3.1			4.3	3.9	3.7	3.5	3.3	3.3	
11 Contribution from real GDP growth	-7.5	-8.3	-5.2	-4.5	35.5			-21.7	-8.8	-8.6	-8.5	-8.3	-8.3	
12 Contribution from price and exchange rate changes 2/	-3.2	-2.7	-1.1	0.3	5.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	9.3	1.8	9.6	8.5	7.6			6.7	10.9	10.0	8.8	10.8	11.3	
External debt-to-exports ratio (in percent)	367.2	342.7	348.1	366.3	529.5			446.8	425.8	403.0	390.4	377.2	369.1	
Gross external financing need (in billions of US dollars) 4/	51526.7	50749.7	46842.3	45680.8	40345.4			41576.8	41329.0	40204.3	39785.8	37681.8	36665.1	
in percent of GDP	89.0	81.6	72.1	68.4	76.2			69.9	65.5	59.5	55.0	48.6	44.2	
Scenario with key variables at their historical averages 5/								**186.3**	**189.5**	**193.5**	**196.1**	**200.6**	**205.6**	**-14.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	5.0	5.6	3.6	3.0	-17.9	3.8	8.1	12.0	5.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	2.0	1.7	0.8	-0.2	-3.4	2.5	3.0	0.2	1.1	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.7	2.8	2.2	2.1	1.6	2.7	0.6	2.4	2.2	2.1	2.0	2.0	2.0	
Growth of exports (US dollar terms, in percent)	-3.3	7.7	5.1	0.1	-29.4	1.0	16.0	22.8	10.7	11.6	8.2	9.6	8.5	
Growth of imports (US dollar terms, in percent)	-6.9	5.8	7.2	-5.3	-36.4	-0.4	18.9	33.5	8.1	8.9	7.0	8.6	8.6	
Current account balance, excluding interest payments	-3.8	-1.7	-4.5	-1.9	5.4	-3.7	4.0	0.9	0.6	0.6	0.7	0.7	0.8	
Net non-debt creating capital inflows	7.9	6.9	7.6	5.5	1.2	6.9	2.2	4.0	6.4	7.0	6.9	7.1	7.1	

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 IV. Debt Sustainability Analysis

1. The amended fiscal rule will place public debt firmly on a declining path. In the baseline scenario, public debt steadily declines from its peak in 2020 (64 percent of GDP) to 56½ percent of GDP in 2026. This is possible thanks to a continuous improvement in the primary balance to GDP (from a 7¾ deficit in 2020 to a ½ surplus in 2026), and to a consistently positive differential between real GDP growth and the real effective interest rate. After peaking at 15¼ percent of GDP, gross financing needs will gradually shrink until reaching 5¾ percent of GDP in 2026, slightly below the 2010–18 average (6½ percent of GDP). This is the result of a decreasing headline deficit, combined with the concentration of net borrowing on instruments with medium- and long-term maturities, essentially global bonds and multilateral debt. While external financing requirements and the share of debt held by non-residents will remain high over the projection horizon, full access to international markets at a low spread on US debt is expected to prevail in the baseline scenario.

2. While the debt to GDP ratio would increase under negative scenarios, eventually it declines. Debt to GDP would only breach the 70 percent of GDP threshold under two shocks: (i) a one-standard deviation two-year growth shock, that would drive the debt to GDP ratio to 82 percent in 2023; (ii) the crystallization of contingent liabilities stemming from the financial sector, involving government's bail outs to banks by 10 percent of the outstanding credit to the private sector, that would raise debt up to 94 percent in 2023. Nonetheless, in both scenarios debt to GDP would decline after 2023. By contrast, debt would remain below the threshold if the calibrated shocks on real interest rates, primary balance and the real exchange rate took place. In terms of gross financing needs, only the contingent liability shock would produce a breach of the 15 percent of GDP benchmark (by 10 percent of GDP) in 2022, its year of occurrence.

Figure A4.1. Panama: Public Sector DSA – Baseline Scenario

(In percent of GDP unless otherwise indicated)

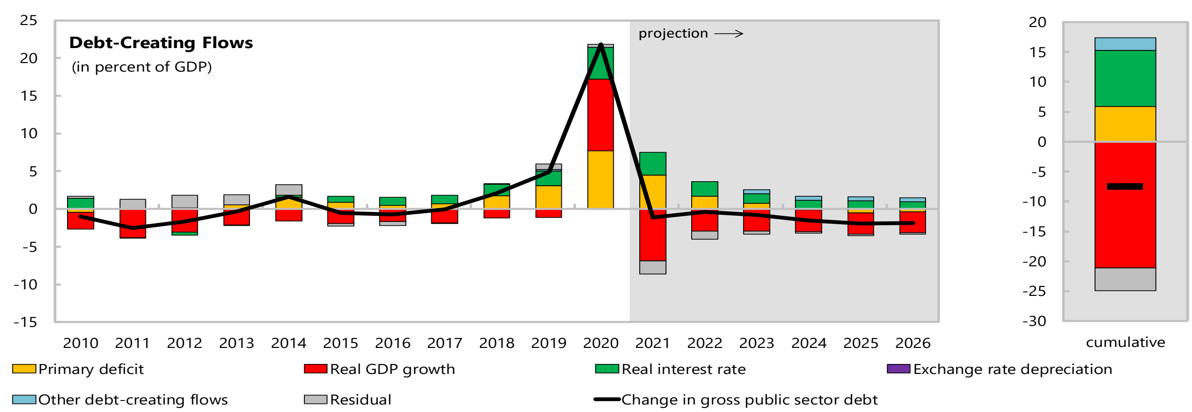
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	36.3	42.2	64.0	62.9	62.5	61.7	60.2	58.3	56.4
Public gross financing needs	6.3	8.1	15.3	11.4	7.4	6.1	7.7	4.8	5.7
Net public debt	22.1	29.4	41.5	45.1	46.6	46.5	45.5	44.0	42.6
Real GDP growth (in percent)	6.5	3.0	-17.9	12.0	5.0	5.0	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	3.5	-0.2	-3.4	0.2	1.1	2.0	2.0	2.0	2.0
Nominal GDP growth (in percent)	10.3	2.9	-20.7	12.3	6.1	7.1	7.1	7.1	7.1
Effective interest rate (in percent) [4/]	5.6	5.2	5.0	5.4	4.4	4.3	4.1	4.0	3.9

As of March 02, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		168
5Y CDS (bp)		68
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	BBB	BBB
Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.4	4.9	21.8	-1.1	-0.4	-0.8	-1.5	-1.9	-1.8	-7.6	
Identified debt-creating flows	-0.9	4.1	21.4	0.6	0.7	-0.4	-1.3	-1.7	-1.6	-3.8	
Primary deficit	0.6	3.1	7.7	4.5	1.7	0.8	-0.1	-0.5	-0.4	5.9	-1.2
Primary (noninterest) revenue and grants	20.9	18.3	18.2	19.3	19.9	20.4	20.8	20.9	21.0	122.3	
Primary (noninterest) expenditure	21.5	21.4	25.9	23.8	21.6	21.2	20.7	20.4	20.6	128.2	
Automatic debt dynamics [5/]	-1.5	0.9	13.7	-3.9	-1.0	-1.6	-1.7	-1.7	-1.8	-11.8	
Interest rate/growth differential [6/]	-1.5	0.9	13.7	-3.9	-1.0	-1.6	-1.7	-1.7	-1.8	-11.8	
Of which: real interest rate	0.6	2.0	4.2	3.0	2.0	1.3	1.2	1.1	1.0	9.4	
Of which: real GDP growth	-2.2	-1.1	9.6	-6.9	-3.0	-2.9	-2.9	-2.8	-2.7	-21.2	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.2	0.0	0.0	0.0	0.5	0.5	0.5	0.5	2.1	
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	0.2	0.0	0.0	0.0	0.5	0.5	0.5	0.5	2.1	
Residual, including other asset changes [8/]	0.6	0.8	0.4	-1.7	-1.0	-0.4	-0.2	-0.2	-0.2	-3.8	



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.

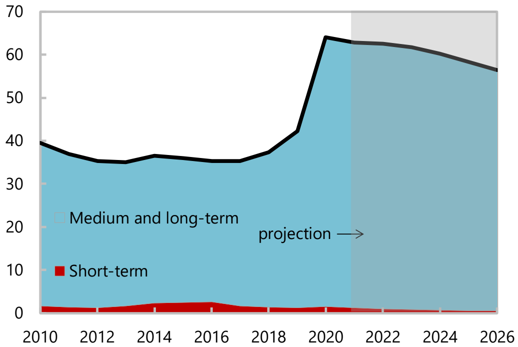
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A4.2. Panama: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

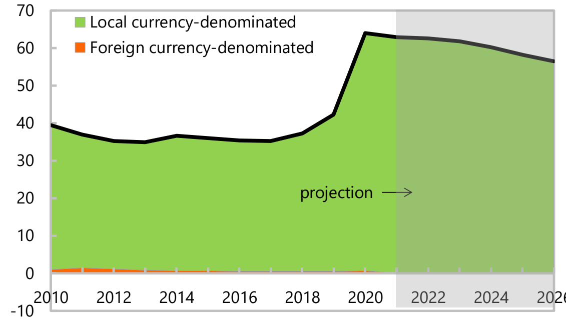
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

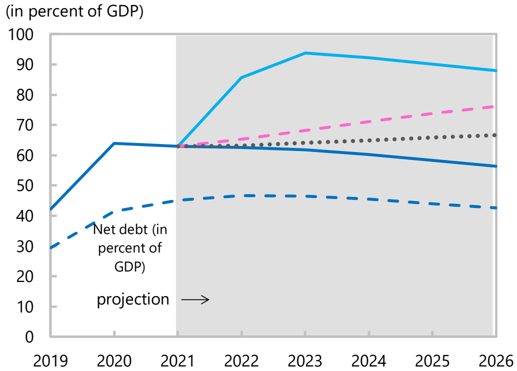


Alternative Scenarios

Baseline
Historical
Constant Primary Balance
Contingent Liability Shock

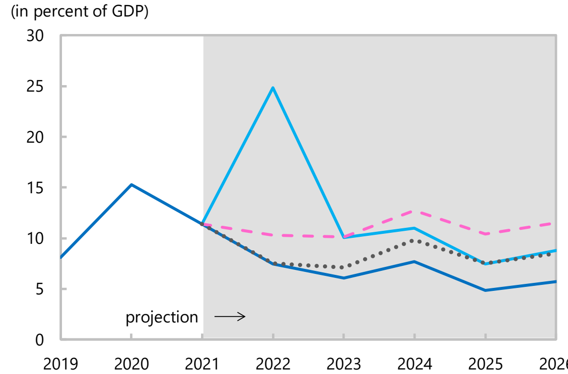
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	12.0	5.0	5.0	5.0	5.0	5.0
Inflation	0.2	1.1	2.0	2.0	2.0	2.0
Primary Balance	-4.5	-1.7	-0.8	0.1	0.5	0.4
Effective interest rate	5.4	4.4	4.3	4.1	4.0	3.9
Constant Primary Balance Scenario						
Real GDP growth	12.0	5.0	5.0	5.0	5.0	5.0
Inflation	0.2	1.1	2.0	2.0	2.0	2.0
Primary Balance	-4.5	-4.5	-4.5	-4.5	-4.5	-4.5
Effective interest rate	5.4	4.4	4.2	4.0	3.8	3.7

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	12.0	3.8	3.8	3.8	3.8	3.8
Inflation	0.2	1.1	2.0	2.0	2.0	2.0
Primary Balance	-4.5	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	5.4	4.4	4.3	4.1	4.0	3.8
Contingent Liability Shock						
Real GDP growth	12.0	-3.1	-3.1	5.0	5.0	5.0
Inflation	0.2	-1.0	0.0	2.0	2.0	2.0
Primary Balance	-4.5	-18.2	-0.8	0.1	0.5	0.4
Effective interest rate	5.4	4.8	5.1	4.9	4.8	4.6

Source: IMF staff.

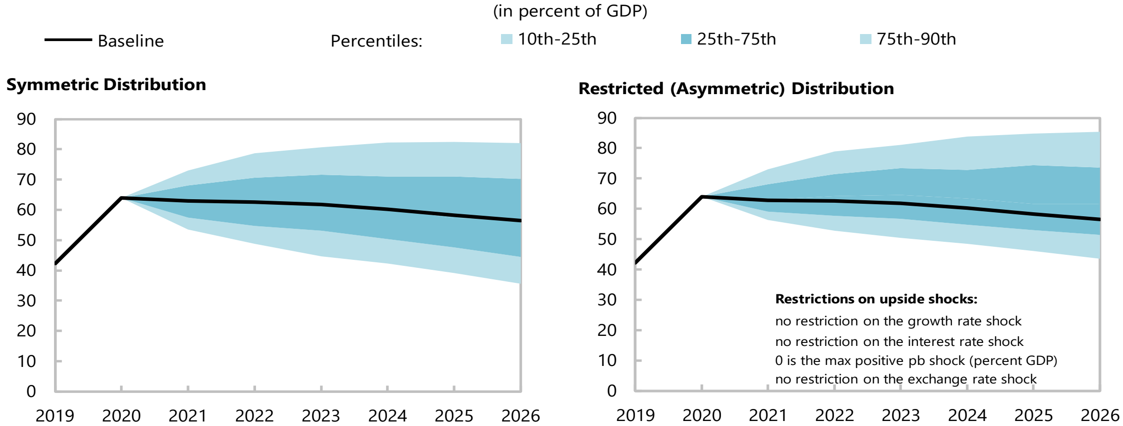
Figure A4.3. Panama: Public DSA Risk Assessment

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

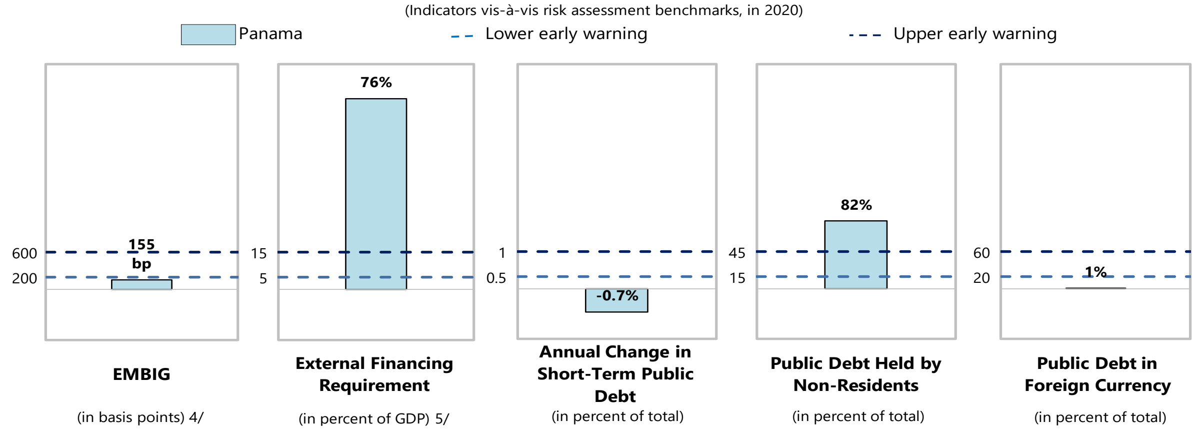
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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, 2-Dec-20 through 2-Mar-2021.

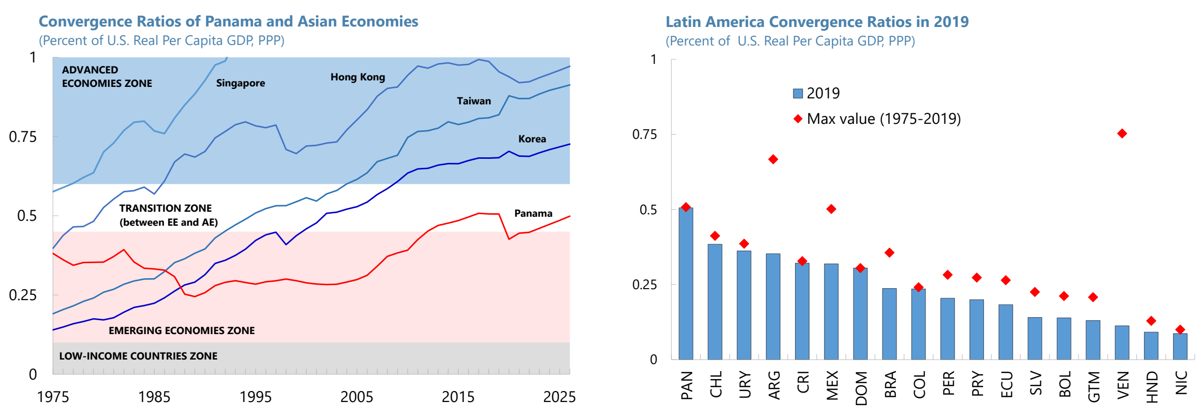
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex V. Economic Convergence of Panama

1. Background. While WEO classifies Panama as an emerging market economy (EE), it is on track to become an advanced economy (AE) if the high growth experienced in the past persists.[1] WEO estimates per capita GDP in Panama, adjusted for purchasing power parity (PPP), at $31,600 before the pandemic (measured in international dollars of 2017), the highest in Latin America. This is twice as high as its unadjusted (non-PPP) level, reflecting a relatively undervalued real exchange rate.[2] However, per capita GDP adjusted for PPP is a more accurate measure of economic progress and it is often used for comparisons with other countries. Frequently the U.S. is used as a benchmark, and the per capita GDP of a country (in PPP real terms) is expressed as a ratio of that of the U.S. The resulting ratio is interpreted as a measure of convergence; the closer (farther) the ratio is to 1, the closer (farther) the economy is to achieve advance economy status. Panama reached a convergence ratio of 0.5 in 2017-19, which is twice its convergence ratio three decades earlier, but still lower than most AEs.

2. Latin American experience. There are no advanced economies in Latin America. Historically, Latin America is a region that has made little or no progress in converging to the level of per capita GDP of the U.S. In the last half a century, only a handful of Latin America countries have reached a convergence ratio similar to that of Panama only to diverge in subsequent years.

Convergence Comparison: Asia vs Latin America



Source: World Economic Outlook and IMF staff calculations.

[1] According to WEO, the classification of an economy as advanced is not based on strict criteria, although there are three main metrics to be considered, namely: (i) per capita income level; (ii) export diversification, and (iii) degree of integration into the global financial system.

[2] The WEO database revised its estimates of per capita GDP on a PPP basis in 2020 following the release of the International Comparison Program's (ICP) 2017 survey for new PPP benchmarks (maintained and published by the World Bank, the OECD and other international organizations). The ICP's PPPs indicate how many units of a country's local currency are needed to buy a comparable basket of goods and services valued in the currency of the numeraire country, the United States. The ICP released PPP estimates for the benchmark year (2017) as well as revised historical PPP estimates through 2011–16. Extrapolations through 2018–26 and prior to 2011 are done by WEO using relative inflation rates based on GDP deflators. See Box 1.1 of the WEO October 2020, IMF.

For example, Mexico achieved a convergence ratio of 0.5 in 1981-82, before the debt crisis of the 1980s, only to lose steam and diverge to 0.32 by 2019. Argentina and Venezuela had convergence ratios of around 0.7 in the mid-1970s (similar to AEs such as Finland, Ireland or Japan), only to be followed by a sharp divergence in the next half a century. Argentina has now a convergence ratio similar to Mexico whereas Venezuela has a ratio similar to Nicaragua (the poorest country in Latin America).[3]

3. **Advanced Economies experience.** According to WEO classifications, there are 39 AEs in the world (about ⅕ of all the economies). Back in 1989, there were only 21 AEs and the remaining 18 economies have been added to the group since 1990.[4] In other words, about half of the AE achieved their status in the last 3 decades. The table to the right lists the 18 new AEs with the year of inclusion as AE and the convergence ratio at that moment. Excluding extreme values, on average, an economy is considered advanced when the convergence ratio is about 0.6, but some economies were given that status with lower ratios. In particular, 6 AEs were given their AE status with convergence ratios similar to Panama in 2019 (4 EU states and 2 Asian Tigers), the list includes: (i) Estonia; (ii) Korea; (iii) Latvia; (iv) Lithuania; (v) Slovak Republic; and (vi) Taiwan Province of China. In fact, there are now 2 AEs with lower convergence ratios than Panama in 2019: Greece and Latvia.

New Advanced Economies: 1990-2016

	Economy	Year of Inclusion as Advanced Economy (AE)	Convergence Ratio at Time of Inclusion as AE
1	Greece	1990	0.61
2	Portugal	1990	0.58
3	Hong Kong SAR	1997	0.79
4	Israel	1997	0.63
5	Korea	1997	0.45
6	Singapore	1997	1.16
7	Taiwan Province of China	1997	0.53
8	Cyprus	2001	0.68
9	Slovenia	2007	0.63
10	Malta	2008	0.59
11	Czech Republic	2009	0.62
12	Slovak Republic	2009	0.46
13	Estonia	2011	0.52
14	San Marino	2012	1.08
15	Latvia	2014	0.44
16	Lithuania	2015	0.53
17	Macao SAR	2016	1.87
18	Puerto Rico	2016	0.58
	Memorandum items:		
	Average		0.71
	Average (excluding values > 1)		0.58

Source: WEO.

4. **Panama's growth outlook.** Panama's convergence ratio before the pandemic was similar to that of Korea 18 years ago (in 2003), Taiwan Province of China 26 years ago (in 1995), Hong Kong SAR 41 years ago (in 1980), and Singapore more than half a century ago. Staff estimates that Panama's potential growth rate is 5 percent per annum. However, the pandemic has been a major setback for the growth aspirations of Panama as real GDP declined about 18 percent in 2020. Current Staff projections indicate that the convergence level achieved in 2019 will only be recovered by 2026. However, there is scope for a

[3] Panama also suffered a divergence experience in the 14-year period from 1975 to 1989, when the convergence ratio fell from 0.38 to 0.24.

[4] The list of the 21 advances economies as of 1989 include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Japan, Luxemburg, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom, and the United States. The advanced economy with the lowest convergence ratio at that time was Ireland with 0.61 (only to double it in the following three decades).

higher growth in the second half of the decade as TFP was artificially negative last decade due to large investments with large gestation periods like the copper mine (the investment is recorded in real time but the returns to investment in terms of output is only recorded later on), and it was artificially negative in the first half of this decade due to the pandemic. There is an upside to the potential growth of 5 percent in the second half of the decade as it is predicated on the assumption of a still negative TFP. If TFP can be turned around from a -½ to a +½ percent (in line with the experience in the 1990s and 2000s), the potential growth rate would increase from 5 to 6 percent per annum. For this reason, it will be important in the meantime to undertake structural reforms that increase productivity in the economy, including by: (i) advancing the quality of education to improve the effectiveness of the labor force; (ii) improving the business environment to continue attracting high levels of investment; (iii) facilitating the absorption of foreign talent to increase human capital; (iv) fostering innovation to adopt better technologies; and (v) reducing institutional vulnerabilities to enhance the overall functioning of the economy. If growth is increased to 6 percent in the second half of the decade, by 2030 Panama would have achieved a convergence ratio of 0.6, which is the average of the economies that have transitioned from emerging to advanced economies in the last three decades.

Panama: Growth Accounting
(In percent)

				Projection	
	1990-99	2000-09	2010-19	2020-24	2025-29
Labor	1.9	1.7	0.8	0.7	0.7
Human Capital	0.4	0.3	0.2	0.2	0.2
Capital	2.9	2.9	7.2	3.9	4.7
TFP	0.4	0.7	-2.0	-3.0	-0.6
GDP	**5.6**	**5.6**	**6.2**	**1.8**	**5.0**

Source: Penn World Table 9.1 and IMF Staff calculations.

Annex VI. COVID-19 in Panama

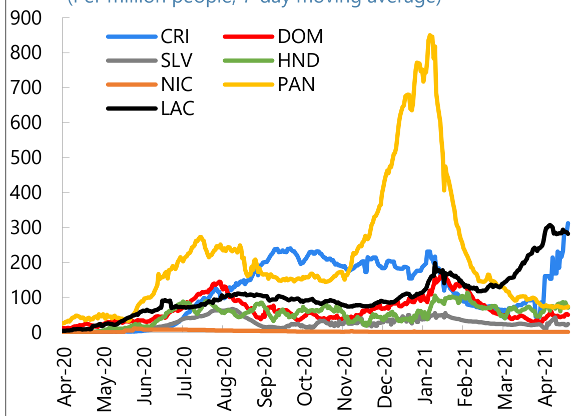
1. Panama has one of the highest new COVID-19 infection rates in the region. Its first confirmed case was reported on March 10, 2020. A first wave of infections peaked in July 2020 but a stronger second wave (almost 3 times stronger than the first) appeared from November 2020 until mid-January 2021, close to four times the region's average. According to Pan American Journal of Public Health, this could be explained by:

- ***Testing.*** Panama has one of the largest testing rates per inhabitant in the region, and consequently, one of the highest numbers of detected cases.

- ***Arrivals.*** The virus likely arrived into Panama City multiple times due to its constant influx of potentially infected cases as it is an international business and financial center, and a hub for canal passage and tourism.

- ***Density.*** High population density in Panama City with a metropolitan population of some 2 million people (second largest in Central America) and about 2½ million overseas visitors each year.

CAPDR and LAC: New Cases
(Per million people, 7-day moving average)

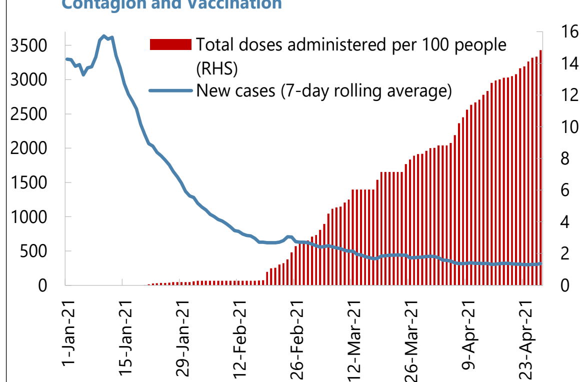


Source: JHU and IMF staff calculations.

2. The authorities implemented prompt and strict containment measures. They declared a national emergency on March 13, 2020; ordered mandatory quarantine with a curfew and movement restrictions; suspended all construction projects except for health-related; closed schools; canceled events; and banned all commercial flights (except cargo and humanitarian). Monthly working hours were also reduced by half.

3. Vaccination. To reduce the infection rate, the authorities allocated US$48 million and earmarked an additional US$20 million from the Panama Savings Fund (0.1 percent of GDP, in total) for the acquisition of COVID-19 vaccines. A platform for public vaccination registration was introduced in January 2021. Since then, vaccination continued to increase, reaching 14.8 doses administered per 100 people at end-April 2021. The authorities aim to vaccinate 3.6 million (over 70 percent of the population) by September 2021.

Contagion and Vaccination



Source: "Our World in Data" database and IMF staff calculations.

4. These efforts significantly reduced the infection rate and supported a gradual reopening of the economy. The number of new cases had declined to 368 cases at end-April 2021, an 84 percent decline from the peak in mid-January 2021. The quarantine ended in late October 2020, although the curfew remains in place. In September 2020, mobility restrictions ended while domestic flights resumed. Restaurants and beaches reopened in February 2021.

5. The risk of foreign transmission remains. Pan American Journal of Public Health warned that the constant arrival of potentially infected cases continues to be a risk for Panama given its international business stature, especially once the economic reactivation starts. Surveillance strategies at the ports of entry may be ineffective due to a prolonged incubation period of 14 days or more, allowing the virus to spread silently and rapidly.

Annex VII. Modified Fiscal Rule and Debt Sustainability

1. The modified fiscal rule approved by the National Assembly in late 2020 enshrined a convergence towards a 1½ percent of GDP deficit fiscal anchor, to be reached by 2025. However, the lockdown under the COVID-19 and its associated demand effects prompted a sharp loss of public revenues, principally taxes and social security contributions, and the need to expand discretionary spending in health and transfers. These developments, which rendered short-term fiscal objectives under the previous fiscal law unattainable, led the government to amend the fiscal rule by providing a lengthier period to reach a more ambitious anchor and increase the authorized deviation in the interim. To allow for a counter-cyclical response to the pandemic, the targeted deficit was set between 9-10½ percent of GDP in 2020 and between 7-7½ percent in 2021. After that year, convergence towards the new anchor, to be achieved in 2025, would follow a faster pace. Importantly, the new anchor was set at a 1½ percent of GDP deficit rather than the previous 2 percent of GDP, to compensate for the additional debt created prior to 2025.

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

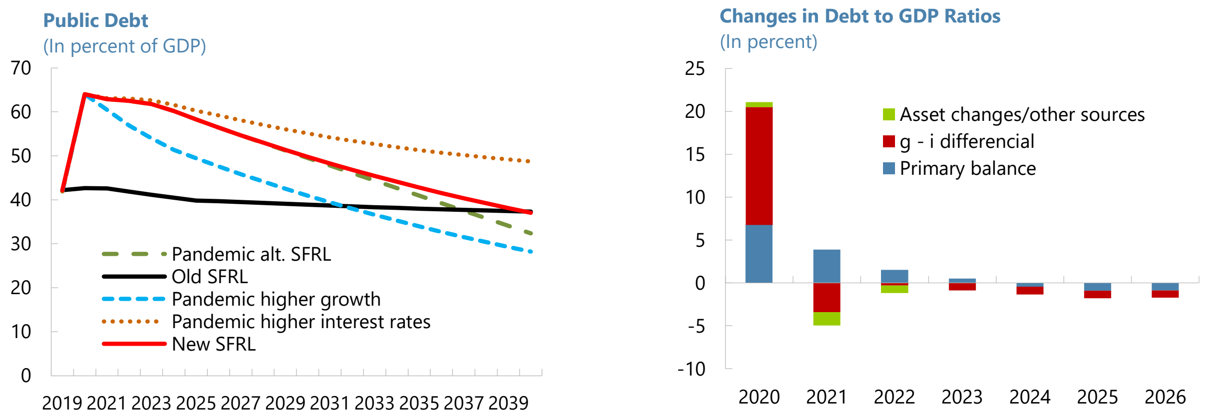
SFRL=Social Fiscal Responsibility Law

2. While in the short term there will be a higher level of debt, over a longer time horizon debt falls to lower levels. This is due to a stronger fiscal anchor under the modified fiscal rule.

- ***Convergence.*** The result is illustrated in the left hand side chart, which compares the public debt path in two main scenarios: (i) the baseline (black line), broadly in line with the 2020 Article IV projections before COVID, and subject to fiscal rule in force until October 2020; and (ii) the 2021 Article IV projections (red line), after COVID and subject to the amended fiscal rule. Public debt to GDP is consistently higher in the pandemic scenario in the next decade, but gradually converges to the baseline levels.

- ***Decomposition.*** It would be instructive to analyze the factors behind the increase in debt between the two fiscal rules. Such difference reaches its peak in 2020 (21.3 percent of GDP) and gradually narrows up to 16.7 percent by 2026. The right hand side chart breaks down the differences in annual debt changes between both scenarios (pandemic less baseline) into the contributions of the primary balance, the differencial between growth and interest rates (i.e., g-i) and asset changes**.** The initial surge of debt during the pandemic is primarily due to a strong deterioration of both g-i and the primary balance. From 2021 onwards, g-i contributes to lowering debt to a greater extent in the pandemic scenario. This is specially evident in 2021, due to the significant cyclical rebound. From 2023, there is also a noticeable contribution of lower interest rates. Deposits are an important source of financing in 2021 during the pandemic, mirroring pre-financing operations in 2020, thereby mitigating debt accumulation.

Debt to GDP Developments in the Medium and Long Term



Source: IMF.

3. In the longer-run, debt to GDP in the pandemic scenario converges to the baseline around 2040 thanks to a higher primary balance under the new rule, but also to the assumption that g-i remains more favorable after 2026 due to lower effective interest rates. The left hand side chart shows also some sensititivity exercises around this convergence path:

- ***The cyclical rebound until 2026 could be more robust.*** In the 2021 Article IV scenario, the level of GDP at current prices in 2026 is some 20 percent lower than in the pre-COVID scenario, and this gap is not closed after that year. The pandemic-higher growth scenario (blue dashed line) pictures a more intense recovery, with GDP in 2026 being 90 percent of the baseline. Under this assumption, debt would decline faster and in 2026 would only be 7 percent of GDP higher than in the baseline. The catch-up with baseline levels would happen before, around 2032.

- ***Interest rates could rise faster during the pandemic.*** This would be especially important if inflationary tensions arise. This possibility is captured by the pandemic-higher interest rates scenario, which assumes that the differential g-i converges to the baseline by 2026 and is constant thereafter. Debt would decline much more slowly in this case, being still 19.5 percent of GDP higher than in the baseline in 2026 and 11.5 percent in 2040. However, if this scenario materialized together with a higher GDP growth, the catch-up with the baseline would equally be achieved around 2040.

- ***Under a constant deficit rule, the primary deficit tends to deteriorate.*** Because the fiscal rule is based on an anchor defined in terms of a constant headline deficit (i.e., 1½ percent of GDP), as long as interest payments decline the primary balance tends to deteriorate. This may happen to a greater extent in the pandemic scenario, where the decline in the stock of debt is faster. One possible way to address this problem and accelerate the catch-up with the baseline would be to redefine the rule in terms of the primary balance. This is captured by the scenario pandemic-alternative fiscal rule. The catch-up with the baseline would take place 4 years sooner, and in 2040 debt to GDP would be almost 5 percent of GDP lower than under the current rule. The declining path of debt would be even steeper after 2040.

Annex VIII. Strengthening the Fiscal Framework

1. **The authorities are committed to undertaking the necessary actions to prevent new buildup of arrears in the future.** The new government elected in 2019 took stock of unrecorded and unpaid arrears generated by the Central Government before 2019 worth US$1.7 billion, of which around US$0.6 billion was due to suppliers or contractors. The bulk of these arrears had been paid by end-2020. Aware of the criticality of arrears prevention to bolster fiscal credibility, the authorities identified the main factors explaining arrears accumulation and developed an Action Plan to address them (based on technical assistance form the Fund).

2. **Domestic arrears were due to weaknesses in budget preparation, execution and accounting, as well as the overarching budgeting legal framework.** To address these issues, the authorities adopted an Action Plan over a two-year period, structured around the following building blocks: (i) developing a full-fledged medium-term budget that sets multi-year expenditure ceilings and ensures that carryovers, when authorized on an exceptional basis, are appropriated in next year's budget; (ii) enhancing the coverage and structure of the investment project database and ensuring its adequate use in budget preparation and its interfacing with the information system, in order to fully factor and transparently disclose the present and future costs of public investment; (iii) adopting an Organic Budget Law that has a superior legal status, with a view to provide a comprehensive scope on fiscal policy-making and the budget process, including by enshrining a multiannual budgeting framework; (iv) strengthening the legal sanctions for spending unappropriated amounts; (v) interfacing the budget information system with those IT applications tracking public contracts and bills, and ensuring that arrears are properly accounted even if they stem from unappropriated expenditure. The authorities are encouraged to continue refining the publication of the fiscal accounts adjusted by these arrears.

3. **Fiscal transparency would benefit from improvements in fiscal reporting, budget documentation and risk disclosure.** Quarterly fiscal reports should reflect operating and financing transactions in a GFS format, and provide an analysis on compliance with fiscal projections and performance drivers. The presently hybrid accounting system should evolve towards a full accrual one, which warrants capturing accrued costs of turnkey and other deferred payment projects[1]. Furthermore, the authorities should also publish consolidated end-year financial statements for the non-financial public sector. The credibility of the budgetary framework could be bolstered by including an updated breakdown of multi-annual costs of public investment by individual project, new and under execution. In the same vein, the Medium-Term Fiscal Framework (*Marco Presupuestario a Medio Plazo*) should incorporate a fiscal risk statement, covering macroeconomic

[1] The current reporting system is close to an accrual one but excludes accrued costs of deferred payment projects. Some of these projects (particularly those undertaken before 2019, worth US$3.4 billion) roughly follow a linear payment schedule, whereby they should not generate large discrepancies between the deficit as per the hybrid system or in pure accrual. However, projects in preparation (worth close to US$200 million) will be paid in two installments, at 50 percent of their execution and at their completion. This second type could be more problematic for an accurate representation of the fiscal deficit under the current system, and their accrued costs could be imputed according to their execution rate.

and specific risks emanating from SOEs or explicit contingent liabilities, as well as a public debt sustainability analysis. All these are basic and good fiscal transparency practices that other advanced countries in the region already adopted in the past or are gradually embracing.

4. Progress towards a more transparent and efficient procurement system was significant in 2020, although information on direct beneficiaries is not disclosed. The new Law 153/2020 on Public Procurement, in force since end-September 2020, has improved the system in several ways. Contracting has been streamlined by the possibility of presenting offers online, and the administrative verification of documents is now electronic. The selection of the members of evaluating committees is now less discretional. Competition has been encouraged by eliminating indicative bands around the reference price, and the contract value threshold above which offer bails are required has been raised from B/.50,000 to 500,000. The predictability of contract execution has been enhanced by the possibility of using arbitrage for dispute settlement, and the narrowing of ranges for contract price modification from 40 to 25 percent. Minor purchases (i.e. below B/.10,000), very common during the pandemic, are now made through a transparent system of online quotations rather than through bilateral contacts, and purchases under the exceptional procedure above B/.300,000 will have to consider at least 3 offers. The public procurement website (*Panama Compra*) has been enriched with a dedicated section on COVID-19 purchases and online quotations for minor purchases, and in the near future it will be expanded to include the documentation of the whole procurement process[2]. However, full information on direct beneficiaries is only requested (as pre-requirement for the presentation of offers) for companies bidding for contracts above B/.500,000, and according to past decisions of the Supreme Court is not disclosed.

5. A transparent disclosure of COVID-19 spending has become one key objective of the authorities, but current initiatives should be reinforced. The regular publication of extensive information on the procurement and execution of COVID-19 spending is a good practice, embraced by numerous countries, to enhance the government's accountability for these socially critical activities. Currently the website of the Panamanian Presidency discloses data on cumulative spending under the program Panama Solidario, and the MEF occasionally publishes dedicated and more comprehensive reports on COVID spending. Furthermore, Panama Compra provides specific data on the procurement of this spending. Nonetheless, further efforts should be made. Dedicated COVID-19 spending reports should be produced more frequently (at least on a quarterly basis), and they should contain more disaggregated data on the executing departments and the economic classification of spending. Furthermore, budget execution and fiscal reports should single out timely and accurately COVID-19 spending, and capture all in-year spending reallocations approved to finance it within the expenditure ceilings. Additionally, the Supreme Comptroller (Contraloria) has not published yet any dedicated audit report on COVID-19 spending, which would be highly recommendable given the streamlined ex-ante procedures that have applied to most of these purchases.

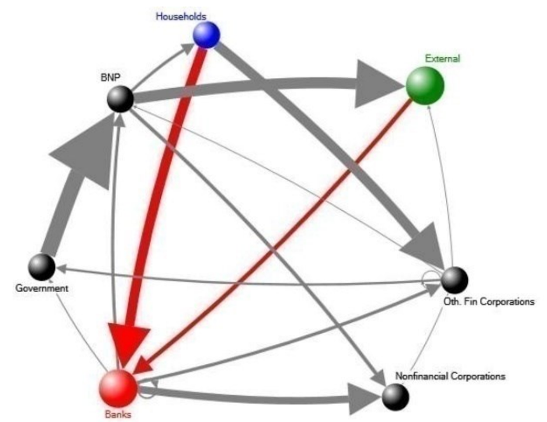
[2] Law 153/2020 also mandates the creation of a Digital Observatory, where the same information will be found in a user-friendly downloadable format, so that citizens can easily track all the stages of the procurement and make complaints when necessary. The authorities expect the Observatory to be launched before mid-2021.

Annex IX. Economy-Wide Balance Sheet Analysis

1. Panama's financial system is highly interconnected. An inter-sectoral balance sheet analysis, derived from net sectoral claims,[1] shows that commercial banks, non-bank financial corporations, government, households, nonfinancial corporations and external creditors are interconnected through the credit channel given Panama's large financial center, which amounts to twice the size of its economy. Commercial banks hold around 90 percent of the financial system's total assets while the remaining are held by insurance companies, securities firms, pension funds, financial cooperatives and other entities.

2. Households and external creditors are the principal net suppliers of loanable funds in Panama with banks serving as the center of linkages to other domestic sectors. In stock terms, households and external creditors provided 5.4 percent of GDP and 2.5 percent of GDP, respectively, of net funds to the banking sector in 2019, mostly in deposits. Nonfinancial corporations were the largest net borrower of funds from the banking sector (including BNP), amounting to 6 percent of GDP. The government also relied heavily on the domestic financial system for financing needs, borrowing a net 3.4 percent of GDP in total from banks and other financial corporations.

Net Inter-sectoral Claims[1]
(In percent of total claims)



Source: IMF Monetary and Financial Statistics, Staff Computation.
1/ Arrow direction shows net claims; arrow thickness shows the magnitude of the claims.

Balance Sheet Analysis Matrix, 2019 Net Positions
(In percent of GDP)

	Government	BNP	Banks	Other Fin. Corporations	Nonfinancial Corporations	Households	External
Government		-7.7	1.0	2.4			
BNP	7.7		1.9	-0.2	-2.1	-1.8	-5.5
Banks	-1.0	-1.9	-1.3	-2.0	-3.9	5.4	2.5
Other Fin. Corporations	-2.4	0.2	2.0	0.4	-0.4	5.8	-0.2
Nonfinancial Corporations		2.1	3.9	0.4			
Households		1.8	-5.4	-5.8			
External		5.5	-2.5	0.2			
Total	4.3	0.1	-0.5	-4.5	-6.5	9.3	-3.3

Sources: International Investment Position (IIP), Monetary and Financial Statistics (MFS).
Note: BNP refers to Banco Nacional de Panama (the largest state-owned bank).

[1] Computed as total assets *minus* total liabilities from one sector to another.

3. Implications. This analysis highlights the importance of maintaining well-functioning credit channels in the economy and healthy balance sheets to mitigate liquidity risks in the financial system.

- ***Credit channels.*** A prolonged economic deceleration which erodes the financial position of corporations could lead to problems in servicing their obligations to banks. This, in turn, may have an impact on the ability of banks to pay interest on household deposits, thereby eroding their confidence in the health of the banking sector. Moreover, weaknesses in banks' balance sheet, triggered by rising asset quality concerns, would reduce credit creation which reinforces the downturn.

- ***Liquidity risks.*** Given the sizable share of net claims by external creditors on banks, mostly in deposits, any large-scale withdrawals could exacerbate liquidity risks in the banking sector and potentially lead to a liquidity squeeze. This risk is magnified if banks face a sudden reversal in their external position, especially when correspondent banking relationships are interrupted. Compounding this risk, corporations facing difficulties in rolling over their external liabilities may be forced to run down their deposits in the domestic financial system to meet their external obligations.

4. To mitigate these risks, the government established a "Fund for Economic Stimulus" in August 2020. This Fund—fully owned by the MEF and operated by the BNP in consultation with SBP—has two programs with dual objectives of extending credit to support the economy during challenging times and providing emergency liquidity to solvent banks in the event of market dislocations.

- ***Stimulus program (SP).*** This program is 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 is 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.

- ***Liquidity program (LP).*** This program is operated jointly by the SBP and BNP. It 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 intending 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. Thus far, it has not been used.

Annex X. Building Resilience to Natural Disasters and Climate Change

1. Panama remains vulnerable to natural disasters and extreme climate conditions. At present, major climate risks are tropical cyclones and El Niño/La Niña events (droughts in the south, flooding in the north). Their impacts include damages to infrastructures, loss of human life, crop failure, reduced water quality and quantity. A possible intensification of both tropical cyclones and El Niño/La Niña events are expected to exacerbate present risks. The future combined annual cost of these extreme weather events is estimated to range between US$125 and US$150 million (0.36 percent to 0.42 percent of GDP), according to the Strategic Government Plan "Panama 2030". Higher air and sea-surface temperatures will lead to more frequent episodes of extreme heat and changes in marine ecosystems, adding stresses to Panama's economy. Sectors that are vulnerable with extensive actions needed to improve their resilience to climate change include agriculture, water resources, and coastal zones and marine ecosystems.[1]

2. Panama has stepped up efforts to build resilience to natural disasters and climate change. The authorities have demonstrated their high-level commitment to these adaptation and mitigation strategies.

- ***Adaptation policies.*** The authorities have developed a number of policies in collaboration with international agencies with expertise in the field. They include the National Climate Change Policy, along with the National Adaptation Plan; National Plan for Coastal Erosion Processes; Integral Plan for Sustainable Urban Mobility; National Energy Plan 2050; National Strategy for Sustainable Livestock; National Forest Strategy 2050; and the Panama Resilience Strategy. In addition, they initiated the creation of a Joint Task Force and a Regional Satellite Visualization and Monitoring System to respond to extreme weather events; the adoption of a National Water Security Plan 2015–50; vulnerable community reallocation programs; and national and regional plans for climate-change resilience of the agricultural sector.

[1] Panama's First National Communication to the United Nations Framework Convention on Climate Change (UNFCCC) provides further details.

Box A10. 1. Climate Change and Natural Disasters: Efforts in Building Resilience

Panama continues to make significant efforts toward mainstreaming climate change, environmental protection, and building resilience against natural disasters in its sectoral planning processes. Here are some of the most important undertakings.

- ***Structural resilience.*** Panama continues to make progress in investing in public infrastructures that also increase its resilience towards extreme weather and climate change. For example, the Panama Bay and City Water Sanitation Project, which in 2035 will feature three modular wastewater treatment plants, allows keeping pollutants from seeping into Panama Bay, especially during extreme rainfall events. This project has also mitigation co-benefits, as methane recovered from the wastewater treatment plant will provide 20 percent of the plant’s electricity and all its heating needs. The canal remains at risk from severe storms, flooding, and drought. As such, further investments would be needed to safeguard the integrity of the structure, infrastructure, and people living nearby. The authorities continue to collaborate with the World Bank through the Global Facility for Disaster Reduction and Recovery (GFDRR) on Panama City Waterfront Redevelopment and Resilience Program and Preparation of a Disaster Risk Management Plan.

- ***Financial resilience.*** Panama participates in the Caribbean Catastrophe Risk Insurance Facility's (CCRIF) parametric insurance cover for excess rainfall and has a country allocation of US$24 million from Green Climate Fund. However, the CCRIF facility is not designed to cover all losses but instead provides capital for emergency relief and early recovery needs to reduce post-disaster resource deficits and government budget volatility. As such, Panama would benefit from a layered approach for building buffers and managing the financial risk of natural disasters, which includes a natural disaster reserve fund to accelerate the financing of immediate recovery and response costs and a mix of risk-retention and risk-transfer instruments (such as ex-ante contingent lines of credit and CCRFIF) to manage risks associated with medium- to high-severity events. Following Hurricane Eta in November 2020, a natural disaster and environmental emergency fund was established with a seed capital of US$100 million. This fund is aimed at providing emergency relief and carrying out adaptation projects. As of end-February 2021, a total of US$26 million has been used. The government will replenish this Fund when an emergency occurs, by reallocating the national budget.

- ***Post-disaster resilience***. Panama has improved its legal and institutional framework for disaster risk management (DRM). The authority for Panama’s DRM National Platform stems from Law No. 7, Resolution 28, which established the National Civil Protection System (SINAPROC) in 2005. SINAPROC is responsible for coordinating DRM as the highest-ranking authority in the event of a natural catastrophe, and is charged with executing the actions, regulations and directives towards alleviating the impacts of disasters on human lives, goods, and society. Panama implemented the first early warning system in Central America that integrates voice and text messaging for communities at risk. The National Civil Protection System has strengthened local capacity for DRM and emergency response capabilities in several communities in the province of Panama, Western Panama and the countryside, Chiriquí, Bocas del Toro, Colón, Herrera and Los Santos. In addition, the SBP is enhancing social and environmental risk management for banks to ensure that banks are able to absorb the impact of natural disasters on their balance sheets. Hurricane Eta in 2020 affected loans in agriculture and livestock, amounting to US$91 million (0.1 percent of total loans).

- ***Mitigation policies.*** The authorities had undertaken several "green" energy initiatives which include fuel pricing mechanisms based on the import parity price and subsidy for LPG targeted to low-income consumers; import tax exemption on equipment and materials used for the installation and maintenance of wind energy generation plants; emission reduction plan for the aviation sector; and an unconditional pledge to increase the share of renewables in the electricity mix to 15 percent by 2030 compared to base year 2014, and 30 percent increase in renewable energy capacity by 2050. In addition, they committed to: (i) promoting the use of new technologies for improving the efficiency, generation, storage, transmission and distribution of energy; (ii) sustainably managing Panama's forest resources, including through reforestation and agroforestry; and (iii) protecting its water resources[2]. In June 2020, the government launched a new national program "Sustainable Panama: Reduce your Footprint" to encourage public and private industries to lower their carbon footprint through measures such as energy efficiency retrofits and switching energy supply to renewable sources. The initiative is aimed at redesigning a more sustainable economy in the wake of COVID-19. Panama's economy-wide emissions reduction targets has also been updated in December 2020, which includes a 11.5 percent reduction in greenhouse gas (GHG) compared with business-as-usual (BAU) by 2030 and a 24 percent reduction in GHGs excluding land use, land use change and forestry (LULUCF) by 2050 compared with BAU.[3]

3. Efforts to limit disruptions caused by natural disasters should continue to focus on three areas: structural, financial, and post-disaster resilience. Panama has achieved marked progress in these areas (Box above). To provide development partners a comprehensive guide to the authorities' needs and plans, and to facilitate the coordination of support, the authorities could benefit from preparing a Disaster Resilience Strategy (DRS) based on a multi-year macro-fiscal framework, with input from stakeholders. Undertaking a Climate Change Policy Assessment (CCPA) would help achieve this objective, in addition to providing an overarching assessment of the country's climate strategies and helping to build coherent macro-frameworks to respond to climate change.

[2] The Panama Canal Authority introduced a freshwater surcharge for ships in transit, raising over US$200 million in 2020 for water management projects.

[3] Both of these targets are conditional on receipt of international climate finance. Panama, along with 110 countries, has communicated an intention to achieve 'carbon neutrality' (net-zero carbon emissions) by 2050. As these targets do not appear to be aligned with the net zero objective, Panama may need to increase them in the future.

Annex XI. Policies to Support the Labor Market

1. **Confronted with rigidities in the labor market, the authorities devised creative solutions to ease the impact of the pandemic.** Dollarized economies are usually associated with rigid labor markets (where nominal wages cannot be easily adjusted or staff reductions are costly, for example) and tend to magnify macroeconomic shocks as these economies do not have the ability to use the exchange rate and inflation as a mechanism to reduce real wages as a buffer for unemployment. Panama is one such case where domestic labor market adjustment mechanisms are unyielding, potentially prolonging the recession after the "shock of a century" brought on by the global pandemic, and where there is no unemployment insurance. However, the Panamanian authorities responded to the shock by rendering the domestic employment practices more flexible by deploying the suspension of labor contracts and making the newly unemployed residents eligible for targeted transfers, which acted as an automatic stabilizer in 2020.[1]

2. **The labor code provided the basis for some labor flexibility by appealing to an infrequently used provision.** While Panama's Labor Code allowed contracts to be suspended under emergency conditions for a short period, this practice was rarely used before the pandemic. Specifically, Article 199 of The Panama Labor Code allows the suspension of employment contracts, temporarily removing the obligation to render services by the employee and to pay wages by the employer, for a maximum term of four months. In response to the pandemic, through Law 157 of August 3, 2020,[2] this term was extended until December 31, 2020, and again stretched through several Executive Decrees, to achieve the gradual reinstatement of employees by economic sector and based on prioritized return according to employee status (such as union rights, maternity leave, disability and length of contract suspension). Before becoming law, this practice was formalized through two decrees: Executive Decree 81 issued on March 20, 2020 (authorizing the suspension of labor contracts for companies that closed due to the state of emergency declared by Panama in response to the COVID-19 pandemic) and Executive Decree 101 issued on July 13, 2020 (establishing that total monthly working hours cannot be reduced by more than 50 percent).

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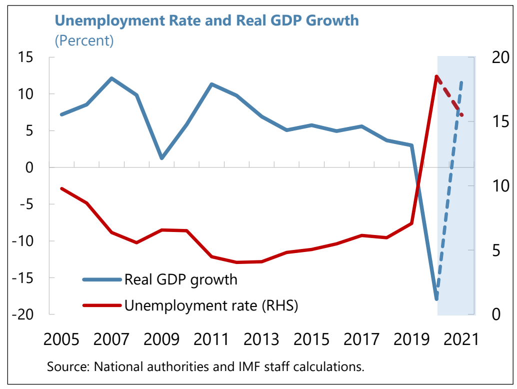
[1] It is estimated that during 2020 the government spent about US$1.1 billion (about 2 percent of GDP) on the "*Panama Solidario*" program to support the population in need due to the COVID-19 pandemic. About ⅓ of that amount was spent in support of unemployed workers with suspended contracts through the "*Vale Digital*" program that would benefit almost 300,000 households or over 1 million people (about ¼ of the population of Panama).

[2] On August 3, 2020, the temporary regulations for the protection of employment for companies affected by the Covid-19 pandemic became law. Provisions in Law 157 include: the extended suspension of labor contracts through December 2020; prohibition of discrimination against workers during their gradual reinstatement to the workplace (they also can't be forced to return to work if they have health concerns); prohibition of hiring new workers, whether for the same or similar role as a suspended one; calculation of seniority and compensation for workers to be completed based on salaries received in the previous 6 months or the last monthly salary before the state of emergency was declared. The law also added an article to the Labor Code regarding maternity leave. The added article established that maternity leave would not be observed for an employee whose contract is otherwise suspended. The remaining time of the maternity leave will resume once the worker is reinstated.

3. The mechanism also allows for a gradual contract reinstatement. On February 25, 2021, President Cortizo enacted Law 201[3], which amended Law 157 to preserve employment and business stability. Most importantly, the new regulations mandated for workers with suspended contracts to be reinstated to their workplace gradually by economic sector, recognized the payment of maternity leave benefits, and made specific provisions for people with disabilities. The gradual return of workers with suspended contracts was arranged by economic sector: companies that are part of the primary sector (mining) have 3 months (until May 2021) to reinstate the suspended workers. Companies in the secondary sector (manufacturing) have 6 months (until August 2021), while companies in the tertiary sector (services, including tourism) and companies with 10 employees or fewer have 8 months (until October 2021) to reinstate their workers.

4. The evidence on labor contract suspensions and reinstatements suggests that the unemployment rate is already falling. The unemployment rate in Panama stood at 7 percent in 2019 and more than doubled to 18½ percent in September 2020 amid labor contract suspensions. In 2020, a total of 284,029 labor contracts were suspended due to the pandemic, or almost 15 percent of the labor force, (estimated at about 2 million people). Based on the latest data, 140,080 contracts have been reactivated, which is almost ½ of the originally suspended contracts as of March 2021. Using this data, staff estimates the unemployment rate could have declined from 18.5 percent to 15½ percent in March 2021. Furthermore, using estimates of Okun's Law and the projected real GDP growth for 2021, the unemployment rate may decline further to around 7 percent by end-2021.



5. Support measures instituted by the government have helped businesses and provided some assistance to workers. To receive employment support, an employer must register the furlough while justifying suspension measures through a digital portal, and get a digital coupon from the Ministry of Labor and Labor Development (MITRADEL). Only those companies that remain closed by order of the Health Authority may keep all workers suspended. The moratorium on servicing bank loans provide some support to businesses, improving the chances of remaining liquid and able to pay their employees as they reintegrate in the workforce. At the same time, furloughed workers receive transfers through the program called *Panamá Solidario* (their benefits are activated in the database once their employer's contract suspension application is approved), transferred through the digital voucher called *Vale Digital* which is linked to their national ID card (essentially turning it into a debit card). The value of the digital voucher is equivalent to US$120 per month, and these have been paid to eligible individuals since March 2020.[4]

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[3] Based on Executive Decree 229 dated December 15, 2020 (https://www.mitradel.gob.pa/wp-content/uploads/2020/12/Decreto-Ejecutivo-229-Reintegro-de-Trabajadores-Suspendidos.pdf). Link to Law 201: https://www.gacetaoficial.gob.pa/pdfTemp/29228_A/83620.pdf

[4] *Panamá Solidario* is a temporary economic support program created in response to the COVID-19 pandemic that provides two types of support: (i) digital vouchers (Vale Digital), targeted at the poor and vulnerable in urban and

(continued)

6. Going forward, the government plans to support the labor market through additional measures. With employment support programs available only to the formal sector of the economy, reducing informality remains an important policy goal. To this end, the authorities have created an inter-agency commission aiming to address informality under the auspices of the Employment Division of MITRADEL. In addition, to reduce the labor force participation gap and help women join the labor market, initiatives are underway to create childcare centers within government facilities. Consideration should also be given to align salary adjustments with productivity and economic conditions, and easing restrictions on foreign employment to foster knowledge sharing.

peri-urban areas and suspended low-salary formal workers; and (ii) food baskets, targeted at the poor and vulnerable living in Indigenous territories and rural areas where the distribution of digital food voucher turned not feasible, as well as those who are in quarantine due to exposure to infected people. The decision to create the PPS payment system linked to the national identification card system during the pandemic responded to the need to reduce the transaction costs of opening bank accounts for new beneficiaries. The program covers citizens and foreign workers alike.

Annex XII. Supporting Sustainable and Inclusive Growth

1. The authorities should design structural policies to perpetuate the high growth of past decades by fostering productivity. Panama had the longest and fastest economic expansion in Latin America of the last quarter century, growing at an average annual rate of 6 percent. Against this background, Panama needs to adopt a structural reform agenda to enhance productivity and perpetuate the high growth observed in the past while avoiding falling in the "middle-income trap". Continuously improving the business environment, advancing the quality of education, mitigating governance and institutional vulnerabilities, and fostering innovation lie at the heart of increasing labor productivity and closing the gap with advanced economies. Over the medium term, upgrading the infrastructure and creating economic conditions that facilitate the transition into technology-intensive, innovative industries with high growth potential will be necessary to achieve high-income living standards. Additionally, enhancing Panama's natural disasters resilience strategy will help limit disruptions to lives and livelihoods (Annex X).

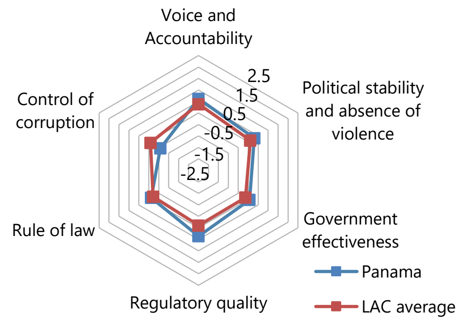
2. Panama needs to upgrade its business climate, innovation capacity and governance to enhance its attractiveness to foreign investment. This will be particularly important in the post-pandemic period as Panama will be competing more intensely with other jurisdictions pursuing similar policies:

- ***Investment climate*.** According to the 2019 Global Competitiveness Report (GCR), Panama performs poorly in the areas of labor markets, information and communication technology (ICT) adoption and innovation capacity. The country's courts need to improve judicial independence and enforcement capacity, especially with respect to business contracts and property rights in rural areas, and the insolvency framework remains weak. At the same time, labor market functions are impeded by various restrictions, including on hiring and firing procedures and the employment of foreign workers, while poor educational outcomes contribute to skilled labor shortages. Current workforce skills fall short of needed skills in the GCR – absent reform efforts to boost educational outcome and enhance labor market flexibility, Panama will face retrenchment in competitiveness in the medium term.

- ***Innovation*.** Perpetuating high growth in Panama will depend on its capacity to innovative. To foster innovation, it will be important to continue attracting large levels of FDI, moving into higher value-added activities and developing a skilled workforce to absorb knowledge spillovers. Unfortunately, Panama lags its peers on the quality of its research institutions and R&D expenditure. Special economic zones were the main attractor of foreign talent and knowledge-intensive industries in the past. However, spillovers to the local economy appear to be limited, partly because of restrictions on the mobility of foreign workers. Staff supports the authorities' intention to raise investment in science, research and development.

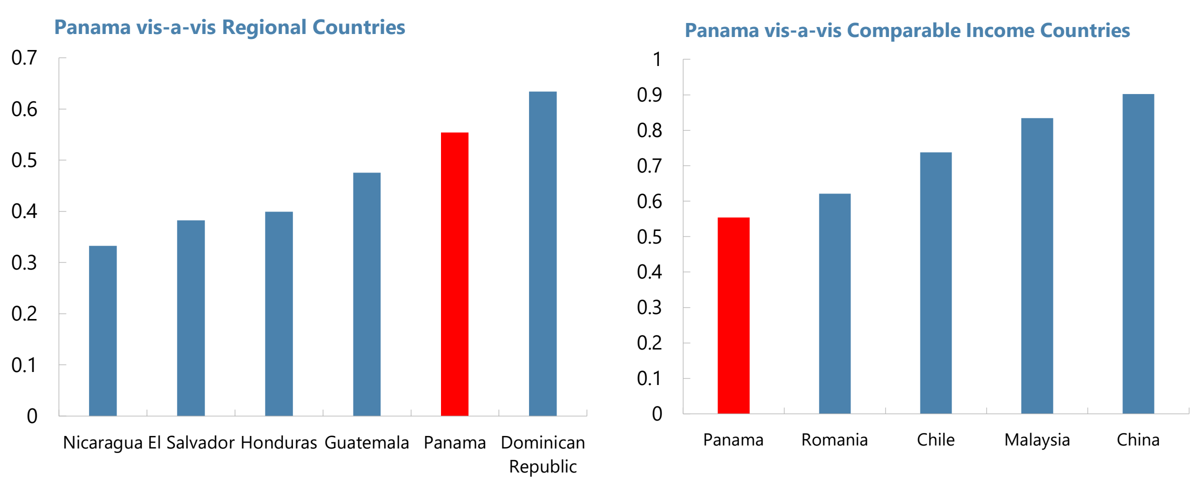
- ***Governance.*** While Panama performs well relative to regional peers in most dimensions, 2019 Worldwide Governance Indicators point to some deterioration in government effectiveness (perceptions of the quality of public services and the degree of policy independence from political pressures) and rule of law in recent years, as well as a decline in the control of corruption indicator, over the last decade. Weaknesses in product markets also remain to be addressed. [1]

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



Source: The Worldwide Governance Indicators and IMF staff calculations.

Overall Financial Inclusion Index



Source: Sahay, Ratna et al. (2020). "The Promise of Fintech: Financial Inclusion in the Post COVID-19 Era". International Monetary Fund

3. **Financial inclusion.** Panama ranks favorably compared to regional peers in terms of overall financial inclusion but underperforms countries with comparable per capita income. While Panama does not have a formal national strategy on financial inclusion (an important development milestone), the SBP issued legal tools that allowed banking entities to offer products for sectors not included in the financial system, such as regulations for opening of accounts for simplified processing, and the implementation of nonbank correspondents. [2] The implementation of these

[1] The Worldwide Governance Indicators (WGI) are perception-based indicators summarizing views of enterprises, citizens and expert survey respondents on the quality of governance in a country complied by the World Bank. For Panama, the average standard error of these indicators is 0.17, which reflects the difficulty in measuring governance. For a detailed definition of all the six WGI, go to: https://info.worldbank.org/governance/wgi/, which includes the standard error of each index. The LAC averages in the chart encompasses the countries within the Latin America and the Caribbean group as defined in the World Economic Outlook.

[2] Simplified due diligence rules apply to accounts with monthly transactions below US$1,500, in compliance with the FATF recommendations. These have been available in Panama since 2015.

tools has contributed to stimulating financial inclusion in Panama. The SBP is also in the process of amending existing regulations to allow fintech firms to interact within the payment ecosystem along with all other financial agents. This would enable payment-focused fintech entities to reduce the cost of access to finance and thereby foster financial inclusion in Panama. It would be important to develop a regulatory sandbox regime to further promote financial innovation through fintech. Furthermore, in October 2019, the SBP launched a National Strategy for Financial Education in cooperation with the government and other financial institutions, which is seen as a prerequisite to broadening financial inclusion.

4. **The pandemic has widened socio-economic gaps and increased poverty, despite the government's mitigation efforts.** The deep and protracted impact of the pandemic exacerbated Panama's preexisting developmental challenges, such as income inequality, lack of social inclusion among women and indigenous communities, rural poverty, and educational gaps. While the timely introduction of various support programs for the vulnerable population segments undoubtedly reduced the magnitude of the shock, poverty rates are still expected by the World Bank to increase by at least 3½ percentage points, especially in rural areas, while disruptions to tourism, construction, logistics and commerce—where the employment share of women, indigenous people and other socioeconomic minorities is high—disproportionately affected these already disadvantaged population segments. In addition, the pandemic disrupted the provision of health and education services, which may have lasting repercussions for human capital, competitiveness, and growth, and contributed to higher incidence of domestic and gender violence during lockdowns.

5. **Reversing socioeconomic contractions will require decisive policy action in the medium term.** While the government's short-term priority is containing the spread of the virus and protecting the vulnerable, long-term goals must include enhancing the efficiency of social spending, (including by centralizing the registry of beneficiaries, which is currently in its final stages), strengthening educational and technical training outcomes, and prioritizing country-appropriate and fiscally-sustainable strategies to reduce inequality, improve the living conditions in the *comarcas* (areas inhabited by indigenous populations), and enhance women's economic opportunities and livelihoods.

6. **The authorities concur that filling the socioeconomic gaps widened by the pandemic is imperative for sustainable growth.** The social support programs operating during the pandemic were key to sustaining the consumption needs of the vulnerable, but post-pandemic recovery necessitates long-term strategic policy action to align Panama's social outcomes with those of countries with comparable income levels. The authorities are cognizant of the importance to make the recovery inclusive and broad-based and welcome continuous cooperation with various development partners to achieve this goal. The importance of supporting a more business-friendly and competitive environment is also well understood – the authorities are advancing such initiatives as accelerating digitization, introducing more flexibility in employment practices, and expanding financial education programs. The authorities welcomed initiatives on promoting financial inclusion and fintech.

INTERNATIONAL MONETARY FUND

PANAMA

May 24, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of April 30, 2021)

Membership Status: Joined March 14, 1946; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	376.80	100.00
Fund holdings of currency	699.20	185.56
Reserve Tranche Position	54.41	14.44

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	197.01	100.00
Holdings	120.72	61.28

Outstanding Purchases and Loans:

Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PLL	Jan 19, 2021	January 18, 2023	1,884.00	0
Stand-By	June 30, 2000	March 29, 2002	64.00	0
EFF	December 10, 1997	June 29, 2000	120.00	40

Outright Loans:

Type	**Date of Commitment**	**Date Drawn**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
RFI	April 15, 2020	May 15, 2020	376.80	376.80

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

	2021	2022	2023	2024	2025
Principal			94.20	188.40	94.20
Charges/Interest	3.00	4.00	3.89	2.34	0.47
Total	3.00	4.00	98.09	190.74	94.67

Implementation of HIPC Initiative: Not applicable

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

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

Safeguards Assessment

A first-time safeguards assessment of the National Bank of Panama (NBP), conducted in connection with the RFI purchase on April 15, 2020, was completed in September 2020. 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 NBP should enhance its investment practices, and the authorities should finalize the framework implementing the Fund for Economic Stimulus (FES), including on aspects of its decision-making processes and operational modalities.[1]

Non-Financial Relations

Exchange Rate Arrangement

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

Last Article IV Consultation

The 2020 Article IV consultation was concluded on April 24, 2020. Panama is on the standard 12-month consultation cycle.

Financial Sector Assessment Program (FSAP)

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

Technical Assistance

Panama is a large recipient of technical assistance (TA) directly through the Fund or CAPTAC-DR. Assistance in the fiscal area included budget execution and control; general diagnostic of the tax system, including tax exemptions; and revenue administration reform. More recently, an STA mission in the area of financial sector focused on improving monetary and financial statistics. Support was provided with in topics relating to national accounts and real sector statistics.

Resident Representative

Metodij Hadzi-Vaskov (based in Guatemala) is the Regional Resident Representative for Central America, Panama and the Dominican Republic.

[1] The legal framework for the FES is in progress as some adjustments to the Trust and By-Laws are needed.

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

(As of February 28, 2021)

World Bank: https://www.worldbank.org/en/country/panama/overview

Inter-American Development Bank: https://www.iadb.org/en/countries/panama/overview

Development Bank of Latin America (CAF): https://www.caf.com/en/countries/panama/

Central American Bank for Economic Integration: https://www.bcie.org/en/member-countries/regional-non-founding-members/republic-of-panama

MAIN WEBSITES OF DATA

National Institute of Statistics and Census (http://www.inec.gob.pa/)

National accounts

Consumer price index

Monthly indicator of economic activity (IMAE)

Balance of payments

International reserves

Exchange rates

Labor and employment

Household income and expenditure survey

Poverty and inequality

Ministry of Economy and Finance (https://www.mef.gob.pa/)

Fiscal accounts

Central government budget

Superintendency of Banks (https://www.superbancos.gob.pa/en)

Balance sheets and income statements

Financial soundness indicators

Interest rates

Monetary and financial indicators

Panama Canal Authority (https://www.pancanal.com/)

Balance sheets and income statements of Panama Canal

Performance indicators for Panama Canal

STATISTICAL ISSUES

(As of May 11, 2021)

I. Assessment of Data Adequacy for Surveillance

General: Data provided to the Fund has some shortcomings but is broadly adequate for surveillance. The accuracy, timeliness, and publication of economic statistics have improved, but weaknesses in national accounts, government finance, and balance of payments statistics need to be addressed.

Real Sector: The timeliness of real sector data provision has improved; however, data continues to be subject to sizable revisions. After the change of the base year of the national accounts to 2007, the rebased GDP from the production approach has been published on an annual and quarterly basis both at current prices and as chained volumes. Annual GDP series from the expenditure and income approaches are available in current prices for 2007-18. Quarterly data from the production approach are available until 2020Q4 and from the expenditure approach until 2020Q3. The monthly economic activity index has benefited from the use of administrative source data and the correct implementation of statistical techniques, such as benchmarking and seasonal adjustment. The IMF national accounts technical assistance (TA) has provided support to improve the compilation of national accounts statistics, including input-output tables, quarterly GDP, institutional sector accounts, and employment matrices. Seasonally adjusted quarterly GDP is not currently available, and a project is underway to develop it. A new benchmark compilation to rebase the national accounts series from 2007 to 2018 is under development, but progress has been slow. The consumer price index (2013=100) is compiled monthly and with an envisaged timeliness of 15 days following the reference month, which is an improvement over the e-GDDS encouraged timeliness of two months, based on the 2007/08 household income and expenditure survey (HIES). A new HIES was collected during 2017/18, and a rebasing of the CPI is expected to be started during 2021. The producer price index (2016=100) is compiled and published quarterly. In addition, IMF TA has been provided to develop updated annual and quarterly producer, export, and import price indices, and support the development of annual economic surveys to non-financial enterprises. The National Institute of Statistics and Census (INEC) is receiving support from the World Bank to fund TA on national accounts.

Government Finance Statistics: Further efforts would improve the quality of fiscal data in support of surveillance. Since January 2018, the authorities have received five TA missions and attended regional training workshops, from CAPTAC-DR to assist in updating GFS and Public Sector Debt Statistics (PSDS) to best international standards for decision making. FAD has provided TA in the area of public accounting, including implementation of government accounting reforms and the practical application of the accounting policies established in the International Public Sector Accounting Standards (IPSAS), an important step toward improving fiscal transparency. The authorities also started publishing information on liabilities derived from the turnkey projects and contingent liabilities.

The authorities launched a new platform for centralized management of public sector financial information (Integración y Soluciones Tecnológicas del Modelo de Gestión Operativa, ISTMO), which is expected to further help enhance transparency and efficiency.

Panama has reported budgetary central government and local government data time series with annual information from 2014 to 2018 to STA for publication in the GFS Yearbook. However, these data are limited to revenue and expenditure data with no financing or debt data yet reported. Panama started publishing fiscal and debt data on a regional database hosted by the Central American Monetary Council (CMCA). INEC has been responsible for the compilation, but primary data is generated within the MOF. MOF and INEC are encouraged to improve coordination to boost the use of data compiled for analysis and decision making.

More progress is expected in improving fiscal tables, including public sector debt data. Currently, the Panama Canal Authority (ACP) and three public enterprises are excluded from the nonfinancial public sector (NFPS) accounts and public debt**.**

Monetary and Financial Statistics: Panama regularly reports monetary data for depository corporations using the standardized report forms (SRFs) for publication in the International Financial Statistics. Panama reports Financial Soundness Indicators (FSIs) to STA on a regular (quarterly) basis with data beginning in 2005. The authorities started using the aggregate housing price index, collected by a contractor. Data gaps still prevent a deeper analysis of systemic risks as the authorities do not collect adequate data on commercial real estate prices, loan write-offs, loan-to-value ratios, and leverage indicators for households and corporates, as there is no mechanism to monitor debtor's income and value of the acquired property objects after the loan has been granted. Panama reports data on several series indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

Balance of Payments: Panama disseminates quarterly balance of payments and international investment position (IIP) data in the BPM6 format, with a timeliness of about one quarter exceeding eGDDS recommendations. Data are subject to revisions and revised estimates in key trade and investment data may result in substantial revisions of the current account of the balance of payments. The review cycle is predetermined and stable. While users are informed whether data are preliminary or revised, the review cycle is not public nor are the causes of the review explained. These revisions may reflect improvements in coverage, but they also suggest that there is room for improvement in quality control procedures. Data on outward FDI and repatriation of profit and dividends from these investments are only collected from the financial private sector. Official statistics may underestimate inward portfolio investment. The Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS) are conducted timely.

II. Data Standards and Quality

Panama has participated in the IMF's General Data Dissemination System (GDDS) since December 2000. With STA assistance, in October 2018, Panama implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS) by publishing critical data through the National Summary Data Page (NSDP). A ROSC –data module was published in October 2006. As the Fund resumed ROSCs, Panama received the first ROSC mission as a follow-up to the 2006 exercise, which was published in February 2021. The 2021 ROSC finds that Panama has a well-developed macroeconomic statistical system and the government recognizes the importance of good statistics for policy and investment decisions, and includes recommendations for Panama to further adhere to international best practices and enhance the analytical usefulness of Panama's statistics.

Table 1. Panama: Common Indicators Required for Surveillance
(as of May 11, 2021)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	2/2021	3/2021	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities	3/2021	4/2021	M	M	M
Reserve/Base Money	3/2021	4/2021	M	M	M
Broad Money	3/2021	4/2021	M	M	M
National Bank of Panama Balance Sheet	3/2021	4/2021	M	M	A
Consolidated Balance Sheet of the Banking System	3/2021	4/2021	M	M	M
Interest Rates[1]	1/2021	3/2021	M	M	M
Consumer Price Index	3/2021	4/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[2] – General Government[3]	12/2020	4/2021	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[2]–Central Government	12/2020	4/2021	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[4]	12/2020	4/2021	M	M	M
External Current Account Balance	12/2020	4/2021	Q	Q	Q
Exports and Imports of Goods and Services	12/2020	4/2021	Q	Q	Q
GDP/GNP	2020	1/2021	Q	Q	Q
Gross External Debt	12/2020	4/2021	Q	Q	Q
International Investment Position [5]	12/2020	4/2021	Q	Q	Q

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

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
June 14, 2021

1. On behalf of our Panamanian authorities, we thank Executive Directors and Management for their continuing support to Panama. We also thank Mr. Santos and his team for their open dialogue during the Article IV consultation and for their informative report on Panama's macroeconomic outlook and policies. The authorities reiterate their utmost appreciation for the Fund's continued technical assistance and valuable policy recommendations.

2. **The pandemic has severely impacted the Panamanian economy**. Real GDP contracted by 17.9 percent in 2020 driven by pandemic-induced disruptions in tourism, air transportation, construction, and commerce, with unemployment reaching 18.5 percent in 2020, compared to 7.1 percent in 2019. Nevertheless, the authorities' swift health response was critical to mitigate the socioeconomic impact of the pandemic. Theseefforts included the creation of *Panama Solidario* to assist unemployed workers and low-income families, the implementation of tax moratoriums, and an ample loan forbearance program. The authorities continue to provide support to vulnerable households and small businesses, while implementing an aggressive vaccination campaign.

Recent Developments and Economic Outlook

3. **Expectations point to a strong rebound in 2021**. A major lockdown in response to a second wave of COVID-19 cases during the holiday season interrupted the recovery momentum in early 2021, with IMAE (the monthly indicator of economic activity)falling 10.1 percent in the first quarter, compared to the first quarter of 2020. However, economic activity has progressively recovered as the government resumed its infrastructure investment plan (headlined by the Metro Line 3 mega-project), in parallel with multiple private sector initiatives. Furthermore, as the commercial and service

   sectors steadily reopen, employment continues to bounce back with about half of the 284 thousand suspended contracts reactivated by end-March. Against this background, the authorities expect real GDP growth to reach 9 percent in 2021.

4. **The progress in the vaccination rollout should provide a boost to the recovery**. Vaccination started in late January with the arrival of the first Pfizer doses. The authorities have reached supply agreements for 9.3 million doses from Pfizer, AstraZeneca and COVAX for full two-dose coverage of the entire population. Through

late May, 17.9 percent of population received at least one dose, while new cases and deaths remained subdued. Fulfilling the current vaccine delivery schedule will be critical to reach herd immunity before the end of the year target, providing a definitive boost to the ongoing economic recovery.

Fiscal Policy and Public Financial Management

5. **The fiscal position deteriorated in 2020 consistent with the recession and the emergency support to the economy but is expected to improve in 2021**. The tax moratoriums and the unprecedented expenditure expansion in response to the pandemic widened the fiscal deficit to 10.1 percent of GDP in 2020 from 3.6 percent of GDP in 2019, pushing the debt-to-GDP ratio to 64 percent at year-end. However, Panama has continued to have ample access to capital markets at favorable conditions, issuing a new US$2.45 billion global bond in mid-January. As the economy responds to the stimulus, the vaccination rollout gathers steam and the policy support becomes more targeted,fiscal performance is projected to improve and close 2021 with a 7.5 percent of GDP budget deficit in line with the Social and Fiscal Responsibility Law (SFRL) ceiling.

6. **Looking ahead, the authorities are fully committed to fiscal consolidation consistent with the strict implementation of the SFRL**. The SFRL targets a declining fiscal deficit of 7.5 percent of GDP in 2021, 4.0 percent in 2022, 2.0 percent in 2023-24 and 1.5 percent in 2025, consistent with a steady decline in the debt-to-GDP ratio. As the global economy recovers and international trade accelerates, fiscal revenue should be supported by the *Cobre Panamá* mine, the Panama Canal and the introduction of revenue- enhancing measures aimed at improving tax collection efficiency, broadening the tax base, and streamlining tax exemptions.

7. **The government is also committed to strengthening public financial management (PFM) by enhancing fiscal transparency and efficiency**. IMF technical assistance on budget management and procurement has become instrumental to this end. The authorities are currently improving the multi-year budget formulation framework, enhancing expenditures controls, and increasing expenditure efficiency to improve social outcomes. Technical assistance is also supporting the work on amending the Organic Budget Law and upgrading internal procedures and controls to avoid future accumulation of arrears.

Financial Sector Performance and Macroprudential Technical Assistance

8. **The financial sector continues to display resilience, with ample liquidity and strong capitalization**. Liquidity indicators stayed above 60 percent of total deposits throughout 2020 and the first quarter of 2021, while the capital adequacy ratio (CAR) reached 15.8

percent at end-March 2021, nearly twice the regulatory benchmark. The credit portfolio that benefitted from the loan moratorium decreased from its US$28.1 billion peak in August 2020 to US$19.6 billion in late April 2021. Provisioning for modified loans was established at 3 percent of gross balances to mitigate the risk of an abrupt increase in nonperforming loans (NPLs). NPLs remained stable throughout 2020 and stood at 1.9 percent by end-March 2021. In addition, the US$1.0 billion fund for economic stimulus (FES), owned by the MEF and operated by the *Banco Nacional de Panama* (BNP), was established as an instrument to provide liquidity for the banking system and support the recovery.

9. **The Superintendency of Bank (SBP) continues to strengthen supervision**. SBP has made progress on draft legislation to bolster bank resolution, update its effectiveness, and increase depositors' protection. In addition, SBP officials have indicated the need of further MCM TA to boost the macroprudential policy framework, systemic risks monitoring, stress-tests, digital banking, and cybersecurity. Moreover, the authorities formally requested in April 2021 the inclusion of Panama in the financial sector assessment program (FSAP). The last FSAP was conducted ten years ago in 2011 andwas instrumental to bolster regulation and consolidated supervision. The authorities look forward to Management's support to move ahead expeditiously with this request.

AML/CFT Regulations, Financial Integrity, and Data Adequacy

10. **Bolstering AML/CFT capacity remains a top priority of the government**. The authorities presented a progress report on AML/CFT issues in early January 2021 as the initial step for FATF's plenary assessment in late February. The plenary assessment concluded that Panama had made progress relative to the Action Plan, yet further actions were still needed. In this regard, the Ministry of Economy and Finance (MEF) hired top consultants to upgrade its response capacity to implement FATF's Action Plan. Building criminal investigation capability and improving cooperation on foreign tax information exchange have been given priority. The authorities also continue to strengthen the enforcement of final-beneficial owner identification and risk-based supervision and regulations of Denominated Non-Financial Businesses and Professions (DNFBP),targeting risks of money laundering in the corporate sector.

11. **Technical assistance remains paramount to further progress in AML/CFT issues**. Technical assistance to address immediate outcome (IO) issues will be provided by the European Union and the World Bank. In addition, the authorities and staff continue to work together to enhance Panama's capabilities to implement FATF's recommendations on AML/CFT violations, sanctions, and money laundering investigations relative toforeign tax crimes. That said, additional technical assistance is needed to tackle the actionplan initiatives and strengthen the AML/CFT supervision framework, investigative capacity, judicial actions, and enforcement of penalties as a deterrent to violations.Delivering on these efforts should accelerate the process of exiting the FATF list.

12. **The authorities remain focused on delivering on their commitment to subscribe to the SDDS by 2022 to enhance the coverage, periodicity, and timeliness of data reporting**. The National Statistics Institute (INEC) is following a work program based onthe 2020 ROSC's guidelines and their 2020-2024 National Statistics Plan towards the modernization and upgrade of the institution's technical capacity. This strengthening process includes increased budget and human resources, training, and technological upgrade. Additionally, INEC has made initial progress in developing a preliminary template for international reserves following STA's guidelines and requirements in the SDDS system. Fund's technical assistance and external consultants will continue tosupport these efforts.