INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/122

PANAMA

March 2023

2022 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 2022 Article IV consultation with Nicaragua, 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 February 22, 2023 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 February 22, 2023 following discussions that ended on December 12, 2022 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 February 8, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** 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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with Panama

FOR IMMEDIATE RELEASE

Washington, DC – **March 24, 2023:** On February 22, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation.[1]

In the decade-and-half preceding the Covid-19 pandemic, an unprecedented construction and investment boom precipitated a rapid economic expansion in Panama. The Panama Canal and Tocumen Airport were expanded, there was large scale building of new skyscrapers in Panama City, and one of the largest copper mines in the world was constructed. Economic growth was further supported by the expansion of the services and logistics sectors, which benefited from the widening of the Panama Canal. With a rapid expansion of the capital stock, real GDP grew by 6 percent annually, poverty declined sharply, and income levels rapidly converged with those in advanced countries.

The Covid-19 pandemic led to a deep downturn, with real GDP shrinking by 18 percent and unemployment spiking to 18½ percent in 2020, from 7 percent in 2019.

The recovery has been very strong, but the outlook is uncertain. Output expanded by 15 percent in 2021 and a projected 9 percent in 2022. Employment has rebounded strongly, while inflation remained low compared with other countries. The fiscal deficit declined to from 10.4 percent of GDP in 2020 to 4 percent of GDP in 2022. Nonetheless, risks of new external shocks have emerged, including a sharper than expected downturn of the world economy, renewed surges of food and energy prices, and disruptions to global capital markets. There are also uncertainties about when the rebound of the deep Covid-related downturn will have run its course, and what the medium-term growth potential of Panama will be given that construction is unlikely to provide the same support to growth as it has in the past decade and a half. Other domestic risks include a prolonged inclusion of Panama in the Financial Action Task Force (FATF) grey list and disruptions to copper mining activities after negotiations between the government and Minera Panama on a new contract failed to meet a mid-December 2022 deadline.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. Panama witnessed a strong post- pandemic economic recovery, supported by a rebound in the global economy. However,

[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.

[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.

the outlook remains uncertain, with risks of new external shocks, vulnerabilities from a prolonged inclusion in the Financial Action Task Force (FATF) grey list, and possible disruptions to copper mining activities following delays in reaching a new mining agreement. Looking ahead, Directors concurred that policies should focus on rebuilding buffers and ensuring the convergence of Panamanian income levels with those in advanced countries continues. While welcoming the recent progress, they underscored the critical importance of prioritizing an exit from the FATF grey list at the earliest date possible by expeditiously addressing the remaining deficiencies in the AML/CFT regulatory framework.

To ensure debt sustainability in the medium term, Directors highlighted the importance of further reducing the fiscal deficit, in accordance with the fiscal rule. They agreed that tax revenue will need to increase to sustainably reduce the fiscal deficit while preserving social spending and creating room for more education spending. In this context, Directors stressed the importance of improving tax and customs collection efficiency; broadening the tax base by reducing exemptions, deductions, and tax expenditures; and addressing the deficits in the defined-benefit pension component of the social security system.

Directors noted that capital adequacy and liquidity indicators in the banking sector are well above regulatory minima. As Panama does not have a lender of last resort and deposit insurance, they emphasized the importance of keeping the banking system well capitalized and liquid. In this context, they highlighted the need for continued intensive supervision and monitoring and expanding the macroprudential policy toolkit to mitigate future asset quality and liquidity risks. They also urged AML/CFT regulation and supervision to be applied to Fintech companies.

Directors noted that Panama’s past income convergence to advanced-economy levels was driven by an unprecedented construction boom. To sustain convergence, Directors underscored the necessity for other productive sectors to take over, and for governance and human capital to improve. They also called for structural reforms to enhance innovation, improve critical infrastructure, and strengthen labor policies to bolster competitiveness and growth potential. Directors encouraged the authorities to work toward SDDS subscription, and stressed the importance of more timely statistics, which would reinforce transparency.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2021)	4.3	Poverty line (percent, 2019)	21.5
Population growth rate (percent, 2021)	1.4	Adult literacy rate (percent, 2019)	95.7
Life expectancy at birth (years, 2019)	78.5	GDP per capita (US$, 2021)	14,664
Total unemployment rate (October 2021)	11.3	IMF Quota (SDR, million)	376.8

					Est.			Projections			
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Production and Prices						(Percent change)					
Real GDP (2007 prices)	**3.7**	**3.0**	**-17.9**	**15.3**	**9.0**	**5.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
Consumer price index (average)	0.8	-0.4	-1.6	1.6	2.9	2.2	2.2	2.0	2.0	2.0	2.0
Consumer price index (end-of-year)	0.2	-0.1	-1.6	2.6	2.1	3.1	2.0	2.0	2.0	2.0	2.0
Output gap (% of potential)	4.2	2.0	-17.1	-6.3	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Demand Components (at constant prices)											
Public consumption	**6.5**	**4.9**	**16.2**	**5.4**	**-5.4**	**-0.4**	**2.0**	**2.6**	**2.1**	**3.1**	**3.1**
Private consumption	2.3	4.9	-15.5	-0.7	15.8	6.0	3.6	3.4	3.0	3.5	3.7
Public investment 1/	6.9	1.0	-62.4	133.7	13.5	12.4	-4.6	-3.4	5.1	8.4	7.7
Private investment	-0.4	-0.9	-45.4	47.4	15.5	5.2	5.9	5.7	3.9	3.2	3.4
Exports	5.3	1.2	-20.6	25.4	12.3	5.4	6.6	5.3	5.5	5.4	5.1
Imports	4.5	-2.5	-34.0	32.4	7.7	2.5	8.7	5.9	5.2	5.7	5.7
Financial Sector											
Private sector credit	**4.5**	**2.4**	**-2.6**	**1.5**	**5.4**	**5.6**	**6.1**	**6.1**	**6.1**	**6.1**	**6.1**
Broad money	2.8	2.3	9.5	4.1	12.1	7.4	6.3	6.1	6.1	6.1	6.1
Average deposit rate (Percent)	1.9	2.0	1.8	1.4	1.8						
Average lending rate (Percent)	7.8	7.8	7.7	7.6	7.6						
Saving-Investment Balance						(In percent of GDP)					
Gross domestic investment	**41.5**	**38.3**	**24.1**	**32.5**	**34.3**	**34.7**	**34.8**	**34.8**	**34.8**	**34.8**	**34.8**
Public sector	6.2	6.0	2.6	5.2	5.4	5.8	5.3	4.9	5.0	5.2	5.4
Private sector	35.3	32.3	21.5	27.3	28.9	28.9	29.4	29.9	29.9	29.6	29.4
Gross national savings	33.9	33.3	23.7	29.3	30.4	30.7	31.2	31.8	32.1	32.1	32.3
Public sector	4.2	2.6	-4.2	-2.1	0.4	2.4	2.6	3.1	3.6	3.8	4.0
Private sector	29.7	30.8	27.9	31.4	30.1	28.3	28.6	28.7	28.4	28.3	28.3
Public Finances 1/											
Revenue and grants	**22.0**	**20.8**	**21.5**	**20.5**	**22.2**	**23.1**	**23.3**	**23.5**	**23.6**	**23.8**	**23.9**
Expenditure	24.9	23.9	30.7	27.1	26.0	25.8	25.1	24.6	24.5	24.7	24.9
Current, including interest	17.2	17.7	25.2	21.9	20.6	20.0	19.8	19.7	19.6	19.5	19.5
Capital	6.6	6.2	5.5	5.2	5.4	5.8	5.3	4.9	5.0	5.2	5.4
Overall balance, including ACP	-2.9	-3.1	-9.2	-6.5	-3.8	-2.7	-1.8	-1.2	-0.9	-0.9	-1.0
Overall balance, excluding ACP	-3.2	-3.4	-10.4	-6.7	-4.0	-3.0	-2.0	-1.5	-1.5	-1.5	-1.5
Total Public Debt											
Debt of Non-Financial Public Sector 2/	**37.3**	**41.9**	**65.6**	**58.4**	**55.4**	**54.9**	**54.1**	**53.2**	**52.4**	**51.5**	**50.8**
External	31.1	35.2	54.1	50.6	50.9	50.8	51.1	50.5	50.2	49.5	48.8
Domestic	6.3	6.7	11.5	7.8	4.5	4.1	3.0	2.7	2.2	2.0	2.0
Debt of ACP	4.2	3.8	4.2	3.2	2.6	2.1	1.7	1.3	1.0	0.7	0.4
Other 3/	4.2	4.1	5.1	4.3	3.9	3.6	3.4	3.2	3.0	2.8	2.7
External Sector											
Current account	**-7.6**	**-5.0**	**-0.4**	**-3.2**	**-3.9**	**-4.0**	**-3.5**	**-3.0**	**-2.8**	**-2.7**	**-2.5**
Net exports from Colon Free Zone	2.5	2.7	3.1	2.5	2.2	2.2	2.2	2.3	2.3	2.4	2.4
Net oil imports	4.4	3.8	1.7	3.1	4.2	3.5	3.2	3.0	2.8	2.6	2.5
Net foreign direct investment inflows	7.5	5.6	0.1	2.6	4.0	4.3	4.3	4.2	4.1	3.9	3.8
External Debt	153.0	155.0	209.4	188.3	169.4	168.1	167.0	166.5	166.0	164.3	162.5
Memorandum Items:											
GDP (in millions of US$)	64,929	66,984	53,977	63,605	71,299	76,540	81,383	86,331	91,580	97,148	103,055

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. These estimates are preliminary.

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 2022 ARTICLE IV CONSULTATION

February 8, 2023

KEY ISSUES

Background. Panama was hit hard by the covid-19 pandemic, but the recovery has been strong. GDP expanded by 15.3 percent in 2021 and a projected 9 percent in 2022. Inflation is low compared with other countries, in part the result of temporary subsidies on fuel and food. The fiscal deficit declined from 10½ percent of GDP in 2020 to 4 percent of GDP in 2022 and central government gross debt is estimated at 60 percent of GDP at end-2022. Banks are, on average, well capitalized and liquid. As insurance against external shocks, the IMF Executive Board approved a two-year Precautionary and Liquidity Line (PLL) arrangement for 500 percent of quota, equivalent to US$2.7 billion (SDR 1.884 billion), on January 19, 2021.

Outlook and Risks. Economic growth is expected to slow to 5 percent in 2023 and 4 percent in the medium term. The expiration of Covid-19 and cost-of-living subsidies, and the adoption of new revenue measures will further reduce the deficit to 3 percent in 2023, in line with the social and fiscal responsibiltiy law. Key risks include a sharper-than-expected slowdown of the global economy, renewed increases in global food and energy prices, rising global interest rates, and dislocations in global capital markets that could put pressures on the rollover of external corporate and sovereign debts. Panama's continued presence on the Financial Action Task Force (FATF) grey list and on the EU list of non-cooperative jurisdictions for tax purposes, could potentially affect correspondent banking relationships and key overseas credit channels.

Policy Advice. Policies should focus on boosting resilience to shocks (by rebuilding fiscal buffers, strengthening financial integrity, and enhancing financial sector oversight) and sustaining the rapid convergence with advanced economies. To reduce the fiscal deficit over the medium term while at the same time creating room for new spending, including on education, and preserving spending on social assistance, the steady decline in the revenue-to-GDP ratio needs to be reversed. To secure an exit from the FATF's grey list, measures to address the remaining items in the FATF action plan should be intensified. Ensuring that banks are well capitalized and liquid is essential to preserve Panama's role as a regional financial center. To sustain convergence, human capital and governance should be strengthened. Implementation of the national statistical plan will improve the quality and timeliness of key macroeconomic data.

Approved By
James Morsink (WHD) and Martin Čihák (SPR)

Discussions took place in Panama City during November 29-December 13, 2022. The in-person staff team comprised of Bas Bakker (Head), Julian Chow, Marina Rousset, Sofia Pires, (all WHD), and Enrico Di Gregorio (FAD). Eloy Fisher (OED) also participated. Paola Aliperti (WHD), Chuling Chen (SPR), José Daniel Rodríguez-Delgado (STA), and Francisco Figueroa (LEG), participated remotely in part of the meetings. 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. Julia Muñoz (WHD) provided administrative support.

CONTENTS

TABLES

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
DRS	Disaster Resilience Strategy
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FES	Fund for Economic Stimulus
INEC	National Institute of Statistics and Census
IO	Immediate Outcome
LCR	Liquidity Coverage Ratio
MEF	Ministry of Economy and Finance of Panama
NEER	Nominal Effective Exchange Rate
NFPS	Non-Financial Public Sector
NIIP	Net International Investment Position
NPLs	Non-performing Loans
PLL	Precautionary and Liquidity Line
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
RFI	Rapid Financing Instrument
SBP	Superintendency of Banks
SFRL	Social and Fiscal Responsibility Law
SWF	Sovereign Wealth Fund
TA	Technical Assistance

BACKGROUND

1. **The Fund has provided significant support to Panama following the outbreak of the pandemic.** Panama benefitted from financial support under the Rapid Financing Instrument (RFI), a two-year PLL arrangement, and a SDR allocation. All in all, the Fund has provided support to Panama for over 6¼ percent of GDP since the beginning of the pandemic.

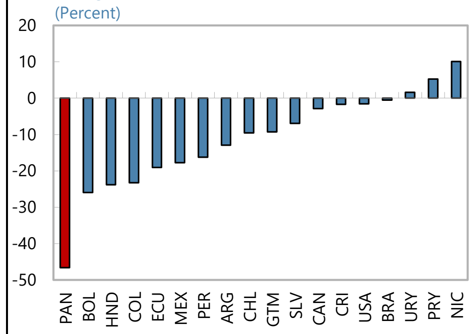
IMF Support

Instrument	Millions SDR (US$)	Percent Quota (GDP)	Other Date (Type)
RFI 1/	377 (515)	100.0 (1.0)	15-Apr-20 (Disbursed)
PLL 2/	1,884 (2,713)	500.0 (4.5)	19-Jan-21 (Precautionary)
SDR Allocation	361 (512)	95.8 (0.9)	23-Aug-21 (Unused)
Total	**2,622 (3,740)**	**695.8 (6.3)**	**... (...)**

1/ Rapid Financing Instrument.
2/ Precautionary and Liquidity Line.

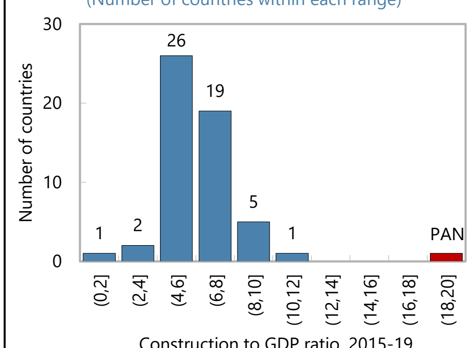
STRONG RECOVERY POST-PANDEMIC BUT LARGE SCARRING

2. **In the decade-and-half preceding the covid-19 pandemic, an unprecedented construction and investment boom led to rapid growth of GDP, employment, and incomes**. The Panama Canal and Tocumen Airport were expanded, there was large scale building of new skyscrapers in Panama City, and one of the largest copper mines in the world was constructed. Economic growth was further supported by the expansion of the services and logistics sectors, which benefited from the widening of the Panama Canal. With a rapid expansion of the capital stock, real GDP grew by 6 percent annually, poverty declined sharply, and income levels rapidly converged with those in advanced countries. In terms of growth accounting, rapid GDP growth was the result of rapid growth of factor inputs, while TFP levels declined. [1]



Sources: IMF, World Economic Outlook.

3. **The construction-to-GDP ratio far outpaced that in other countries.** The level and the increase were also far higher than in other well-known construction booms (Figure 14).[2]



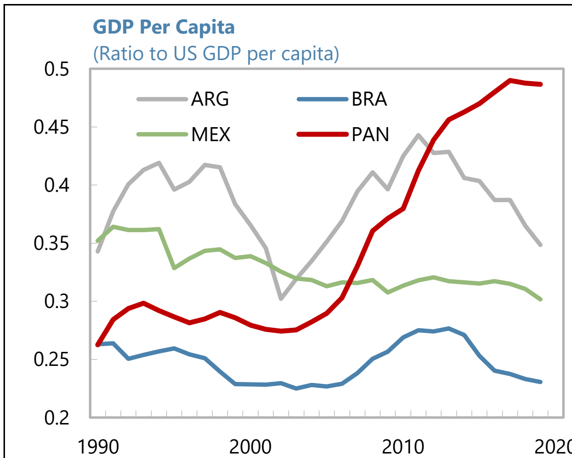
Source: UN Stats.

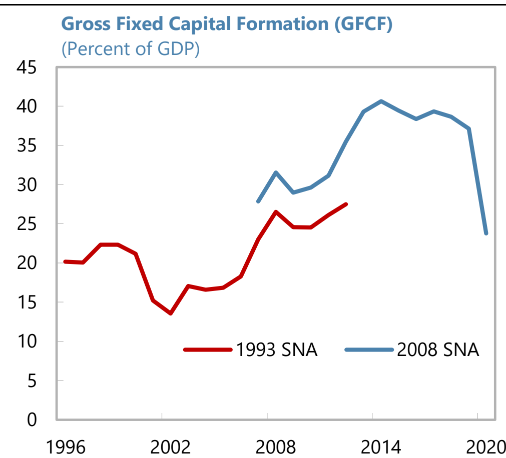
[1] See the accompanying Selected Issues Paper "Panama's Growth Story".
[2] Construction as a share of GDP (i.e., domestic value added) peaked at 20.0 percent in 2018. In the same year, *investment* in construction amounted to 32.4 percent of GDP, of which 10.3 percentage points was for residential building; 12.1 for other buildings and 10.7 in other constructions and works (Figure 13).

Panama's Large-scale Construction Projects

Title	Phases	Construction dates
Tocumen Airport Expansion	1. Renovation and expansion (new gates, boarding bridges and VIP lounge)	2006
	2. Northern Terminal (12 new gates, road and taxiways)	2009-12
	3. New terminal (20 gates, parking, river diversion and roads)	2012-19
Panama Canal Expansion	Expanding existing channels, adding two sets of locks, and raising operating level of Lake Gatun	2007-16
Cobre Panama copper mine	Under the ownership of First Quantum	2013-19
Panama City metro	Line 1	2011-14
	Line 2	2015-19
	Line 3	2021 onwards
Cinta Costera	Phases I, II and III (with Maracana Stadium and viaduct)	2009-14
Tallest Skyscrapers	Miramar and Platinum Towers	1996
	Mirage and Credicop Bank Tower	1997
	Torre Vista Marina	2002
	Torre Global Bank, Mystic Point 100 and 200	2005
	Aqualina Tower, Aquamar, Bahia Pacifica	2007
	Ocean One, Venetian Tower, Costa del Este, Country Club 1, Bella Mare	2008
	Sky Residences, Pacific Village 1 and 2, Sevilla 1 and 2, Astoria Tower,	2009
	Ocean Two, Dupont Tower, The Sea Waves	2010
	JW Marriott Panama, Tower Financial Center, F&F Tower, Pearl Tower, Torre Waters, Torre Megapolis, Q Tower, Ten Tower, White Tower, Yacht Club Tower, Torre Allure	2011
	Vitri Tower, Rivage, YooPanama, Oasis on the Bay, Oceania Business Plaza 1 and 2	2012
	Star Bay Tower, Arts Tower, Destiny Panama Bay, Grand Tower	2013
	HSBC Tower, Golden Tower	2014
	Evolution Tower	2017

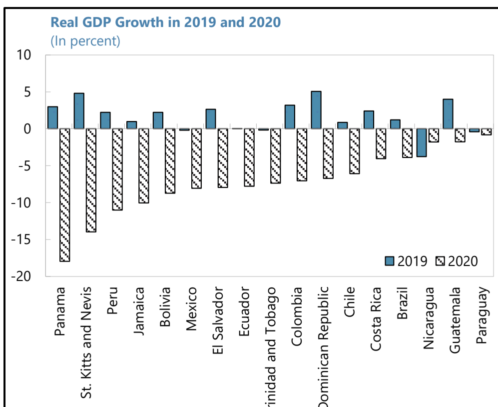
Sources: Wikipedia and Panamanian press.





Sources: Haver Analytics, National Authorities and IMF staff calculations.

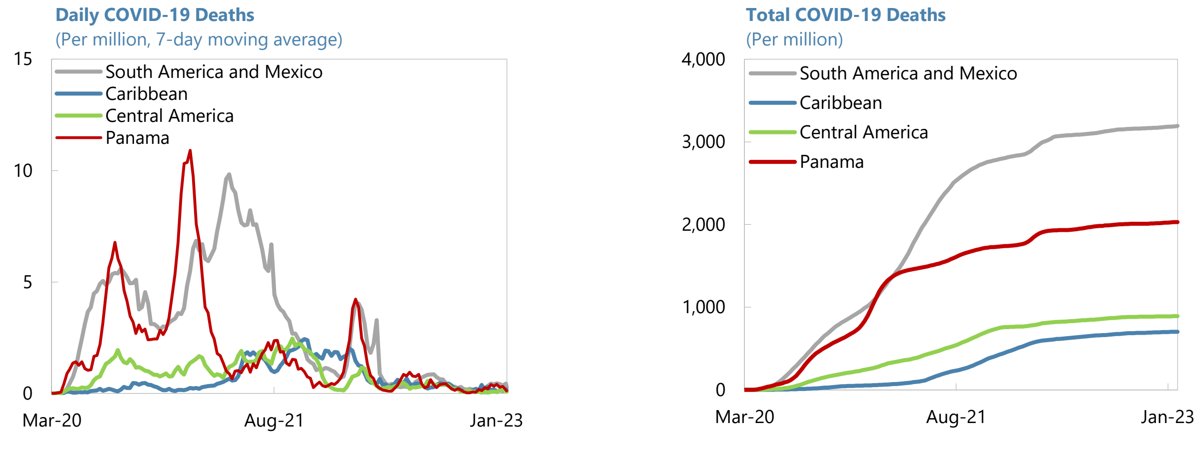
4. In 2018, the boom had started to slow, and in 2019 the economy grew by 3 percent only. Investment gradually slowed following the completion of major public infrastructure projects, including the Canal expansion and a new terminal in the Tocumen International Airport (Annex VII).



Source: IMF, World Economic Outlook.

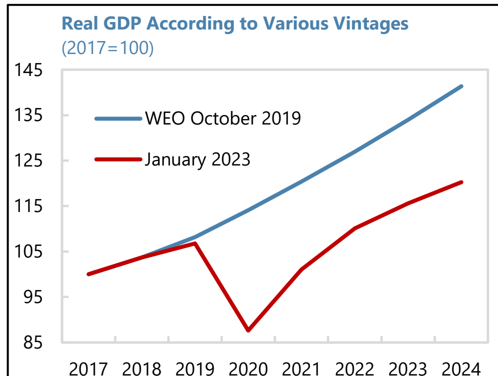
5. **Panama was hit hard by the covid-19 pandemic.**[3] A long and strict lockdown to mitigate the spread of the pandemic had a severe social[4] and economic[5] impact. GDP declined by 18 percent and unemployment spiked to 18½ percent in 2020, from 7 percent in 2019. A forceful government response-which included sharp increases in social and medical spending, and a change of the fiscal responsibility law to allow automatic stabilizers to operate—mitigated the impact of the pandemic on livelihoods**.**

Covid-19



Source: Johns Hopkins University CSSE Covid-19 Data

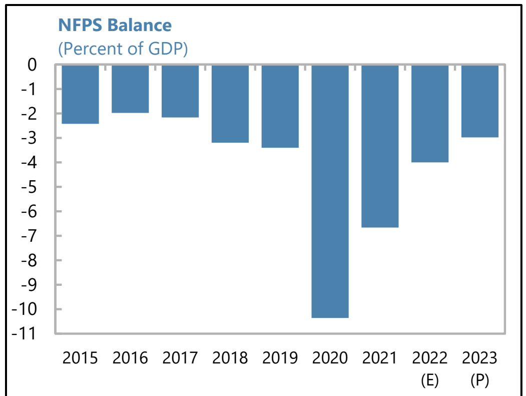
6. **The recovery has been strong, but GDP levels remain well below pre-crisis projections.** Real GDP grew by 15⅓ percent in 2021 and a projected 9 percent in 2022. However, GDP in 2022 is still 13 percent below the level projected before the pandemic and it is likely that GDP will remain well below pre-covid trends. Lower GDP levels are in large part the result of lower potential GDP growth, as a sharp decline in investment has led to a lower growth of the capital stock.



Sources: IMF, World Economic Outlook and IMF staff calculations.

7. **Rising food and energy prices precipitated social unrest.** Inflation rose from -2 percent in October 2020 to 5.2 percent in June 2022. Public protests against rising food and fuel prices in early July 2022 (Annex VI) prompted the government to announce a slew of measures, including subsidizing fuel prices at $3.25 per gallon, initially for a period of 3 months, and later extended to January 2023, and an extension of targeted pandemic-era subsidies. Food and fuel subsidies helped reduce headline inflation, which stood at 2.1 percent in December.

[3] Panama's covid-19 death toll (1,900 per million) is higher than that in the region, but below the US, Europe, and South America.
[4] See Annex VI for details.
[5] Construction was shut down for six months, contributing to a 50 percent decline in investment (Annex VI).

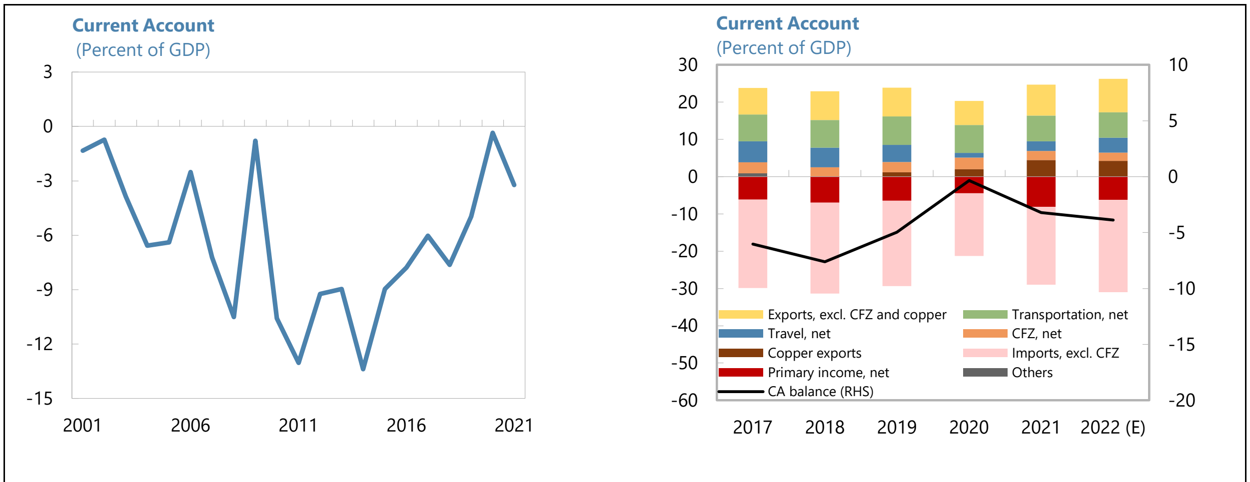


Sources: National authorities and IMF staff calculations.

8. The Non-Financial Public Sector (NFPS) deficit fell from 10½ percent of GDP in 2020 to 6.7 percent of GDP in 2021—below the 7-7½ percent of GDP limit established by the fiscal rule.[6] The improvement in the public sector deficit was due to recovering revenues as well as to a decline in spending on transfers as the economy recovered.

9. In 2022, the NFPS deficit was further reduced, to 4 percent of GDP. On the revenue side, the deficit reduction was helped by a further rebound in tax revenues, contributions from the Panama Canal Authority (ACP). On the expenditure side, the fiscal cost of the food and fuel subsidies and the extension of the pandemic-era subsidies was offset by cuts in the wage bill and goods and services. Excluding a cash-flow swap operation that shifted 0.5 percentage point in interest payments to later years, the deficit would have been about 4½ percent of GDP.[7]

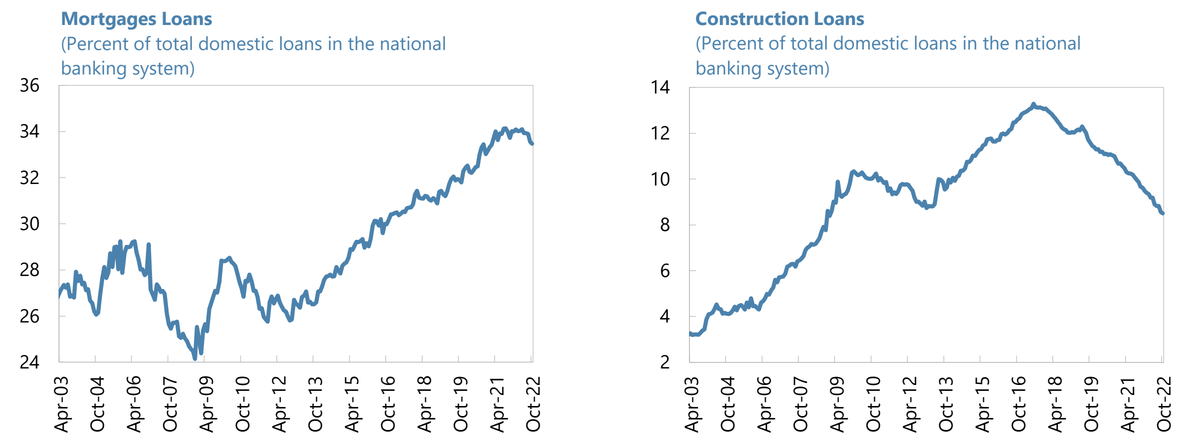
10. The economic recovery and the surge in food and energy prices have led to a deterioration of the current account, but the external position remains strong. In 2020, a sharp drop in imports temporarily narrowed the current account deficit, before it widened again to 3¼ percent of GDP in 2021 and is estimated to have reached 4 percent of GDP in 2022, due to a brisk recovery. Strong capital inflows from foreign direct investment and portfolio inflows continue to support the deficit and reinforce external buffers. The external position is assessed to be broadly consistent with the level implied by fundamentals and desirable policy settings (Annex III).[8]



Sources: INEC and IMF staff calculations.

[6] The SRFL prescribes a gradual reduction in the NFPS deficit, from 10½ percent of GDP in 2020, to 7-7½ percent of GDP in 2021, to 4 percent of GDP in 2022, converging to 1.5 percent of GDP in the medium term.
[7]Under the swap, a major global bank paid part of the interest payments on global bonds in 2022. These cashflows were subtracted from the interest payments shown in the (cash-based) public finances."
[8] The External Balance Assessment (EBA)-lite model shows a current account norm of -2.7 percent of GDP.

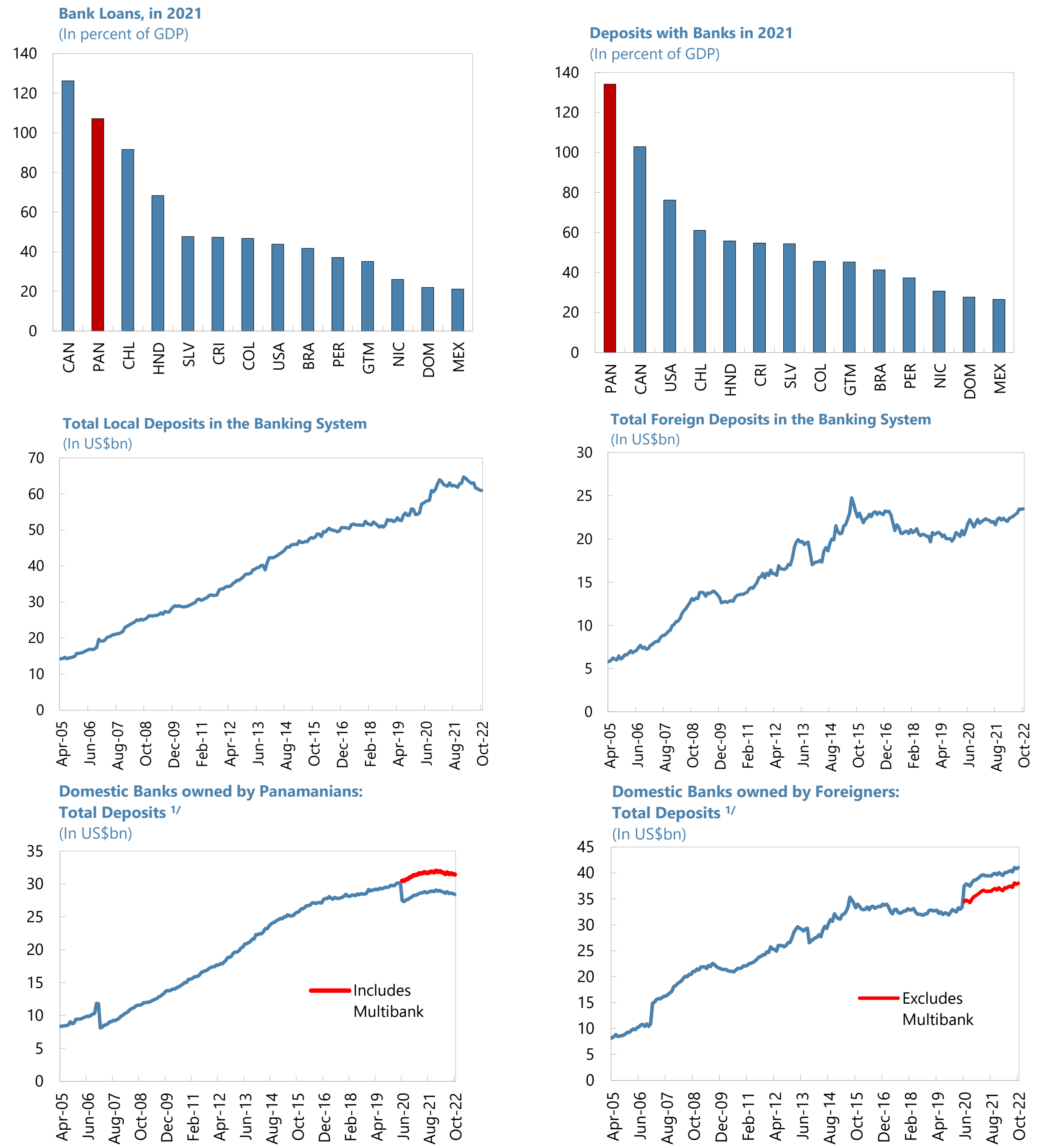
11. Panama's large banking sector[9] played an important role in the construction boom, providing construction loans for construction of residential and office buildings and mortgages for residences. The share of mortgage and construction loans in banks' portfolios increased sharply in the last two decades. Currently, they comprise 42.7 percent of total lending.



Sources: SBP and IMF staff calculations.

[9] Panama's banking sector comprise domestic and international banks. Domestic banks (general license, local and foreign ownerships) dominate the banking sector; their business model revolves around providing credit and financial services, with insignificant exposures to derivatives. International banks are usually subsidiaries of large regional and global banking groups.

Figure 1. Panama: Banking Sector



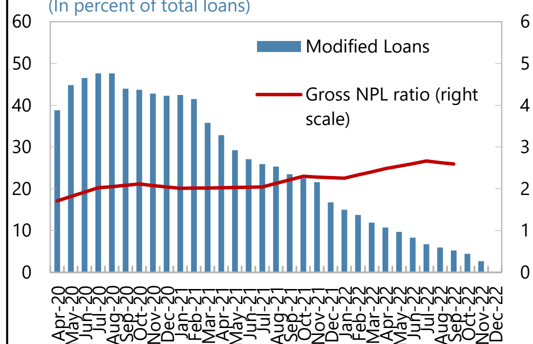
Sources: IMF Financial Access Survey, SBP and IMF staff calculations.
1/ Multibank was reclassified as a foreign-owned general license bank in June 2020 after its acquisition by a foreign bank.

Structure of Financial System, 2021				
	Number of Institutions	Total Assets		Share of the total assets
		(US$ billion)	(% GDP)	(%)
Commercial Banks	**67.0**	**133.3**	**210**	**90.0**
Domestic Banks 1/	42	117.5	185	79.3
o/w Domestically-owned	15	59.0	93	39.8
o/w Foreign-owned	27	58.6	92	39.5
International banks 2/	25	15.8	25	10.7
Non-bank Financial Intermediaries	**1351**	**14.9**	**23**	**10.0**
Insurance and Reinsurance	54	3.7	6	2.5
Securities companies and pension funds	179	5.0	8	3.4
Cooperatives	536	2.4	4	1.6
Other financial entities	582	3.8	6	2.6
Total	**1418**	**148.2**	**233**	**100.0**

Sources: Superintendency of Banks and IMF staff calculations.
1/ Banks with General Banking License conducting business with residents and non-residents, as well as interbank operations.
2/ Banks with International Banking License conducting business only with non-residents and limited interbank operations.

12. The impact of the pandemic on banks' asset quality appears modest. From March 2020 to June 2021 a temporary moratorium on loan service was in place to support borrowers who had difficulty servicing their loans (Annex V). Loans that were modified under the moratorium were not classified as NPL. Since the end of the moratorium, the share of modified loans has declined sharply, but the share of NPLs has increased only modestly.[10] From January 2023, all remaining modified loans were reclassified according to the pre-pandemic regulation.

Modified Loans and Nonperforming Loans
(In percent of total loans)



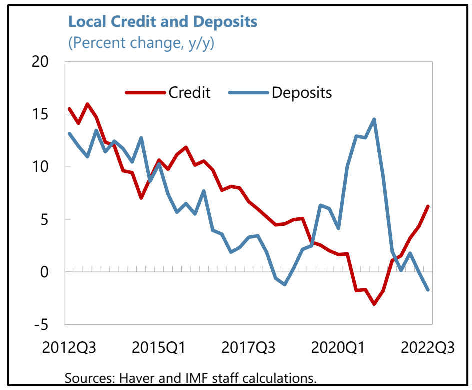
Source: SBP.

13. As a result of US monetary tightening, long-term interest rates have increased sharply. Panama's 10-year government bond yield has risen by 244 bps since the beginning of 2022, compared with 190 bps in the US.[11] Further increases in US interest rates, or increases in global risk aversion, could put pressures on short-term external debt of nonfinancial corporations, which amounts to 8 percent of GDP.

14. The increase in local bank rates has so far been modest, but this is unlikely to last. The average bank deposit rate increased 40 bps while the lending rate only rose 5 bps (compared to the

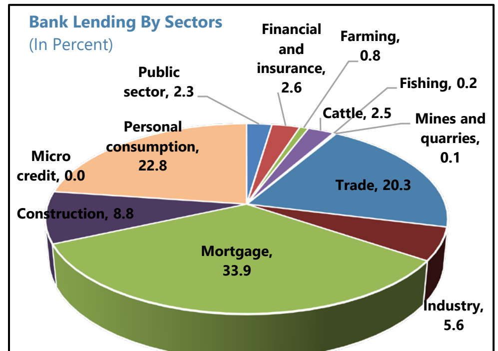
[10] Loan-loss provisions stood at 144 percent of NPLs at end-September 2022.
[11] This will add about 0.4 percent of GDP to government annual interest costs by 2027. Every 100 bps higher interest rates add 0.2 percent of GDP to annual interest costs by 2027.

400 bps increase in the Fed Funds rate) due to high liquidity in the domestic banking system.[12] Traditionally, banking rates adjust with a lag to US rates, and it is unlikely that this time will be different. The increase in bank rates will increase the risk that economic activity slows (section C). Higher interest rates will also add to the debt servicing costs of households and nonfinancial corporations and reduce the interest rate coverage ratio of nonfinancial corporations.

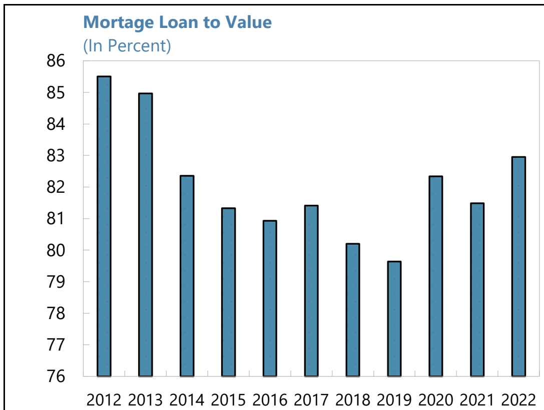


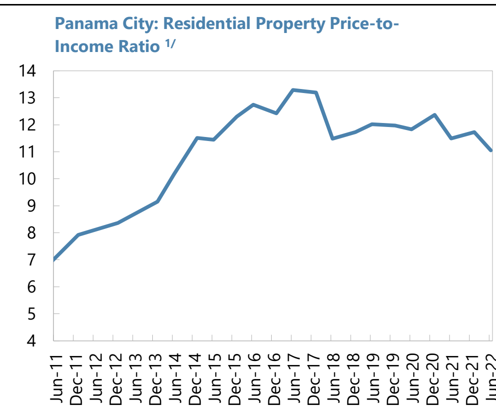
Sources: Haver and IMF staff calculations.

15. Banks' exposure to the real estate sector is high. [13] A fall in house prices or a decline in economic activity could lead to an increase in NPLs on mortgages and a decline in capital. Foreclosure could lead to losses as the average loan-to-value rate of new loans has been high (over 80 percent). Other loan types could be affected as well—borrowers facing difficultly in servicing their mortgage could stop servicing their personal consumption loans.



Source: SBP.





Source: Numbeo.
1/ The methodology is described in: https://www.numbeo.com/property-investment/indicators_explained.jsp

16. Private credit growth is recovering. Private credit grew 6 percent (y/y) in November 2022, up from -3 percent in March 2021. Negative credit growth during the pandemic was likely the result of weak credit demand, as deposit growth was very strong, but deposit growth has since decelerated.

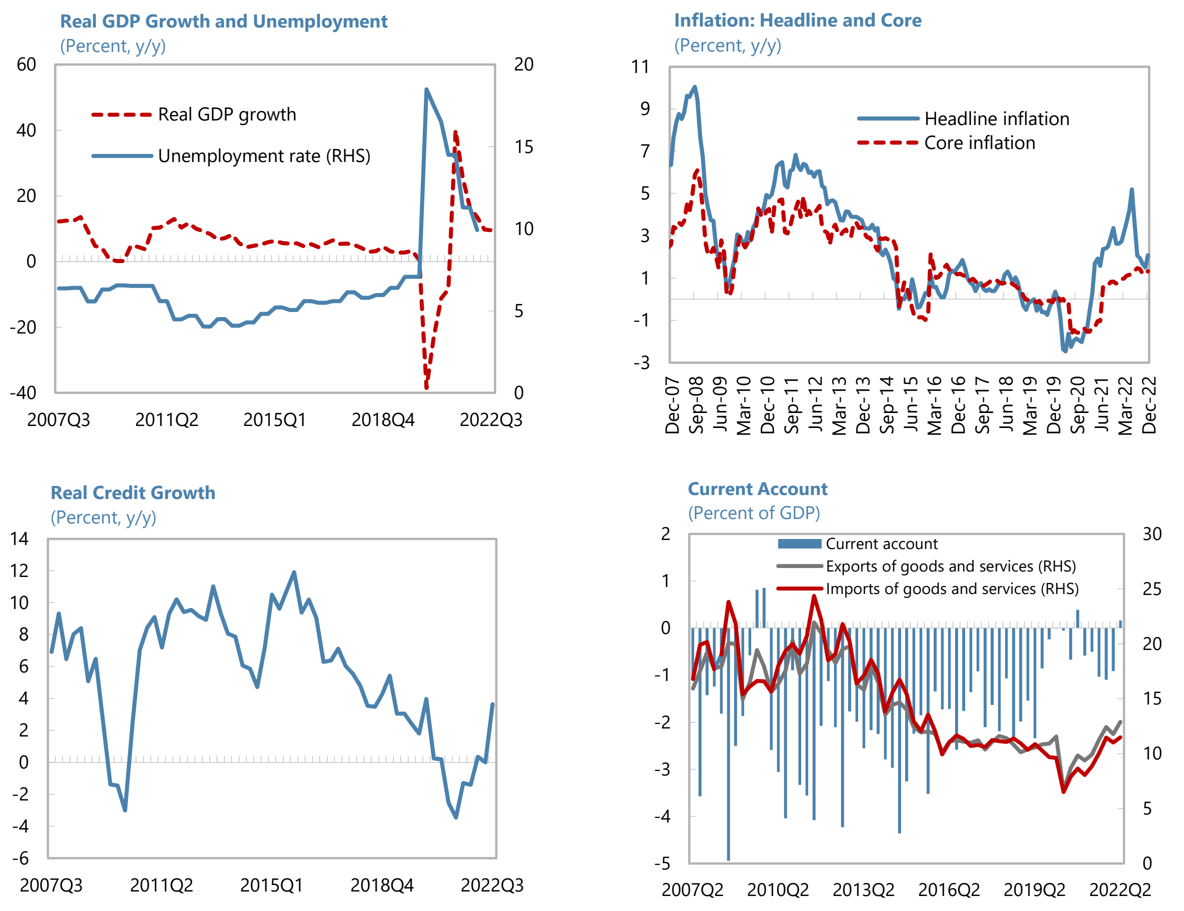
17. Panama remains on the FATF grey list. Since October 2021, the FATF has been expressing significant concern at the conclusion of its plenary meetings that Panama failed to complete its action plan, the deadlines for which expired in January 2021. The FATF strongly urged Panama in

[12] External wholesale deposits only account for 7 percent of total deposits in the banking system.
[13] Banks' exposure to the government amounts to 9 percent of total assets.

October 2022 to swiftly complete its action plan by February 2023 or the FATF will consider calling on its members and urging all jurisdictions to apply enhanced due diligence to business relations and transactions with Panama.

18. **Panama continues to step up efforts to build resilience to natural disasters and climate change.** The authorities have engaged in a number of initiatives to ramp up their climate policy (see Annex VIII).

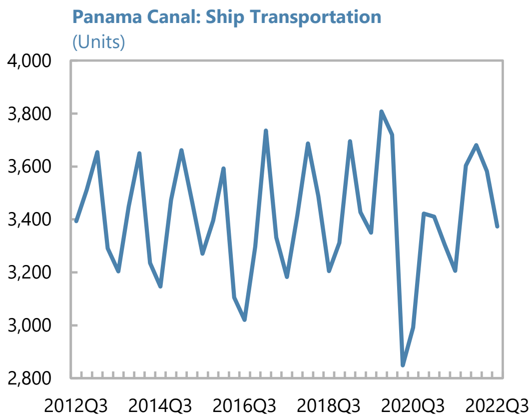
Business Cycle: A Recovery from Unprecedented Shock



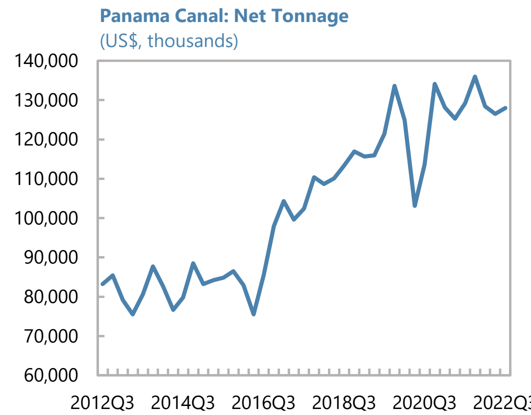
Sources: INEC, SBP and IMF staff calculations.

Figure 2. Panama: Panama Canal

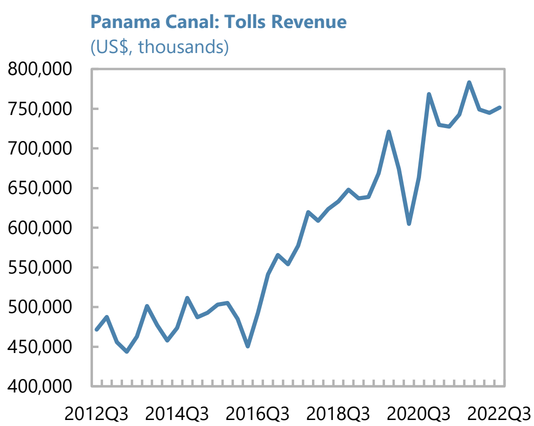
Covid led to a sharp one-quarter drop in transportation through the Panama Canal, both in terms of ships…



…and tonnage



Which affected revenues from tolls.



Source: Haver.

OUTLOOK AND RISKS

19. GDP growth is likely to slow to 5 percent in 2023 as the rebound from the covid-19 lockdowns fades and the impact of higher US interest rates, higher energy and food prices and slower partner country growth is felt. Over the medium term, output is expected to grow in line with its estimated potential growth rate of 4 percent. This is lower than growth in the pre-covid years, as construction and investment is unlikely to provide the same support to growth going forward. Even if the level of construction remains high, its growth rate is likely to be considerably lower than in the pre-covid years, when construction activity increased by 250 percent between 2009 and 2019. The unemployment rate is projected to fall to 8 percent by end-2023, Staff's current estimate of the NAIRU.

20. Inflation is likely to edge up from 2.1 percent (y/y) at end-2022 to 3.1 percent (y/y) by end-2023, as the subsidies that reduced fuel and food prices in 2022 expire. Inflation is projected to gradually decline to 2 percent (y/y) over the medium term**.**

21. The current account deficit is projected to narrow from about 4 percent of GDP in 2022 to 2½ percent of GDP in the medium term, primarily due to a decline in the cost of fuel imports. From a saving-investment perspective, the gradual reduction in the current account deficit over the medium term reflects a strengthening in domestic savings (reflecting lower spending on fuel and a rebound from the dissaving during the pandemic).

22. Private sector credit is likely to grow in line with nominal GDP. NPLs are likely to remain low as modified loans decrease with continued restructuring and more write-offs, and capital adequacy and liquidity ratios are expected to remain well above regulatory requirements.

23. The balance of risks is tilted to the downside, including global uncertainties arising from Russia's war in Ukraine, faster-than-expected US monetary tightening, tighter global financial conditions, higher crude oil prices, new variants of the covid-19 virus, setbacks in fiscal consolidation, disruptions in copper production, and domestic civil unrests that may derail the recovery. Specifically:

- ***External risks.*** A sharper-than-expected slowdown of the global economy, or a further intensification of global tensions, could adversely affect Panama's Canal traffic and Panama's economy more broadly. Increases in global risk aversion could lead to spikes in sovereign bond yields and disruptions to external financing. Renewed increases in global food and energy prices would boost inflation and reduce economic growth.
- ***Listings.*** Insufficient progress in implementing measures with respect to the items in the action plan designed to improve the effectiveness of the AML/CFT regime has prevented the removal of Panama from the FATF grey list. This, along with lack of progress in removing Panama from the EU list of non-cooperative jurisdictions for tax purposes, could potentially affect correspondent banking relationships and key overseas credit channels, threatening financial stability. It could also lead to an exodus of foreigners from the local real estate market.
- ***Financial stability risks.*** A weak economy could lead to higher unemployment and deterioration in real estate prices, resulting in higher defaults on loans. Large deposit

withdrawals could affect liquidity in the banking sector, especially banks with lower liquidity buffers. Dislocations in global capital markets could put pressures on the rollover of external nonfinancial corporate and sovereign debts.

- ***Security and climate risks.*** Cyberattacks could bring significant disruptions to digital infrastructure, while more frequent and severe climate-change related natural disasters could adversely affect Canal activity, agriculture, and tourism.
- ***Disruptions in copper production.*** Negotiations between the government and Minera Panama about a new contract are ongoing. There is a risk of disruptions in copper production and exports, which could affect growth, BOP and fiscal revenues (Annex X).

24. The fiscal policy stance in 2023 is expected to be mildly contractionary. The structural primary fiscal deficit is projected to contract by 0.3 percentage points of GDP in 2023. Long-term government bond yields have increased by 260 basis points since end-2021, but deposit and lending rates remain low by historical standards.[14]

Medium-Term Macroeconomic Outlook

					Est.	Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(In percent)										
Macroeconomic Developments											
Real GDP growth	3.7	3.0	-17.9	15.3	9.0	5.0	4.0	4.0	4.0	4.0	4.0
Output gap	4.2	2.0	-17.1	-6.3	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Unemployment rate	6.0	7.1	18.5	11.3	8.8	8.0	8.0	8.0	8.0	8.0	8.0
CPI inflation (average)	0.8	-0.4	-1.6	1.6	2.9	2.2	2.2	2.0	2.0	2.0	2.0
Private credit growth	4.5	2.4	-2.6	1.5	5.4	5.6	6.1	6.1	6.1	6.1	6.1
	(In percent of GDP)										
Fiscal Accounts											
Overall balance	-3.2	-3.4	-10.4	-6.7	-4.0	-3.0	-2.0	-1.5	-1.5	-1.5	-1.5
Structural primary balance	-2.3	-2.1	-4.3	-3.4	-2.1	-0.9	0.3	0.9	0.7	0.6	0.5
Public debt (gross) 1/	37.3	41.9	65.6	58.4	55.4	54.9	54.1	53.2	52.4	51.5	50.8
Public debt (net) 2/	26.0	28.9	43.2	40.8	40.4	40.6	40.2	39.4	38.6	37.9	37.3
External Sector											
Current account balance	-7.6	-5.0	-0.4	-3.2	-3.9	-4.0	-3.5	-3.0	-2.8	-2.7	-2.5
Foreign direct investment	-7.5	-5.6	-0.1	-2.6	-4.0	-4.3	-4.3	-4.2	-4.1	-3.9	-3.8

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

25. The authorities broadly concurred with staff's views on the outlook and risks. They expected growth of 5 percent in 2023. They recognized global headwinds, but remained positive on medium-term growth prospects, underpinned by infrastructure projects that support investment, full scale copper production, Canal traffic volume and revenue, and a recovery in private investment and tourism.[15]

[14] As of October 2022, the average deposit and lending rates stood at 1.5 percent and 7.6 percent, respectively, somewhat below their 20-year averages of 2.35 percent and 8.05 percent, respectively.
[15] In 2019, according to Statista, inbound tourism accounted for 10.6 percent of GDP. In the second and third quarter of 2020, BOP personal travel services credits dropped to zero. In 2022Q1, they rebounded to 80 percent of 2019Q1 levels.

26. They recognized that the role of construction in the economy was going to diminish but were optimistic about the contribution to growth in the near term. They pointed to a long list of ongoing and yet to be started multi-year construction projects—including a new metro line, a fourth bridge over the canal, a power plant and transmission line, water treatment facility, and several road constructions and renovations—that will boost construction in the near term.

Main Investment Projects with Disbursements in 2023

(In millions of US$)

	Project description [1/]	Type	Status	Total investment	Total Public Investment	Public Disbursement 2023	2024	2025
1	Metro line 3	Transportation	In progress	2841	2841	199	285	457
2	Metro line 2	Transportation	Completed	2063	2063	177	172	177
3	*Gatún* Power Plant	Power and water	Feasibility Studies	1185	51	42	4	5
4	IDAAN Projects (Water Treatment Plants)	Power and water	Redesign; Financial Feasibility Studies	877	877	5	20	47
5	Hospital construction (*Ciudad Hospitalaria*)	Health	In progress	608	608	128	148	152
6	Support program for MSMEs	MSMEs	In progress	460	460	50	60	50
7	Extension of the Bridge of the Americas until *Arraiján*	Transportation	In progress	384	384	58	58	58
8	Road construction connecting *Chorrera-Santa Cruz*	Transportation	In progress	237	237	45	45	45
9	Extension of Metro line 1	Transportation	Completed	204	204	37	62	67
10	Extension of Metro line 2	Transportation	In progress	103	103	32		
	Other infra-structure projects w/ disbursements in 2023, 2024, and 2025			1194	1194	597	275	247
	Other infra-structure projects w/ disbursements in 2024 and 2025			668	1484		309	400
	Total			10824	10505	1368	1437	1704

Sources: National authorities and IMF staff calculations.

1/ This table shows the largest investment projects with public disbursements in 2023. Most projects are financed through national banks with some exceptions. Projects 1, 2, 9, and 10 are financed through both national and international banks; projects 3 is financed through partnerships of capital contribution; and project 6 through the IDB. Future projects without disbursements in 2023 include the PPPs for *Panamericana Oeste* and the *Panamericana Este*, which together account for a total invest of approximately US$ 602 million, with an initial disbursement of US$ 94.6 million in 2025. The Government plans to invest on some other large projects which are not included in this table as the disbursement plan is not yet concluded. For example, there are plans to construct the fourth bridge over the canal (*Cuarto Puente*), the fourth power transmission line, and the Canal Tunnel, with a total investment of US$ 1.3 billion, US$ 696 million, and US$ 300 million, respectively.

POLICIES

Policies should focus on boosting resilience to shocks and sustaining the rapid convergence with advanced economies. To boost resilience, fiscal buffers should be rebuilt, financial integrity strengthened, and financial sector policies further enhanced. To sustain convergence now that the construction boom may be over, improving human capital and governance is key.

A. Rebuilding Fiscal Buffers

27. The authorities' 2023 NFPS deficit target of 3 percent of GDP (the ceiling set by the SRFL) is appropriate. The further reduction in the deficit will enable a gradual reduction in the public debt to GDP ratio after the sharp increase during the pandemic without putting an undue burden on still strong economic activity. Adhering to the SRFL is also important for fiscal credibility.

28. Staff expects authorities to meet their 2023 deficit target. The reduction in the deficit will be underpinned by the expiration of large covid-19 and cost-of-living subsidies, the elimination of the ITBMS (VAT) exemption on digital platform purchases, and the adoption of several tax administration measures. The Internal Revenue (DGI) and Customs Administration are undertaking significant modernization reforms, including electronic invoicing to

2023 Selected Fiscal Measures

(In percent of GDP)

Expenditure measures	1.3
End of COVID-19 related measures	0.9
Expiration of fuel subsidies	0.2
Restraint in wages, goods and services	0.2
Tax revenues measures	0.6
Expansion of electronic invoicing	0.1
Revenues from LTU introduction	0.1
Other DGI modernization plans	0.1
Digital platform purchase taxation	0.3

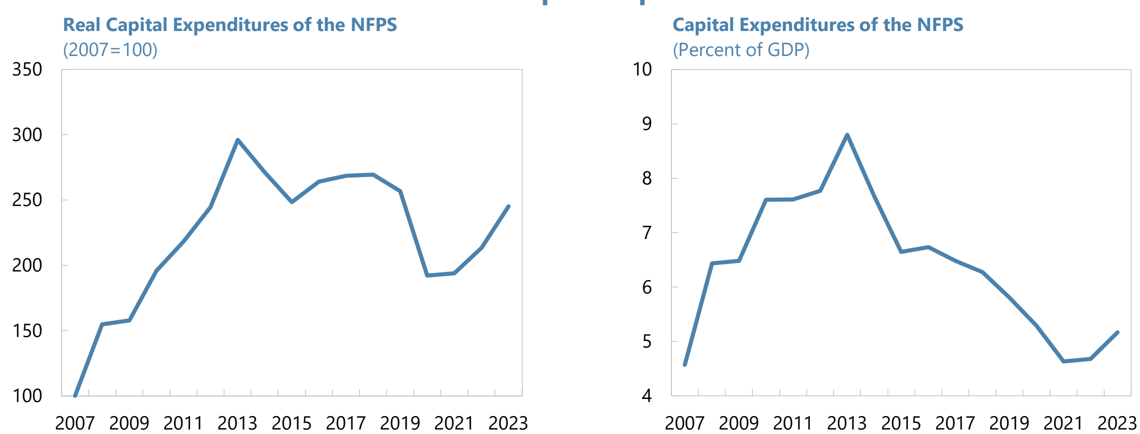
Source: IMF staff calculations.

prevent VAT under-reporting, greater scrutiny on large corporations by the new Large Taxpayers Unit (LTU), and new, state-of-the-art, scanners at customs checkpoints.[16] Part of the resulting fiscal space will be used for an increase in capital expenditure (see chart). Education spending will be increased to meet legally-mandated targets.[17]

29. The government's plans to further reduce the deficit to 2 percent in 2024 and 1½ percent of GDP in 2025 and beyond in line with the SFRL are appropriate, as they would underpin a gradual decline in the public debt-to-GDP ratio over the medium term.

30. In staff's baseline outlook, which assumes no new tax initiatives beyond 2023, the deficit target would be met by a reduction in the expenditure-to-GDP ratio.[18] This could partly be achieved by returning wages and public consumption to pre-covid levels, but would likely also require a reduction of the public investment to GDP ratio (Table 2).[19]

Public Capital Expenditures



Sources: National authorities and IMF staff calculations.

31. To sustainably reduce the fiscal deficit while creating room for education, social spending, and investment, staff recommend increasing tax revenue. Panama's central government tax-to-GDP ratio is low (in 2022, Panama's central government tax revenue-to-GDP

[16] The approved budget does not include proceeds from the new tax on digital platform purchases and the impending new agreement with Minera Panamá, but is more optimistic than the staff on indirect taxes and capital revenues.
[17] According to Panama's education laws, the government budget should allocate 6 percent of the previous year's GDP to the education sector. The government plans to do so by 2024. In 2023, education spending will increase to 5.77 percent of 2022 GDP from 5.4 percent of 2021 GDP.
[18]The baseline assumes that tax revenue will increase by 0.8 percentage point of GDP between 2023 and 2028 because of existing tax administration initiatives (including the establishment of LTU) and a cyclical rebound in revenues from the pandemic. It further assumes that the central government spending-to-GDP ratio reverts to pre-pandemic levels through restraint in the growth of the public wage bill and public consumption. Central government transfers to the CSS gradually increase over time to fully cover the deficit in the defined-benefit component of the pension system (note that this does not affect the deficit of the non-financial public sector).
[19] The government does not publish medium-term revenue and expenditure projections underlying the deficit target.

ratio is only 7.8 percent) and was declining even before the pandemic. Tax revenues are low because tax rates are low (especially for the ITBMS, reflecting Panama's investment-friendly business model), many exemptions exist, tax expenditures are high and tax collection efficiency is weak (see SIP 'Panama: Toward a Modern Tax System'). Low tax revenues are partly compensated by non-tax revenues (mainly contributions from the Panama Canal Authority) but total general government revenue is low as well.

32. As the government prefers not to raise the main tax rates, improving tax and customs collection efficiency and broadening the tax base will be key. Broadening the tax base could occur by reducing exemptions, deductions, and tax expenditures. Many of these exemptions are regressive—they mainly benefit higher income levels. More specifically, staff suggests that the government (i) reviews ITBMS tax exemptions and streamline the process for refunds; (ii) reviews exemptions and deductions from the PIT base and (iii) reviews tax incentives for CIT. As regards to raising tax rates, the government could consider raising cigarette and fuel excises to bring them in line with the externalities they cause. Adopting a minimum corporate income tax for companies that pay taxes in the countries where they are headquartered (in response to the introduction of an international minimum tax) could further raise revenues.[20]

33. In addition, the social security administration (CSS) needs to address a deficit in the defined benefit component of the social security system.[21] There are two pension systems within the social security system: (i) a defined benefit plan, which was closed for new participants in 2008; and (ii) a newer, mixed system (largely defined contributions). The defined benefit plan is running deficits, currently financed through the pension fund's reserves and an escrow fund that the government established in 2004, but these reserves will run out in late 2024 or early 2025. The government has not yet committed to a reform plan.[22] It is waiting for the "social dialogue" with employers and unions scheduled in early 2023.

34. Strengthening medium-term fiscal planning would further help achieve the fiscal targets. So far, the government adheres to a modified fiscal rule that focuses on the deficit of the non-financial public sector. Adoption of a broader medium-term fiscal framework that sets out the levels of revenues and expenditures consistent with achieving this target would enhance the credibility of this framework. Parliamentary approval of the General Budgetary Administration Law (which is expected in the first half of 2023) will further strengthen the fiscal strategy.[23]

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[20]Planned IMF Technical Assistance (TA) aims to strengthen the effectiveness of the Customs administration through the implementation of an information exchange agreement with the tax administration and the streamlining of main customs processes.

[21] The deficit of the defined benefit pension system of about 1.1 percent of GDP in 2022 is partly offset by surpluses in other programs of the CSS, but current regulations disallow cross-subsidization. The overall CSS deficit of about 0.7 percent of GDP is projected to remain relatively constant over the next few years.

[22] Options include parametric reforms, such as raising the retirement age for not-yet retired participants, and finding of new funding sources.

[23] TA in the area of public financial management focuses on multi-annual budget preparation and management of fiscal risks. Work priorities for 2023 include the application of the IMF Fiscal Risk Assessment Tool, enhancing the registration of accounts payable, and the implementation of the new budget administration law. Areas of weakness that remain to be addressed are government procurement and fiscal transparency, including in the context of publication requirements of key budget and procurement documents and covid-related spending.

Authorities' Views

35. **The authorities noted that fiscal policy had played an important role in supporting the economy during the pandemic**. This had been particularly important given that Panama did not have its own monetary policy. They were confident they would meet the fiscal target in both 2022 and 2023 and were committed to reduce the fiscal deficits in line with the ceilings set in the SFRL in later years. At the same time, they planned to support the economy through extensive infrastructure and investment projects.

36. **The authorities agreed with the need to boost revenues.** While they believed that a low tax burden greatly benefits Panama's business environment, they were open to reductions in tax expenditures that could reduce economic inequality, and to tax measures that addressed profit-base erosion on the part of multinational corporations. They were also committed to implement several measures to reduce non-compliance; including a track-and-trace system to reduce illegal commerce and smuggling of cigarettes and alcohol beverages; tighten the control of withholding systems; and improve the cross-checking of tax information. They had submitted a bill to impose VAT on digital services provided by non-resident platforms and taxpayers.

B. Strengthening Financial Integrity

37. **Panama has been on the FATF grey list since June 2019.** In 2019, the FATF designated Panama as a "jurisdiction with strategic deficiencies" due to low levels of effectiveness identified in several areas of its AML/CFT regime. In response, the authorities agreed on an action plan with the FATF to address: (i) national and sectoral ML/TF risks; (ii) supervision and sanctions against AML/CFT violations; (iii) verification and update of ultimate beneficial ownership (UBO) information of legal persons and arrangements; and (iv) investigation and prosecution involving foreign tax crimes. The original deadlines for implementing all the necessary reforms were September 2020 for items (i) to (iii) and January 2021 for item (iv).

38. **The authorities have made important progress in addressing outstanding issues of the FATF action plan.** By October 2022, the authorities had, "largely addressed" 12 out of 15 action items on the FATF action plan, while "partly addressing" the remaining 3. Recent progress to address the remaining items is discussed in Annex IX.

39. **Addressing the remaining issues is critical to avoid adverse action by the FATF and preserve Panama's role as a regional financial center.** At the conclusion of the four most recent FATF plenaries, the FATF expressed discontent with the pace of progress towards completing the action items on Panama's FATF action plan, threatening adverse action. After the October 2022 plenary, the FATF urged Panama to swiftly demonstrate significant progress in completing its action plan by February 2023 or it would consider next steps, which could include calling on its members and urging all jurisdictions to apply enhanced due diligence to business relations and transactions with Panama.

40. **Fintech companies should be subject to AML/CFT regulation and supervision.** In December 2022, there were 10 Fintech companies operating within the financial sector with

authorizations granted by the Ministry of Industry and Commerce (MICI), focusing largely on providing lending products and payment services to households and non-financial corporations. However, these Fintechs are not currently subject to AML/CFT preventive measures, either at the early stages of the licensing process or to supervision by the MICI or SBP (currently the designated AML/CFT supervisory authority for "*Financieras*", as per Law 23).

Authorities' Views

41. The authorities believed that the remaining items on the FATF action plan were likely to be considered "largely addressed" in 2023—if not at the FATF meeting in February then at the latest at the next meeting in June. They remain committed to enhance the effectiveness of Panama's AML/CFT regime beyond the immediate goal of exiting the FATF grey list, which is evident in the new resources and staff assigned to the appropriate government agencies.

42. The authorities agreed that virtual asset service providers (VASP) should be subject to adequate regulation and supervision to ensure effective implementation of the obligations imposed under Law 23 of 2015 (AML/CFT Law). They noted that the AML/CFT Law needs to be amended to designate: (i) VASPs as reporting entities subject to all preventive measures obligations; and (ii) a competent supervisory authority with responsibility over these financial institutions.

C. Strengthening Financial Sector Resilience

43. In the absence of a lender of last resort and deposit insurance, ensuring that banks are well capitalized and liquid is essential to preserve Panama's role as a regional financial center. Aggregate capital and liquidity buffers in Panama's large banking sector are currently well above regulatory minima.[24] The capital adequacy ratio was 15 percent at end-September (above the minimum requirement of 8 percent), while liquidity buffers at end-2022 covered 57 percent of short-term deposits (almost double the regulatory requirement of 30 percent).

44. The SBP conducts regular stress tests to ensure that banks have adequate capital and provisions. The latest stress test shows that—in an adverse scenario with a real GDP growth of -2 percent, unemployment rate of 18 percent, and after accounting for all modified loans—all banks remain solvent although the capital adequacy ratios of two small banks could fall below the Basel III minimum of 8 percent.

Distribution of Banks According to Capital Adequacy 1/

Capital Adequacy Ratio	Actual *(as of October 2022)*	Stressed Scenario *(after 12 months)*
Below 8%	0	2
Above 8% to 10%	1	3
Above 10% to 12%	7	3
Above 12%	26	26

Source: SBP.
1/ Based on 34 banks accounting for 90 percent of total assets in the banking system.

45. The SBP continues to step up its prudential supervision. Its post-pandemic supervision focuses on three main areas to ensure that banks: (i) reclassify modified loans and make loan-loss provisions correctly in line with the pre-pandemic classification rule; (ii) have sound business

[24] Total assets amount to 210 percent of GDP. The sector contributes around 6.5 percent to GDP each year.

strategies to address asset quality and liquidity risks; and (iii) incorporate and properly manage climate risks as part of their operational risk.

46. Actions that would further strengthen the resilience of the banking sector include:

- ***To mitigate asset quality and liquidity risks:***.
  - A risk-focused approach to examine loan portfolios—guided by solvency stress tests—should continue to ascertain banks' credit risk, provisioning and capital buffers.
  - Instituting liquidity stress test—with the support of IMF TA—will help determine whether banks have sufficient funding sources to withstand unexpected market disruptions, particularly systemically important ones.
  - Expanding the macroprudential policy toolkit[25] with additional borrower-based measures for households—such as caps on the loan-to-value and debt-service-to-income ratios—and mapping them to vulnerabilities will enhance monitoring and enable timely activation of macroprudential policies to preempt and mitigate asset quality risks. Completing the ongoing initiatives to enhance data collection would enable the implementation of these borrower-based indicators.
- ***To enhance resilience:*** Implementing the Basel III capital conservation buffer and surcharge for systemically important banks will further increase loss-absorbing capacity.
- ***Crisis preparedness***. All banks should prepare recovery plans, with the SBP developing resolution plans for systemic banks. In the medium term, a deposit insurance scheme should be developed to protect depositors, and an official lender of last resort function put in place to support sound banks experiencing temporary liquidity shortfalls. Until these reforms have been implemented, the emergency liquidity window of the FES[26] should be kept in place.

47. Initiatives to strengthen banks' management of climate risks are underway. A new Rule 11-2022 has been implemented requiring banks to incorporate climate risks in the measurement of operational risk.

48. Safeguards assessment. The BNP has implemented all the recommendations from the first-time safeguards assessment completed in September 2020. Separately, the legal framework for operationalizing the FES has been approved, foreign exchange investment practices were enhanced, and new control procedures to mitigate risks of misreporting of monetary data to the Fund have been established, building on a review by the internal audit function.

[25] Currently, the main broad-based macroprudential measures are dynamic provisioning and a minimum requirement for the leverage ratio. The SBP is planning to introduce capital conservation buffer and systemic bank surcharge in the medium term, and is considering countercyclical capital buffer.

[26] The FES is a $1 billion financial stability fund. It comprises an emergency liquidity window to support banks ($500 million) and a credit facility to stimulate the economy. It is owned by the MEF and operated by BNP.

Authorities' Views

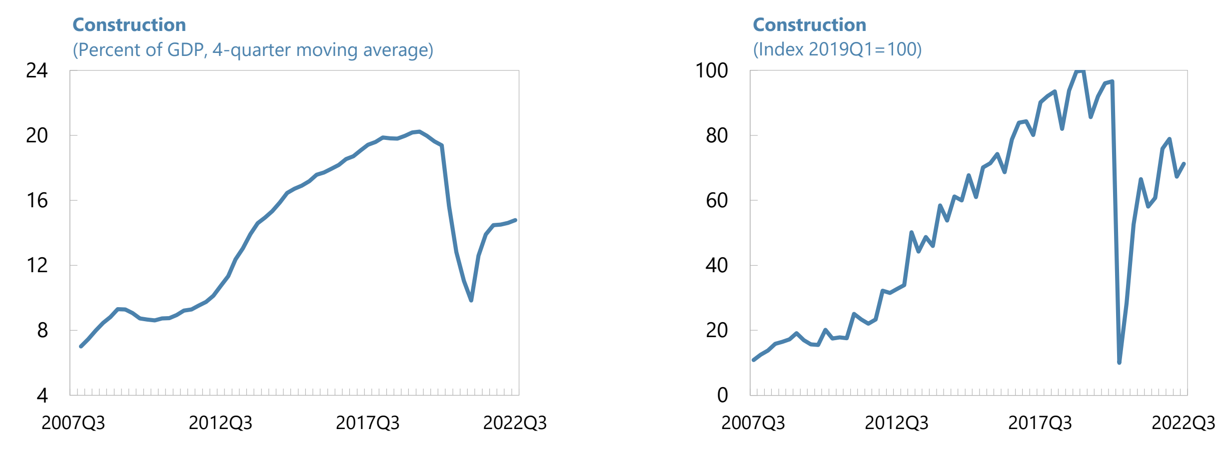
49. **The authorities highlighted that the banking system remains well capitalized and liquid and were committed to tight regulatory oversight.** They expressed concerns that pockets of vulnerabilities remain, as global uncertainties and rising interest rates could result in tighter funding conditions, particular for smaller banks with limited deposit base. They emphasized that safety nets—especially from the liquidity facility in the FES—were important and that intrusive supervision and intensive monitoring of banks would continue to preempt risks, and recalibrate capital and provisioning requirements. They agreed that, in the longer run, deposit insurance could be another important safety net although cost issues would first need to be addressed.

50. **They remained committed to implement additional prudential measures**, including macroprudential tools, to safeguard financial stability. Initiatives are underway to address the remaining data gaps in households and corporate sector to supporting the establishment of borrower-based indicators. Additionally, they will continue to refine banks' management of climate risk based on the outcomes of surveys.

D. Sustaining Convergence

51. **The future contribution of construction to growth is uncertain.** Construction activity increased by 250 percent between 2009 and 2019, and at the peak of the construction boom in 2013 contributed 3.0 percentage point to annual growth. If—as staff projects—construction *levels* will stabilize, the contribution to GDP growth will drop to zero.

52. **To sustain rapid growth, other productive sectors will need to take over**, including the export sector, which—with the notable exception of mining—has seen little expansion in the last two decades.



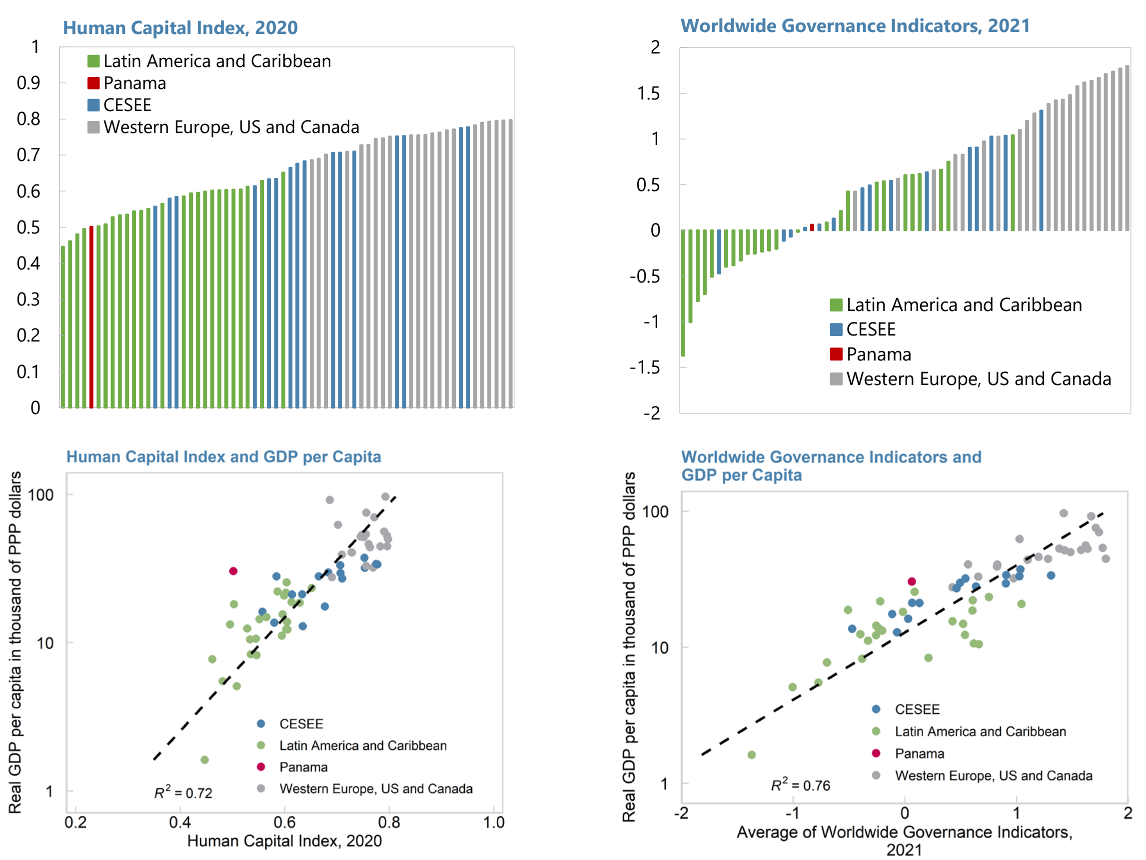
Sources: Haver and IMF staff calculations.

53. **To sustain convergence, improving human capital and governance is key.** According to Bakker et al. (2020), there is conditional convergence—countries tend to converge to levels consistent with their human capital and governance indicators. Countries with high human capital

and governance tend to be rich, and countries with low indicators stay poor (see chart). For its per capita income level, Panama scores poorly on governance and human capital relative to peers.

- **World Bank human capital index scores are low not just compared with high-income countries, but also by regional standards.**[27] Human capital has likely deteriorated further during the pandemic. Schools were closed for more than 15 months, with varying access to and quality of digital learning. A World Bank survey suggested a high disengagement rate among remote learners, particularly among poor and rural households, widening educational gaps for the economically disadvantaged populations.
- **Governance indicators are well below high income countries to which Panama hopes to converge.** According to the 2021 Worldwide Governance Indicators[28] which report on six dimensions of governance, Panama performs similar to Latin America and Caribbean, but worse than Western Europe, North America, and CESEE.

Human Capital and Governance Indicators 1/



Sources: World Bank, Worldwide Governance Indicators, 2022 Update, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank), Penn World Tables 10.0, and IMF staff calculations.

1/ The values for the governance indicator are the average of the estimates for the 6 aggregate indicators of governance from the Worldwide Governance Indicators. CESEE refers to Central, Eastern, and Southeastern Europe.

[27] This reflects low scores on standardized tests.

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

54. Better education and an alignment of academic curricula with job market needs would boost human capital. A knowledge exchange with industry leaders would help the education system prepare students for high skilled jobs. Vocational and on-the job training (such as *Aprender Haciendo* for youth) as well as supporting infrastructure for commuting and childcare would help move labor into productive sectors.

55. Tailored support to women and indigenous groups seeking to enter (or re-enter) the labor force would further help. Other gender-focused reform priorities include integrating women in the workforce (through training) and formalizing their entrepreneurial activities (through workshops and outreach).

56. To improve governance, Panama needs to enhance its public sector efficiency and transparency. Low corruption perception scores point to a lack of trust in institutional functions, while low judicial independence and weak insolvency frameworks and property rights dampen the business climate. Additionally, the authorities need to strengthen contract enforcement, enhance public communication and outreach (including through reliable data provision and timely information sharing), and enhance the degree of digitalization of government services. Areas of governance where Panama performs relatively well include regulatory quality, voice and accountability, and political stability and absence of violence/terrorism.

57. Other reforms include updating labor laws (overly stringent firing practices and restrictions on foreign workers coupled with a lack of skilled local labor thwart foreign investment), raising innovation capacity by boosting incentives for investment in science and research, and improving critical infrastructure (expanding road connectivity, providing reliable utilities, and enhancing the energy matrix and water management).

Authorities' Views

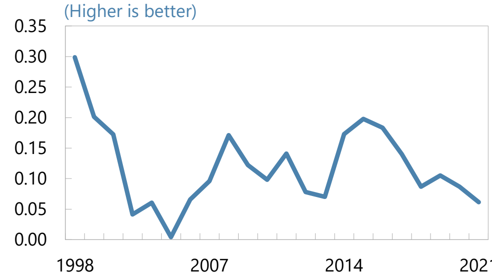
58. The authorities agree with the need to boost human capital and productivity. They noted that the increase in education spending aims at boosting academic outcomes, focusing in particular on primary education, digital literacy, and English proficiency. They are also cognizant of the need to boost Panama's productive capacity by digitizing public service delivery, enhancing the skillset and digital literacy of the workforce through training programs, and reducing labor market informality. They are working on simplifying and automating government procedures as well as improving citizen engagement to reduce corruption perceptions.

E. Improving Statistics

59. Data is broadly adequate for surveillance albeit with some shortcomings, particularly on timeliness (see Informational Annex). For example, 2022Q2 BOP data was only published in January 2023.

Governance Indicators [1/]

(Higher is better)



Source: The Worldwide Governance Indicators, 2022 Update. D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank).
1/ Average of the estimates for the 6 aggregate indicators of governance.

60. Staff turnover and the ongoing census and GDP rebasing projects have caused broad delays in the release of macroeconomic statistics including labor and external sector data, and impacted the timely publication of the IMAE.

61. More timely publication of the IMAE is a key remaining issue before Panama subscribes to the SDSS. Panama can currently only publish the IMAE with a timeliness of 55 days, while the SDDS requires 6 weeks. Compliance with the current eGDDS targets set by the authorities for timeliness and frequency is also required.

62. Several ongoing projects will improve statistics.

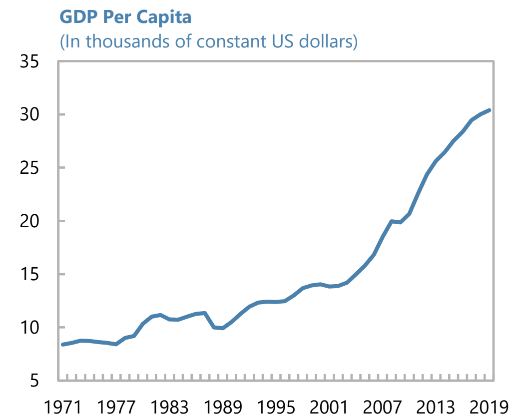
- **Seasonal adjustment methodology for the monthly IMAE indicator**—supported by IMF TA—will support high-frequency monitoring and reflect the current economic structure and growth engines.
- **The National Statistical Plan (NSP) 2021-25** will foster statistical development and help advance toward SDDS subscription.

Authorities' Views

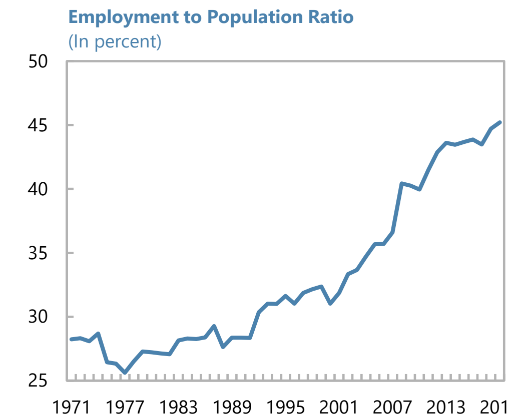
63. The authorities remain committed to subscribe to the SDDS in the near-term. They are pressing ahead with the implementation of the NSP while re-prioritizing amid limited resources. The population census as well as the GDP and CPI rebasing exercises are key priorities for 2023.

Figure 3. Panama: Real GDP and Production Factors
(In constant US dollars)

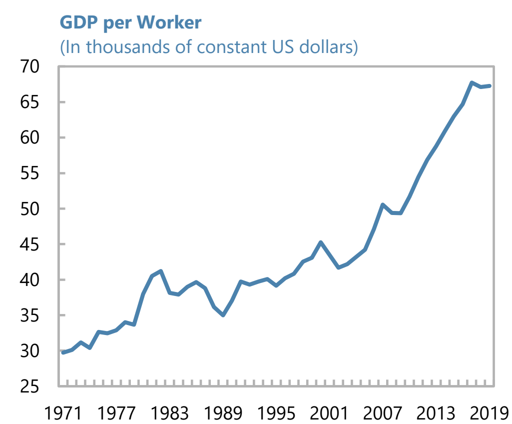
Per-capita incomes grew strongly before the pandemic…



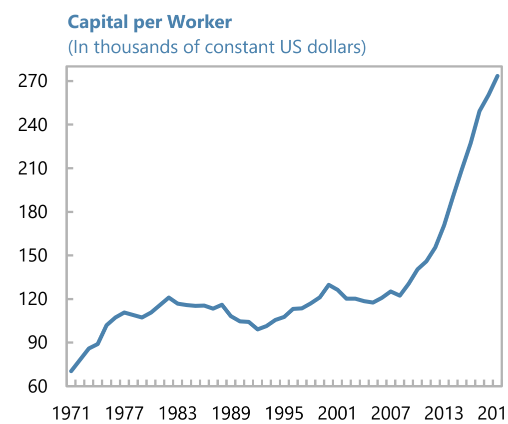
…while the employment to working age population rose sharply



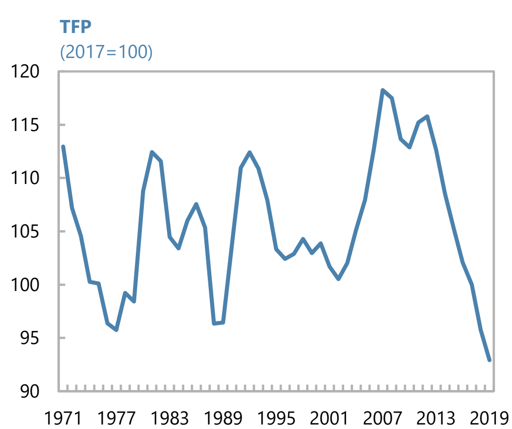
Output per worker more than doubled over 50 years…



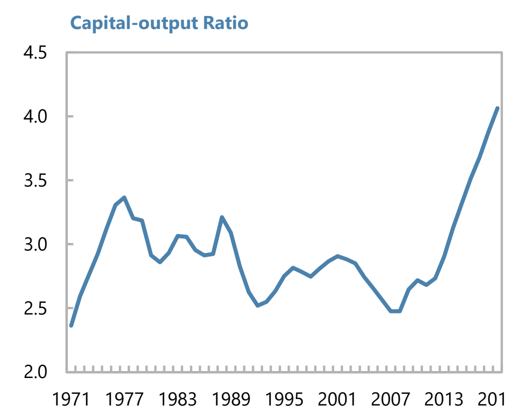
the result of a sharp increase in capital per worker….



…rather than an increase in TFP.



As a result, the capital-output ratio rose sharply.



Source: Penn World Tables 10.

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64. Post-pandemic policies should focus on rebuilding buffers and ensuring the convergence of Panamanian income levels with those in advanced countries continues.

65. The government's plans to further reduce the overall NPFS deficit to 3 percent in 2023 and 1½ percent of GDP in 2025 are appropriate. To sustainably reduce the fiscal deficit while preserving social spending and creating room for more education spending, tax revenue will need to increase. Improving tax and customs collection efficiency and broadening the tax base—by reducing exemptions, deductions, and tax expenditures—will be key.

66. Exiting the FATF grey list remains a priority. The authorities need to expediently address the remaining deficiencies in Panama's AML/ CFT regulatory framework identified by the FATF.

67. With no lender of last resort and deposit insurance, it is imperative that the banking system remains well-capitalized and liquid. Current capital-adequacy and liquidity indicators in the banking system are well above regulatory minima, and continued intensive supervision and monitoring and expanding the macroprudential policy toolkit will help mitigate future asset quality and liquidity risks. Fintech companies should be subject to AML/CFT regulation and supervision. The ongoing FSAP will further inform the performance and vulnerabilities in Panama's financial system.

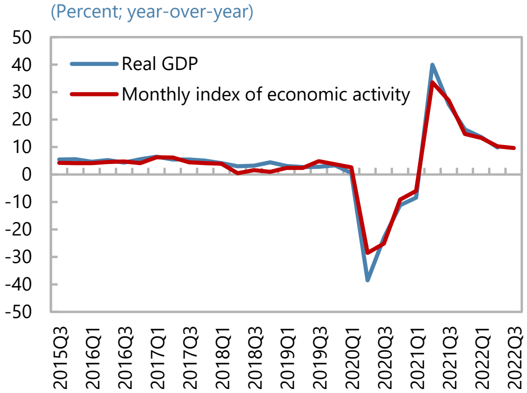
68. Going forward, it is likely that construction will not provide the same boost to growth as it has in the past two decades. For convergence to continue, other sectors will need to take over, and bringing human capital and governance standards in line with those in advanced countries would help.

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

Figure 4. Panama: Real Sector Developments

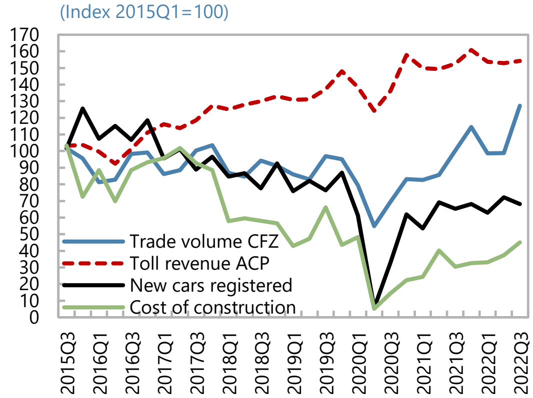
The economic contraction was sharp and especially drastic in Q2-2020, followed by a resolute recovery in 2021

Economic Activity
(Percent; year-over-year)



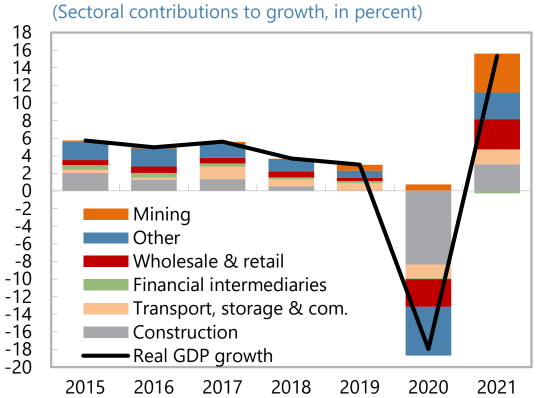
...amid rebounding activity across sectors albeit less pronounced in construction.

High-Frequency Indicators
(Index 2015Q1=100)



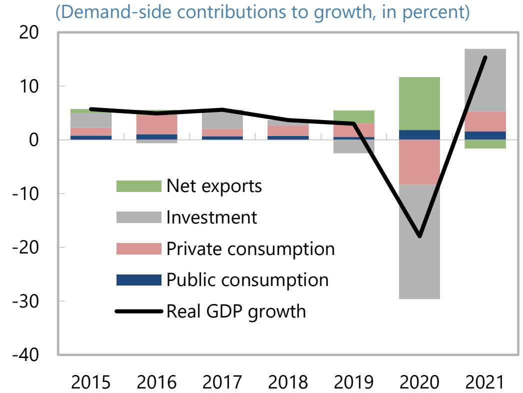
All sectors (but mining) experienced a contraction in 2020, with construction contributing the most.

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



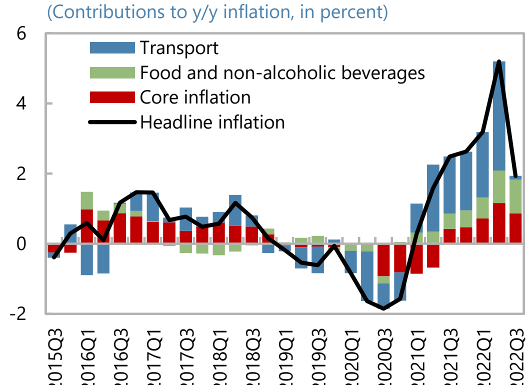
Before the pandemic, investment was already weak, with consumption and exports propelling growth.

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



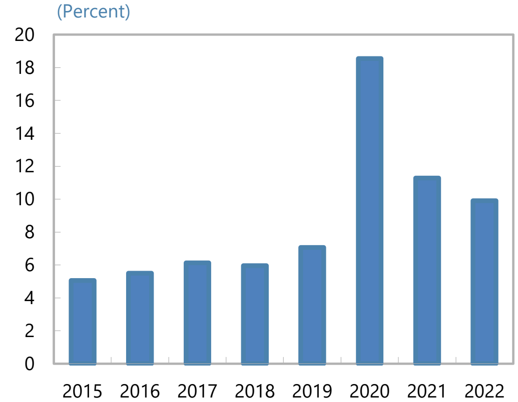
Prices were soft in 2020, reflecting weak demand, but inflation picked up in 2021-22 amid supply shocks.

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



Employment growth collapsed during the pandemic, with the services sector affected the most, with a partial recovery in 2021

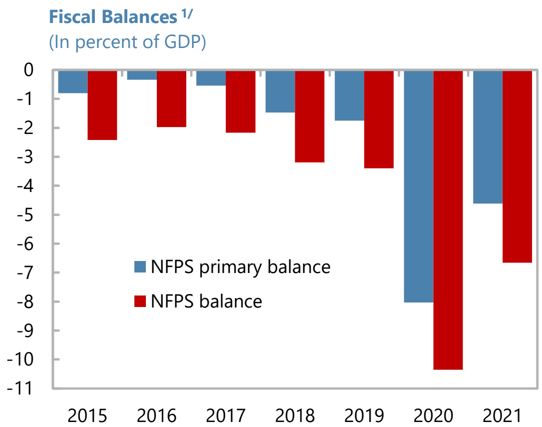
Unemployment Rate [1/]
(Percent)



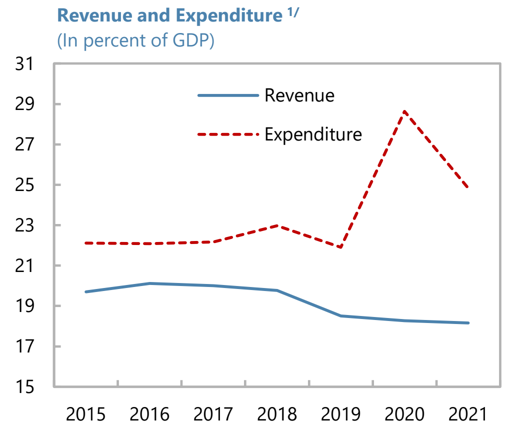
Sources: INEC and IMF staff calculations.
1/ 2022 data is from the April 2022 labor market survey.

Figure 5. Panama: Fiscal Developments

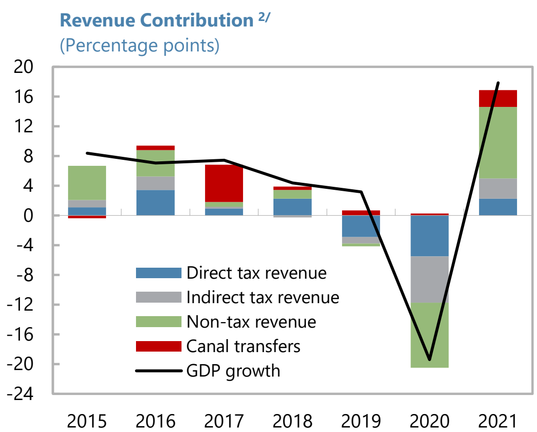
The fiscal deficit widened significantly as a result of the pandemic, but experienced a cyclical improvement in 2021…



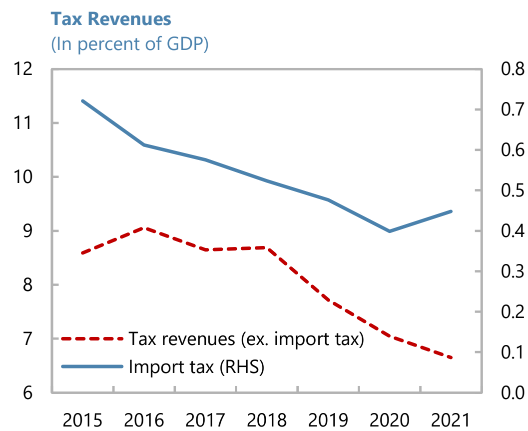
… reflecting both sharp changes in expenditure and revenue losses, which partly unwound in 2021.



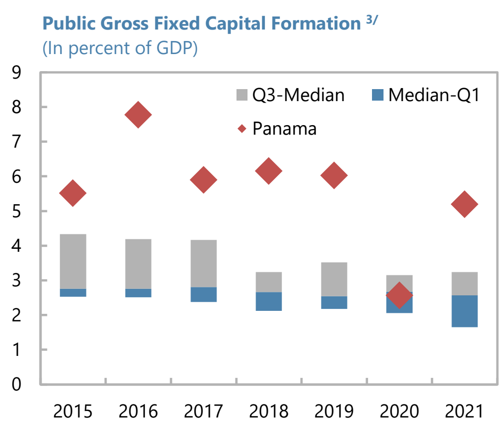
Non-tax revenue explains most of the 2021 revenue recovery…



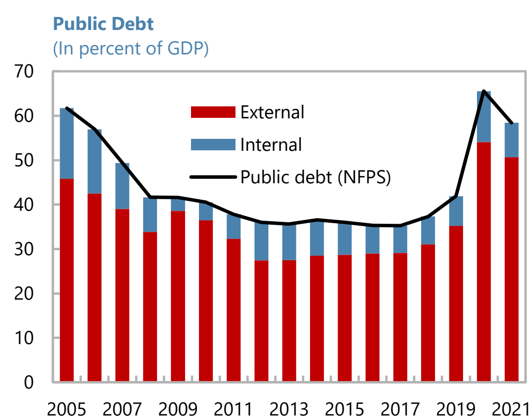
…while challenges in tax and customs administration, and tax exceptions continue to affect tax and tariff collection.



Public investment had started to recover as covid-related spending receded.



Public debt peaked in 2020, but declined in 2021, reflecting a lower-than-expected deficit.

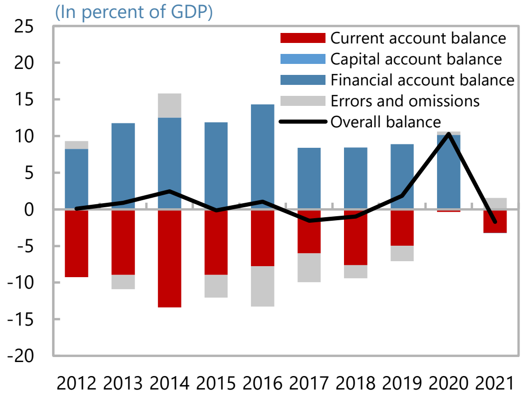


Sources: National Authorities, World Economic Outlook and IMF staff calculations.
1/ Non-Financial Public Sector.
2/ Data refer to the Central Government.
3/ Countries in the chart are CAPDR (Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica, Panama and Dominican Republic) and Brazil, Chile, Colombia,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

Figure 6. Panama: External Sector Developments

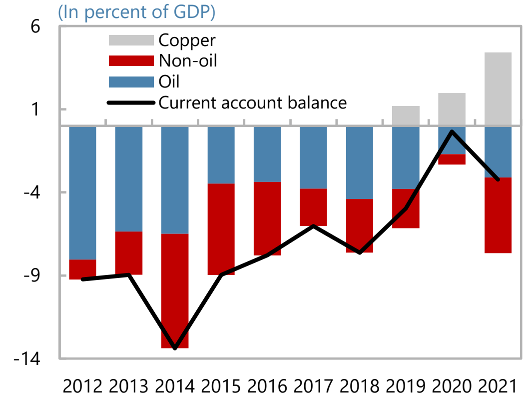
Overall balance has declined after temporary current account improvement during the pandemic…

Overall Balance of Payment
(In percent of GDP)



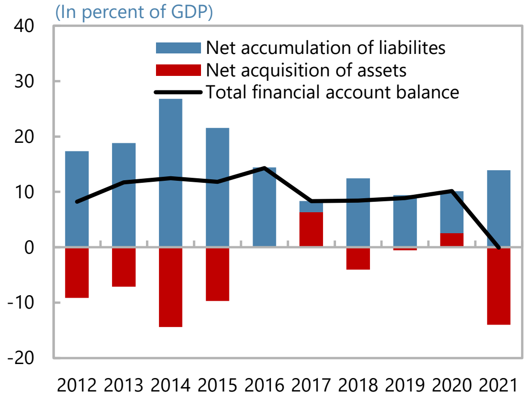
… The CA deficit widened with economic recovery amid rising food and fuel imports, despite higher copper exports.

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



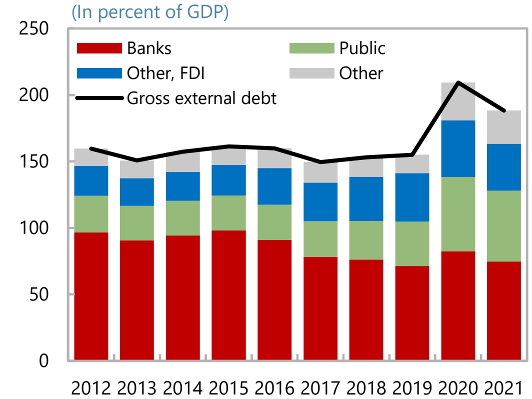
Inflows from financial account resumed …

Financial Accounts
(In percent of GDP)



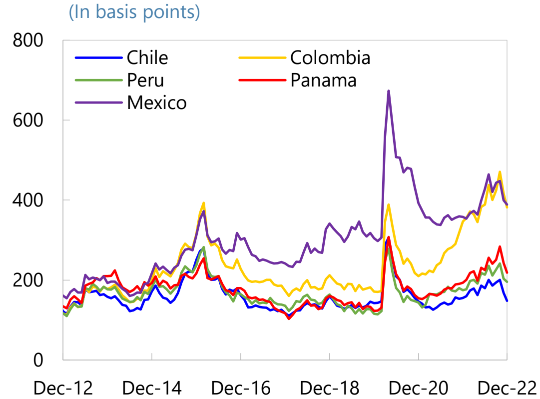
while external debt ticked up with high public debt issuance and a GDP denominator effect.

External Debt
(In percent of GDP)



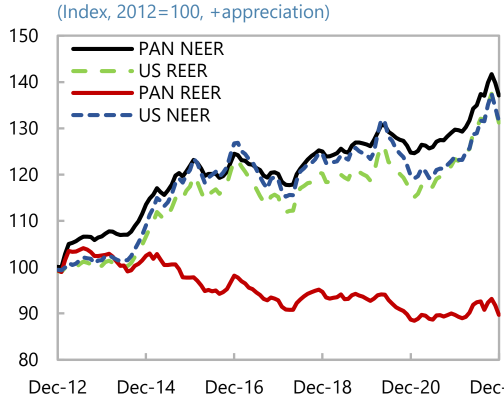
Sovereign bond spread has been relatively low as compared to peers.

EMBIG Spreads
(In basis points)



The REER continues to depreciate as inflation in Panama is relatively lower than peers.

Nominal and Real Effective Exchange Rates 1/
(Index, 2012=100, +appreciation)

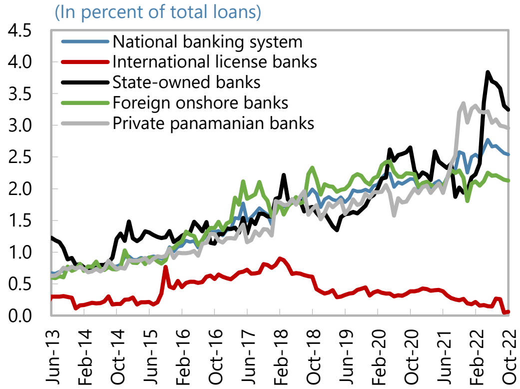


Sources: INEC and IMF staff calculations.
1/ Panama's NEER and REER exclude Venezuela.

Figure 7. Panama: Banking Sector Soundness

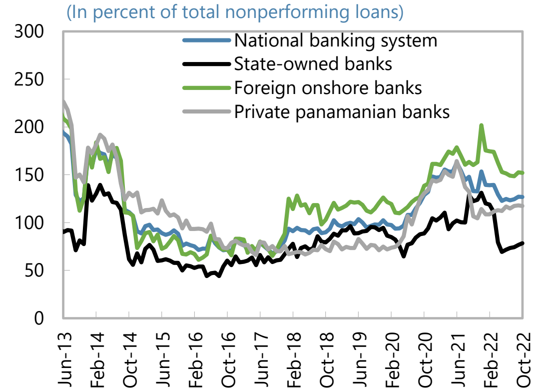
NPLs rose following the onset of the covid-19 pandemic…

Nonperforming Loans
(In percent of total loans)



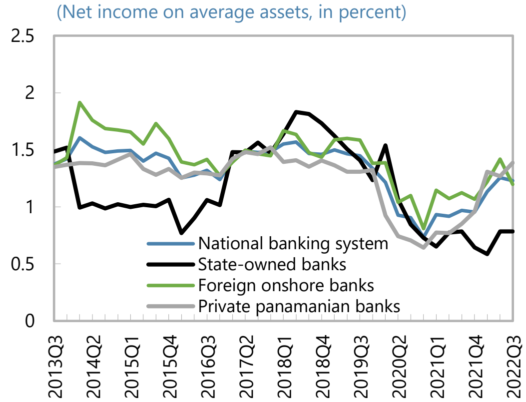
… but, loan-loss provisioning increased with the adoption of stricter provisioning requirements.

Provisioning
(In percent of total nonperforming loans)



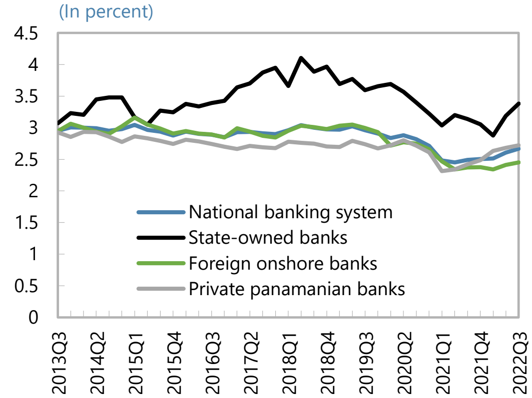
Profitability is recovering …

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



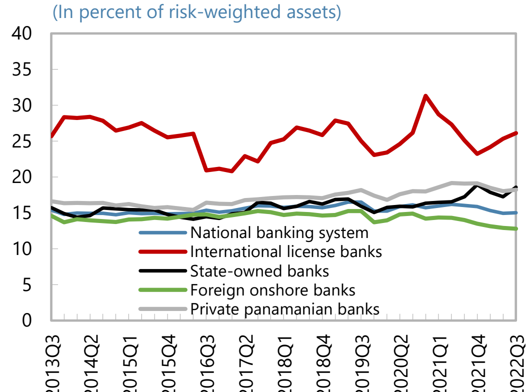
… as net interest margins recover slightly.

Net Interest Margin
(In percent)



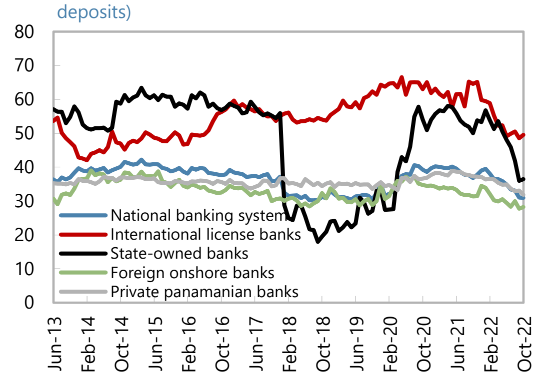
Banks' capital adequacy remains above regulatory minimum…

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



… while liquidity levels continue to be high.

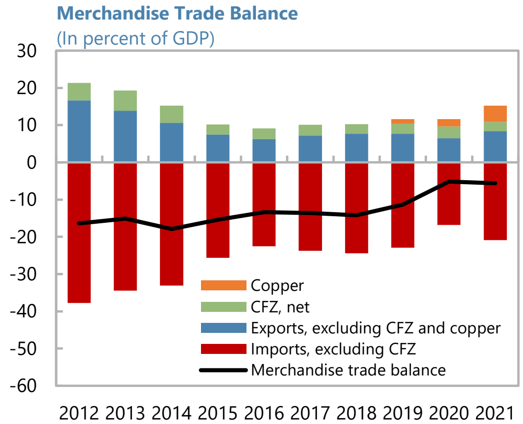
Bank Liquidity
(Ratio of liquid assets plus marketable securities to total deposits)



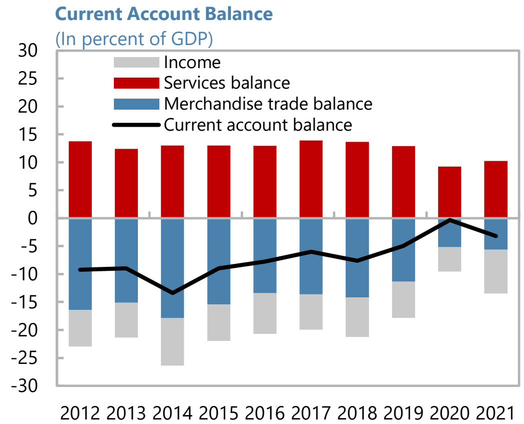
Sources: SBP and IMF staff calculations.

Figure 8. Panama: Balance of Payments

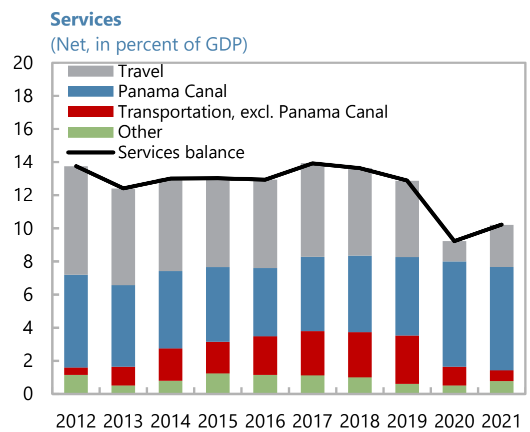
Exports of goods have increased thanks to copper.



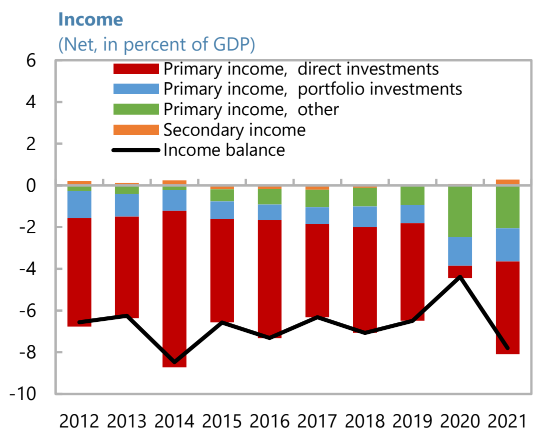
The trade deficit is offset by a surplus on services.



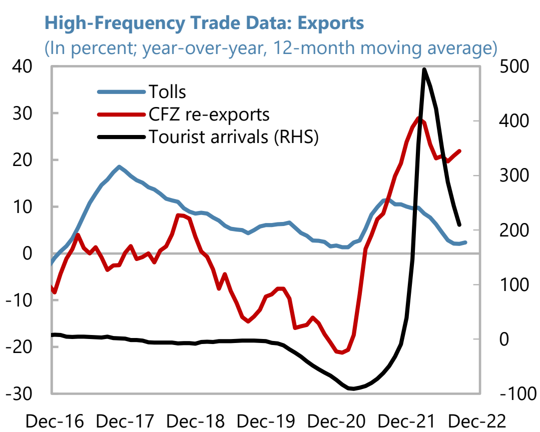
Service exports rely on the Panama Canal and tourism.



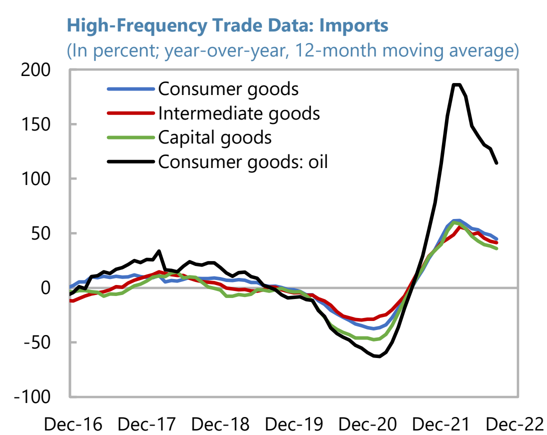
Income outflows are mainly from direct investment.



Exports are picking up from the recovery.



Imports have rebounded too and especially for oil and fuel.

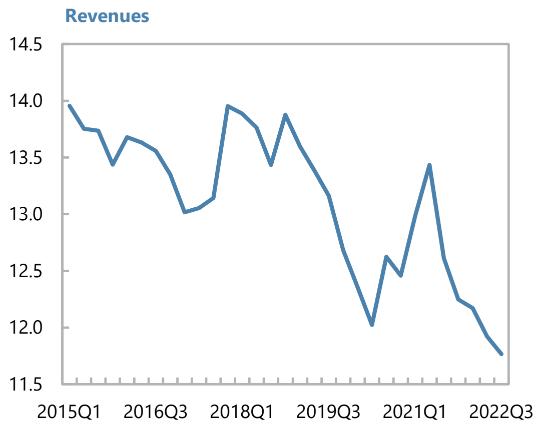


Source: Haver.

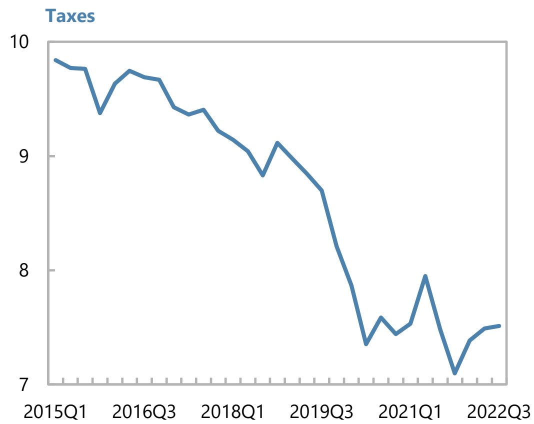
Figure 9. Panama: Central Government Finances

(Percent of GDP, four quarter totals)

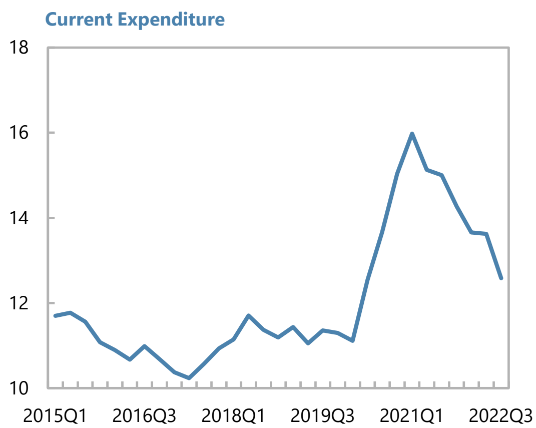
Government revenues have declined over time…



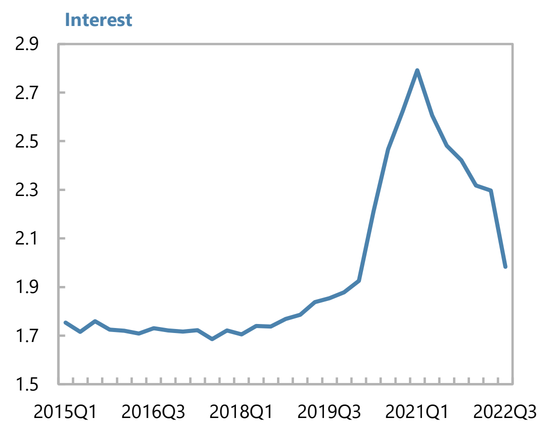
…the result of a decline in tax revenue.



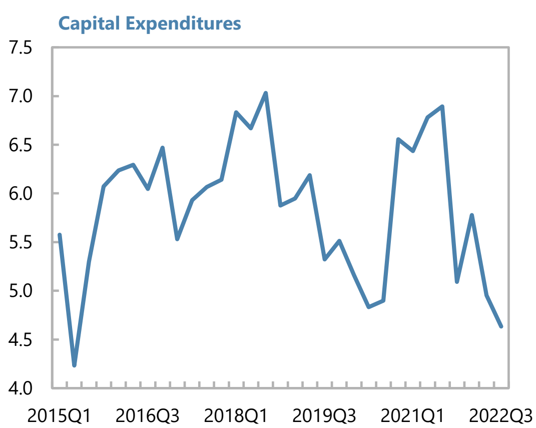
At the same time, the post-pandemic correction in current spending has only been partial so far…



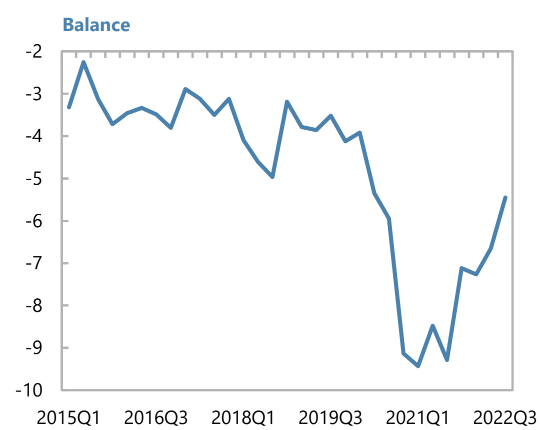
…while the interest bill adds pressure on public finances.



Capital spending fluctuates…



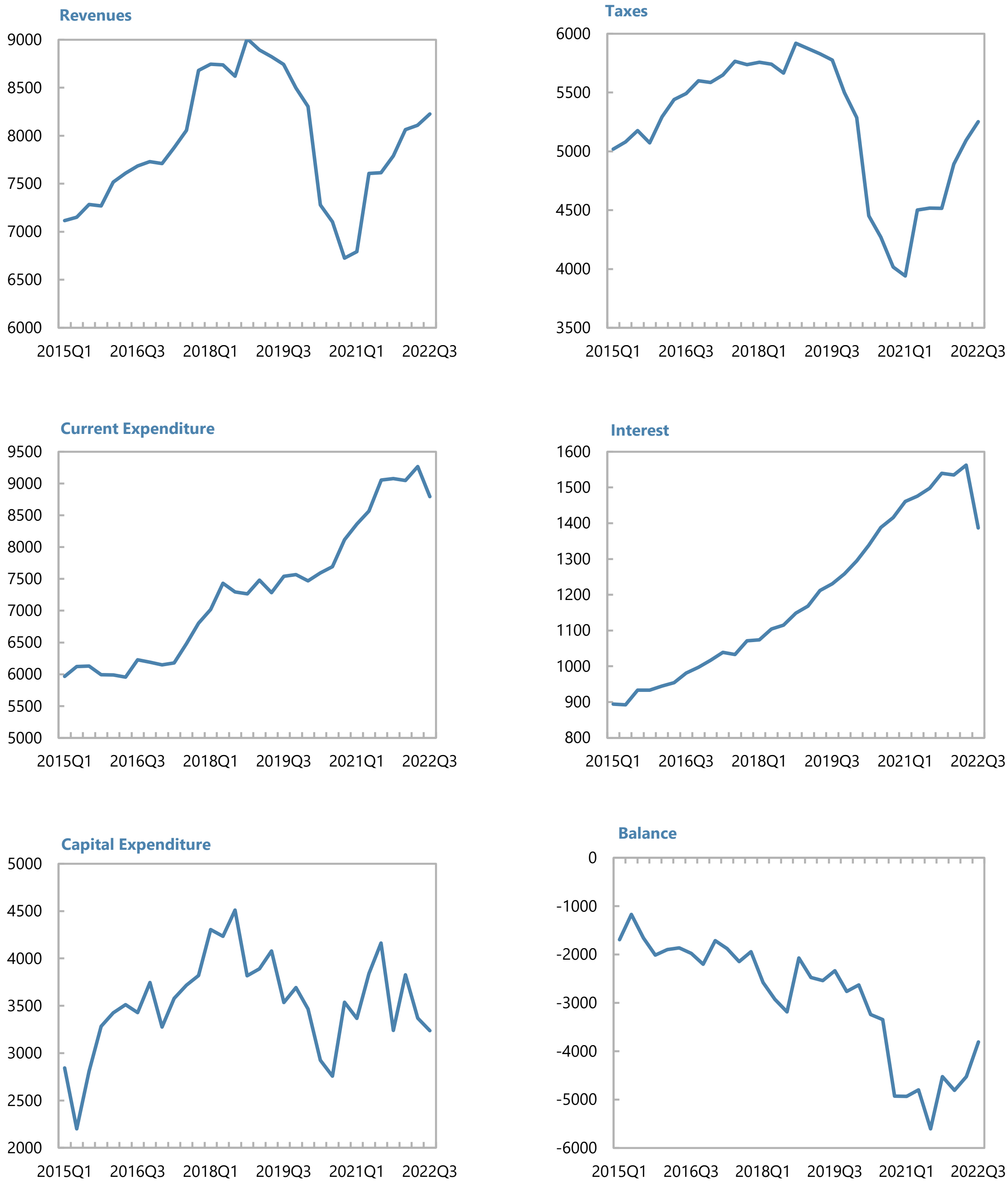
The deficit has been on an upward trend



Sources: Haver and IMF staff calculations.

Figure 10. Panama: Central Government Finances

(US$ millions, four quarter totals)



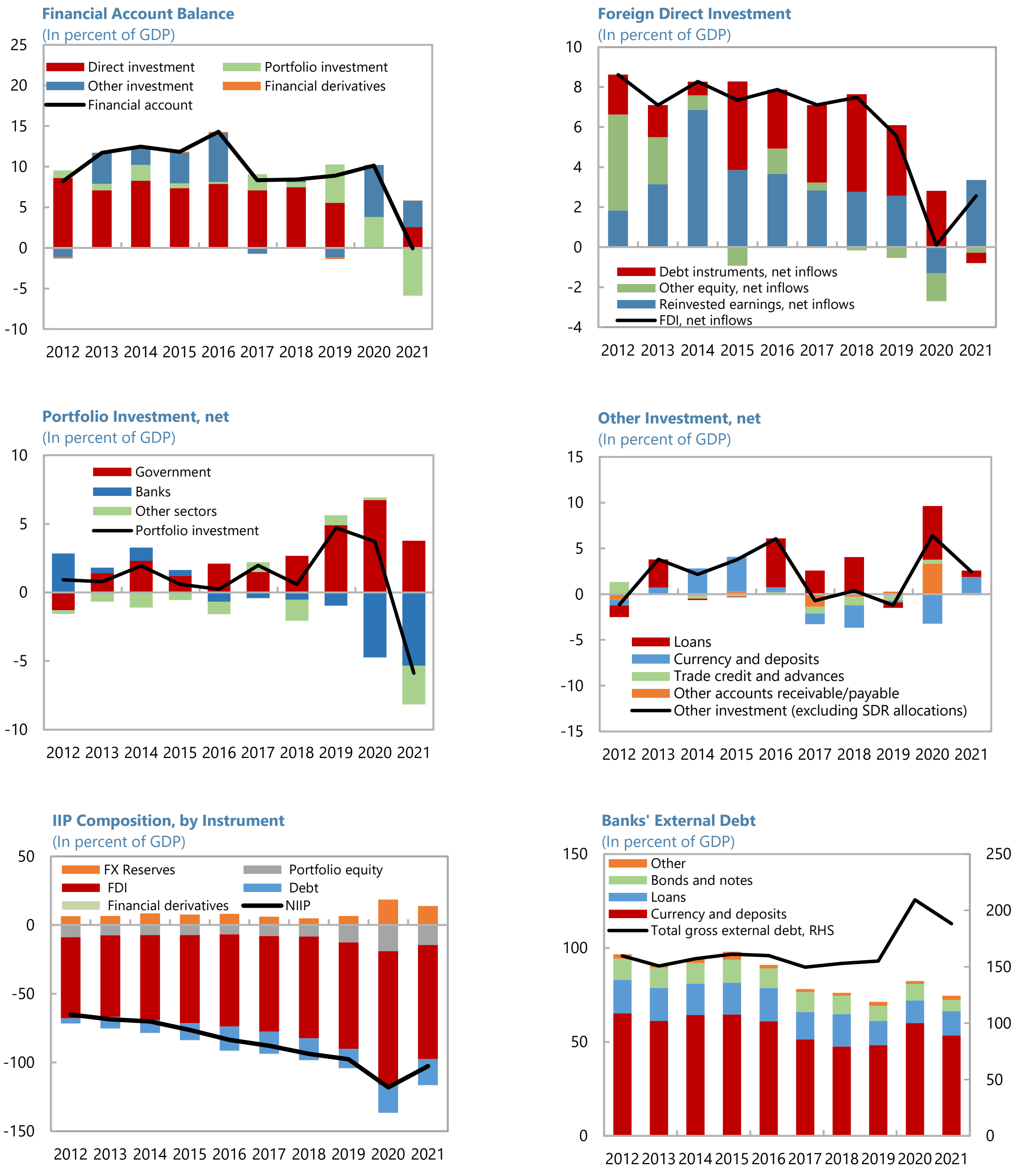
Sources: Haver and IMF staff calculations.

Figure 11. Panama: General Government Finances

(US$ millions, four quarter totals)

Sources: Haver and IMF staff calculations.

Figure 12. Panama: Balance of Payments

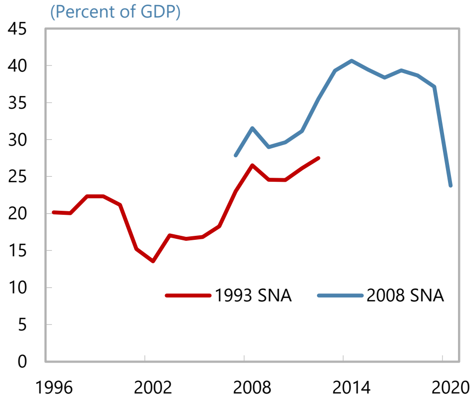


Sources: INEC, Haver and IMF staff calculations.

Figure 13. Panama: Investment by Activities

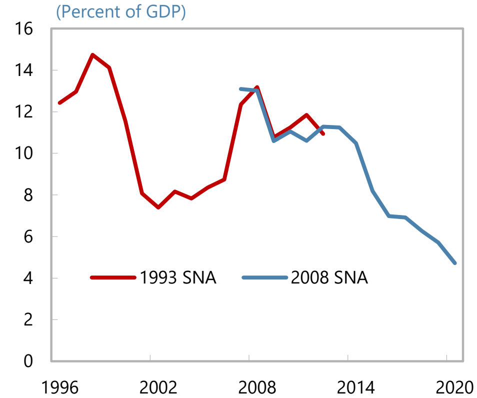
Investment rose sharply

Gross Fixed Capital Formation (GFCF)
(Percent of GDP)



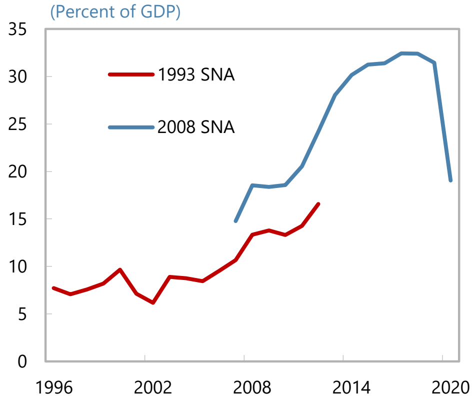
Investment in capital assets declined....

GFCF: Capital Assets
(Percent of GDP)



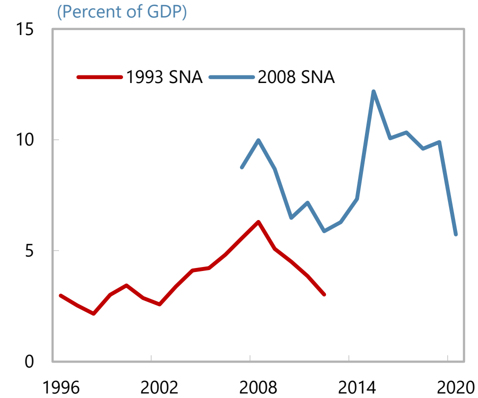
Construction surged...

GFCF: Construction
(Percent of GDP)



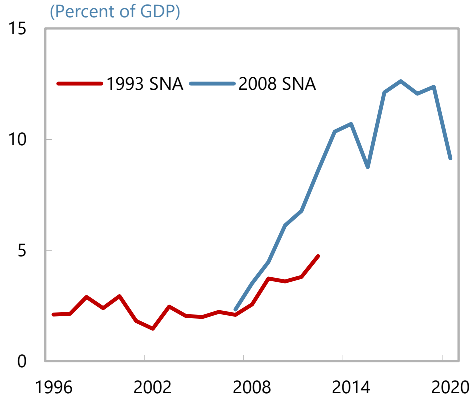
Driven by residential buildings, ...

GFCF: Construction - Residential Buildings
(Percent of GDP)



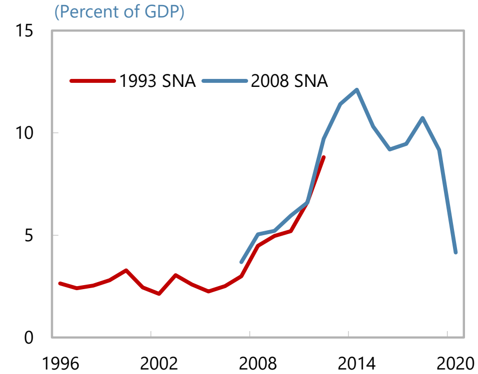
...other buildings...

GFCF: Construction - Other Building
(Percent of GDP)



...and other construction.

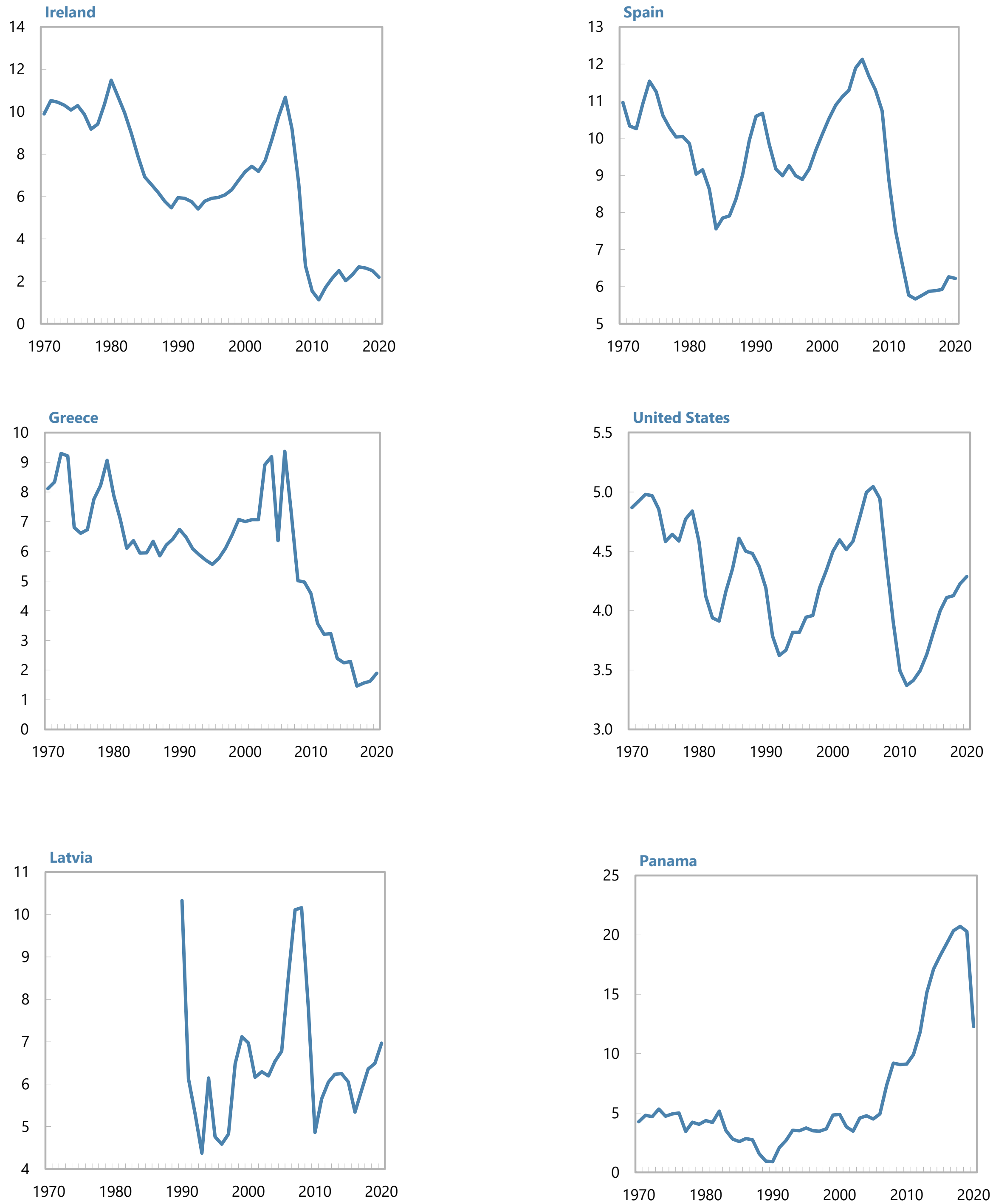
GFCF: Construction - Other Constructions & Works
(Percent of GDP)



Sources: CEIC database, INEC and IMF staff calculations.

Figure 14. Panama: Construction – Comparison between Countries
(Percent of GDP)

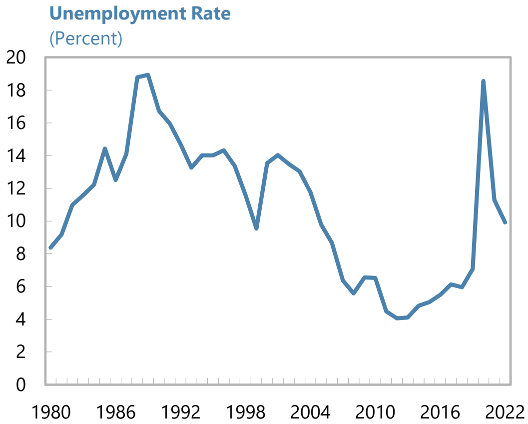
The increase and level of the construction-to-GDP ratio in Panama in the past decade has been much stronger than in other well-known examples of countries that experienced construction booms.



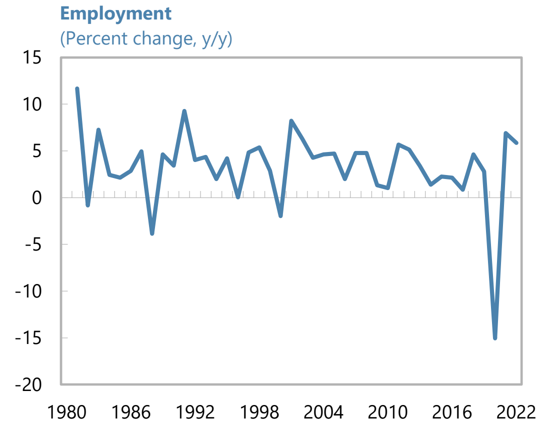
Sources: UN database of national accounts and IMF staff calculations.

Figure 15. Panama: Labor Markets

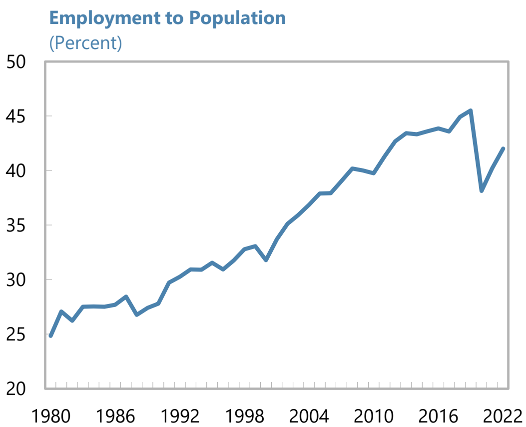
Panama's unemployment rate declined sharply post-covid



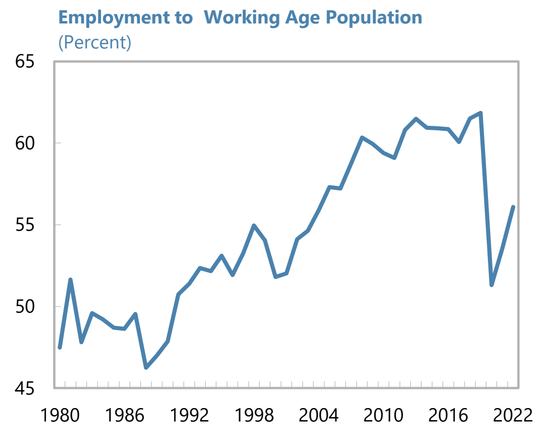
...as employment recovered in 2021.



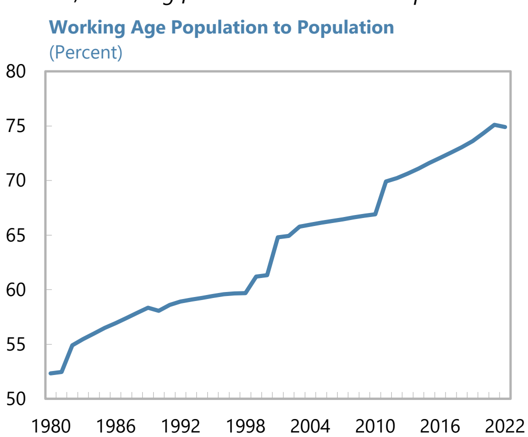
Employment rose both as a share of population...



....and working-age population, albeit not yet to pre-pandemic levels



The share of working-age population has risen steadily over time, revealing favorable labor-market potential.



Sources: INEC and IMF staff calculations.

Table 1. Panama: Selected Economic and Social Indicators 2018–28

Population (millions, 2021)	4.3	Poverty line (percent, 2019)	21.5
Population growth rate (percent, 2021)	1.4	Adult literacy rate (percent, 2019)	95.7
Life expectancy at birth (years, 2019)	78.5	GDP per capita (US$, 2021)	14,664
Total unemployment rate (October, 2021)	11.3	IMF Quota (SDR, million)	376.8

					Est.	Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					(Percent change)						
Production and Prices											
Real GDP (2007 prices)	**3.7**	**3.0**	**-17.9**	**15.3**	**9.0**	**5.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
Consumer price index (average)	0.8	-0.4	-1.6	1.6	2.9	2.2	2.2	2.0	2.0	2.0	2.0
Consumer price index (end-of-year)	0.2	-0.1	-1.6	2.6	2.1	3.1	2.0	2.0	2.0	2.0	2.0
Output gap (% of potential)	4.2	2.0	-17.1	-6.3	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Demand Components (at constant prices)											
Public consumption	**6.5**	**4.9**	**16.2**	**5.4**	**-5.4**	**-0.4**	**2.0**	**2.6**	**2.1**	**3.1**	**3.1**
Private consumption	2.3	4.9	-15.5	-0.7	15.8	6.0	3.6	3.4	3.0	3.5	3.7
Public investment 1/	6.9	1.0	-62.4	133.7	13.5	12.4	-4.6	-3.4	5.1	8.4	7.7
Private investment	-0.4	-0.9	-45.4	47.4	15.5	5.2	5.9	5.7	3.9	3.2	3.4
Exports	5.3	1.2	-20.6	25.4	12.3	5.4	6.6	5.3	5.5	5.4	5.1
Imports	4.5	-2.5	-34.0	32.4	7.7	2.5	8.7	5.9	5.2	5.7	5.7
Financial Sector											
Private sector credit	**4.5**	**2.4**	**-2.6**	**1.5**	**5.4**	**5.6**	**6.1**	**6.1**	**6.1**	**6.1**	**6.1**
Broad money	2.8	2.3	9.5	4.1	12.1	7.4	6.3	6.1	6.1	6.1	6.1
Average deposit rate (Percent)	1.9	2.0	1.8	1.4	1.8						
Average lending rate (Percent)	7.8	7.8	7.7	7.6	7.6						
					(In percent of GDP)						
Saving-Investment Balance											
Gross domestic investment	**41.5**	**38.3**	**24.1**	**32.5**	**34.3**	**34.7**	**34.8**	**34.8**	**34.8**	**34.8**	**34.8**
Public sector	6.2	6.0	2.6	5.2	5.4	5.8	5.3	4.9	5.0	5.2	5.4
Private sector	35.3	32.3	21.5	27.3	28.9	28.9	29.4	29.9	29.9	29.6	29.4
Gross national saving	33.9	33.3	23.7	29.3	30.4	30.7	31.2	31.8	32.1	32.1	32.3
Public sector	4.2	2.6	-4.2	-2.1	0.4	2.4	2.6	3.1	3.6	3.8	4.0
Private sector	29.7	30.8	27.9	31.4	30.1	28.3	28.6	28.7	28.4	28.3	28.3
Public Finances 1/											
Revenue and grants	**22.0**	**20.8**	**21.5**	**20.5**	**22.2**	**23.1**	**23.3**	**23.5**	**23.6**	**23.8**	**23.9**
Expenditure	24.9	23.9	30.7	27.1	26.0	25.8	25.1	24.6	24.5	24.7	24.9
Current, including interest	17.2	17.7	25.2	21.9	20.6	20.0	19.8	19.7	19.6	19.5	19.5
Capital	6.6	6.2	5.5	5.2	5.4	5.8	5.3	4.9	5.0	5.2	5.4
Overall balance, including ACP	-2.9	-3.1	-9.2	-6.5	-3.8	-2.7	-1.8	-1.2	-0.9	-0.9	-1.0
Overall balance, excluding ACP	-3.2	-3.4	-10.4	-6.7	-4.0	-3.0	-2.0	-1.5	-1.5	-1.5	-1.5
Total Public Debt											
Debt of Non-Financial Public Sector 2/	**37.3**	**41.9**	**65.6**	**58.4**	**55.4**	**54.9**	**54.1**	**53.2**	**52.4**	**51.5**	**50.8**
External	31.1	35.2	54.1	50.6	50.9	50.8	51.1	50.5	50.2	49.5	48.8
Domestic	6.3	6.7	11.5	7.8	4.5	4.1	3.0	2.7	2.2	2.0	2.0
Debt of ACP	4.2	3.8	4.2	3.2	2.6	2.1	1.7	1.3	1.0	0.7	0.4
Other 3/	4.2	4.1	5.1	4.3	3.9	3.6	3.4	3.2	3.0	2.8	2.7
External Sector											
Current account	**-7.6**	**-5.0**	**-0.4**	**-3.2**	**-3.9**	**-4.0**	**-3.5**	**-3.0**	**-2.8**	**-2.7**	**-2.5**
Net exports from Colon Free Zone	2.5	2.7	3.1	2.5	2.2	2.2	2.2	2.3	2.3	2.4	2.4
Net oil imports	4.4	3.8	1.7	3.1	4.2	3.5	3.2	3.0	2.8	2.6	2.5
Net foreign direct investment inflows	7.5	5.6	0.1	2.6	4.0	4.3	4.3	4.2	4.1	3.9	3.8
External Debt	153.0	155.0	209.4	188.3	169.4	168.1	167.0	166.5	166.0	164.3	162.5
Memorandum Items:											
GDP (in millions of US$)	64,929	66,984	53,977	63,605	71,299	76,540	81,383	86,331	91,580	97,148	103,055

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. These estimates are preliminary.

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, 2018–28[1]

(In percent of GDP)

					Est.	Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Non-Financial Public Sector						
Revenues	**19.8**	**18.5**	**18.3**	**18.2**	**19.0**	**19.9**	**20.1**	**20.4**	**20.5**	**20.6**	**20.8**
Current revenue	19.8	18.5	18.3	18.2	18.4	19.9	20.1	20.3	20.5	20.6	20.7
Tax revenue	9.2	8.2	7.4	7.1	7.8	8.4	8.6	8.8	9.0	9.1	9.2
Nontax revenue	4.4	4.3	4.8	4.9	4.8	5.5	5.4	5.4	5.4	5.4	5.5
o/w: Panama Canal fees and dividends	2.6	2.7	3.4	3.2	3.5	3.5	3.4	3.4	3.4	3.4	3.5
Social security agency	5.6	5.5	5.7	5.4	5.4	5.5	5.5	5.5	5.5	5.5	5.5
Public enterprises' operating balance	0.0	0.0	-0.2	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.1
Other 2/	0.5	0.5	0.6	0.8	0.2	0.4	0.5	0.5	0.5	0.5	0.5
Capital revenue 3/	0.0	0.0	0.0	0.0	0.5	0.0	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	**23.0**	**21.9**	**28.6**	**24.8**	**22.9**	**22.9**	**22.2**	**21.9**	**22.0**	**22.1**	**22.3**
o/w COVID-19 related expenditure			3.0	2.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Current primary expenditure	13.7	14.2	20.7	17.8	16.2	15.3	14.9	14.8	14.8	14.9	14.9
Central government 4/	8.1	8.3	13.2	11.1	9.5	8.7	8.4	8.2	8.2	8.2	8.2
Rest of the general government	5.6	5.9	7.5	6.7	6.7	6.7	6.5	6.6	6.6	6.6	6.7
Social security agency	5.2	5.4	6.9	6.1	6.1	6.1	6.1	6.1	6.1	6.2	6.2
Decentralized agencies	0.4	0.4	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Interest	1.8	1.9	2.6	2.4	2.1	2.4	2.6	2.7	2.5	2.4	2.3
Capital	6.3	5.8	5.3	4.6	4.7	5.2	4.6	4.4	4.7	4.9	5.1
Accrued spending 5/	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance 6/	**-3.2**	**-3.4**	**-10.4**	**-6.7**	**-4.0**	**-3.0**	**-2.0**	**-1.5**	**-1.5**	**-1.5**	**-1.5**
Net Financing 7/	**4.5**	**4.2**	**7.2**	**4.2**	**4.2**	**3.0**	**2.0**	**1.5**	**1.5**	**1.5**	**1.6**
External	3.1	5.1	10.3	4.8	5.9	3.4	3.3	2.3	2.6	2.2	2.1
Domestic	1.4	-0.9	-3.0	-0.6	-1.7	-0.4	-1.3	-0.8	-1.1	-0.7	-0.6
					Panama Canal Authority (ACP)						
Revenue	**4.8**	**5.0**	**6.6**	**5.6**	**6.7**	**6.7**	**6.5**	**6.5**	**6.5**	**6.6**	**6.6**
Expenditure	**4.6**	**4.7**	**5.4**	**5.5**	**6.5**	**6.4**	**6.4**	**6.2**	**5.9**	**6.0**	**6.0**
Current primary expenditure	1.6	1.5	1.7	1.6	2.2	2.2	2.2	2.2	2.2	2.3	2.3
Transfers to the government	2.6	2.7	3.4	3.2	3.5	3.5	3.4	3.4	3.4	3.4	3.5
Interest payments	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Capital expenditure	0.3	0.3	0.2	0.6	0.7	0.6	0.7	0.5	0.3	0.3	0.3
Overall Balance	**0.2**	**0.3**	**1.1**	**0.1**	**0.2**	**0.3**	**0.2**	**0.3**	**0.6**	**0.6**	**0.6**
					Consolidated Non-Financial Public Sector						
Overall Balance (incl. ACP)	**-2.9**	**-3.1**	**-9.2**	**-6.5**	**-3.8**	**-2.7**	**-1.8**	**-1.2**	**-0.9**	**-0.9**	**-1.0**
Memorandum Items:											
Primary balance (excl. ACP)	-1.5	-1.8	-8.0	-4.6	-2.3	-0.9	0.3	0.9	0.7	0.6	0.5
Structural primary balance (excl. ACP) 8/	-2.3	-2.1	-4.3	-3.4	-2.1	-0.9	0.3	0.9	0.7	0.6	0.5
Primary balance (incl. ACP)	-1.1	-1.3	-6.8	-4.4	-2.0	-0.5	0.5	1.3	1.3	1.2	1.1

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

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

2/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies. Also includes in 2021 a debt issue premium by US$241 million.

3/ In 2022, includes one-off land sale by the central government to the ACP.

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

5/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2014-19. These estimates are preliminary.

6/ Excluding the impact of the 2022 cash-flow swap operation, the deficit would be 4.5 percent of GDP in 2022, 1.8 in 2024, 1.3 in 2025, and 1.4 in 2026.

7/ 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.

8/ Primary balance adjusted for the output gap.

Table 3. Panama: Summary Operations of the Central Government, 2018–28
(In percent of GDP)

	2018	2019	2020	2021	Est. 2022	Projections 2023	2024	2025	2026	2027	2028
Revenues and Grants	**13.9**	**12.7**	**12.5**	**12.2**	**13.3**	**14.1**	**14.3**	**14.5**	**14.6**	**14.7**	**14.9**
Current revenue	13.9	12.7	12.4	12.2	12.8	14.1	14.3	14.5	14.6	14.7	14.9
Taxes	9.2	8.2	7.4	7.1	7.8	8.4	8.6	8.8	9.0	9.1	9.2
Direct taxes	5.1	4.4	4.2	3.9	4.4	4.7	4.9	5.0	5.0	5.1	5.1
Income tax	4.6	4.0	3.8	3.5	4.0	4.3	4.4	4.5	4.5	4.6	4.6
Tax on wealth	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Indirect taxes	4.1	3.8	3.2	3.2	3.4	3.7	3.8	3.9	3.9	4.0	4.1
Import tax	0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
ITBMS	2.3	2.1	1.8	1.7	1.8	2.1	2.2	2.3	2.3	2.4	2.4
Petroleum products	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other tax on domestic transactions	0.8	0.8	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Nontax revenue	4.6	4.5	5.0	5.1	5.0	5.7	5.6	5.7	5.6	5.7	5.7
Dividends	2.4	2.2	2.8	2.8	2.8	2.9	2.9	2.9	2.9	2.9	3.0
Of which: Panama Canal Authority	1.8	1.8	2.4	2.3	2.6	2.6	2.5	2.5	2.5	2.5	2.6
Panama Canal Authority: fees per ton 1/	0.8	0.9	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Transfers from decentralized agencies	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other 2/	1.0	1.0	0.9	1.1	1.0	1.6	1.5	1.5	1.5	1.5	1.5
Capital revenue 3/	0.0	0.0	0.0	0.0	0.4	0.0	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**	**17.3**	**22.6**	**19.4**	**17.4**	**17.6**	**16.8**	**16.4**	**16.5**	**16.6**	**16.7**
o/w COVID-19 related expenditure			3.0	2.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Current	11.0	11.5	17.1	15.2	13.2	12.5	12.3	12.1	11.9	11.8	11.7
Wages and salaries	4.7	4.8	6.6	5.8	5.4	5.3	5.1	5.0	5.0	5.0	5.0
Goods and services	1.2	1.3	1.7	1.5	1.4	1.3	1.2	1.2	1.2	1.2	1.2
Current expenditure of CSS	0.6	0.7	0.6	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Transfers to public and private entities	2.7	2.8	5.6	4.4	3.2	2.4	2.2	2.2	2.1	2.1	2.2
Interest	1.8	1.9	2.6	2.4	2.1	2.4	2.6	2.7	2.5	2.4	2.3
Domestic	0.3	0.4	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
External	1.4	1.5	2.1	2.0	1.7	2.1	2.3	2.3	2.2	2.1	2.0
Capital	5.8	5.8	5.5	4.2	4.2	5.1	4.5	4.3	4.6	4.8	5.0
Accrued spending 4/	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings 5/	2.9	1.2	-4.6	-3.0	-0.3	1.6	2.0	2.4	2.7	3.0	3.2
Overall Balance 6/	**-3.7**	**-4.5**	**-10.1**	**-7.2**	**-4.1**	**-3.5**	**-2.5**	**-2.0**	**-1.9**	**-1.9**	**-1.8**
Financing (net) 7/	4.3	3.0	9.6	4.7	4.3	3.5	2.5	2.0	1.9	1.9	1.9
External	3.3	5.4	10.3	4.8	5.9	3.4	3.3	2.3	2.6	2.2	2.1
Of which: Multilateral lenders	1.4	1.2	4.6	2.0	1.8	1.0	1.0	0.9	0.9	0.8	0.8
Of which: Private creditors	2.7	4.9	8.8	5.0	5.6	3.5	3.8	3.7	3.6	3.2	3.0
Of which: Other lenders	-0.7	-0.7	-3.1	-2.2	-1.5	-1.1	-1.5	-2.4	-1.9	-1.8	-1.6
Domestic	0.9	-2.4	-0.7	-0.1	-1.6	0.0	-0.8	-0.4	-0.7	-0.3	-0.3
Of which: Net credit from banks	0.4	-2.2	-3.3	2.2	-0.3	0.1	0.1	0.0	-0.3	2.6	2.3
Of which: Net credit from non-banks	-0.3	1.6	-0.1	-2.2	-1.7	-0.2	-0.8	-0.1	-0.1	-2.5	-2.1
Of which: Other lenders	0.8	-1.8	2.7	0.0	0.5	0.1	-0.2	-0.3	-0.4	-0.4	-0.5
Memorandum Items:											
Primary balance	-1.9	-2.7	-7.5	-4.8	-2.1	-1.1	0.1	0.7	0.6	0.5	0.5
GDP (in millions of US$)	64,929	66,984	53,977	63,605	71,299	76,540	81,383	86,331	91,580	97,148	103,055

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes public service fees.
2/ Includes in 2021 a debt premium by US$241 million as per GFSM 1986, the reporting system followed by the authorities.
3/ In 2022, includes one-off land sale by the central government to the ACP.
4/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2014-19. These estimates are preliminary.
5/ Current revenues and grants less current expenditure.
6/ Excluding the impact of the 2022 cash-flow swap operation, the deficit would be 4.6 percent of GDP in 2022, 2.3 in 2024, 1.7 in 2025, and 1.8 in 2026.
7/ 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, 2018–28
(In percent of GDP)

					Est.			Projections			
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Central Government						
Gross Debt 1/	42.3	47.1	72.2	64.1	60.5	59.6	58.5	57.4	56.3	55.2	54.3
of which: held by social security (CSS)	4.8	5.4	6.7	5.7	5.1	4.7	4.4	4.2	3.9	3.7	3.5
Domestic	10.2	10.6	16.5	12.0	8.3	7.6	6.3	5.9	5.1	4.8	4.6
of which: unrecorded arrears (prel).	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: floating debt (prel.)	0.6	0.4	3.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	32.1	36.6	55.8	52.1	52.2	52.0	52.2	51.5	51.2	50.4	49.7
Financial Assets	4.1	6.3	12.3	8.5	7.2	6.9	6.7	6.9	7.1	7.3	7.5
Deposits 2/	1.9	3.9	8.2	4.8	3.9	3.5	3.2	2.9	2.7	2.4	2.2
Sovereign Wealth Fund 3/	2.0	2.1	2.6	2.2	1.9	2.1	2.4	2.8	3.3	3.8	4.3
Loans	0.0	0.0	1.2	1.3	1.1	1.0	1.0	0.9	0.9	0.8	0.8
SDR holdings	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Net Debt	38.2	40.9	60.0	55.6	53.3	52.7	51.8	50.5	49.2	47.9	46.8
					Non-Financial Public Sector						
Gross Debt 1/	37.3	41.9	65.6	58.4	55.4	54.9	54.1	53.2	52.4	51.5	50.8
of which: unrecorded arrears (prel.)	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: floating debt (prel.)	0.5	0.6	3.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Assets	11.3	13.0	22.4	17.6	15.0	14.3	13.9	13.8	13.7	13.6	13.5
Central government	4.1	6.3	12.3	8.5	7.2	6.9	6.7	6.9	7.1	7.3	7.5
Decentralized institutions (incl. CSS) 2/	7.2	6.8	10.1	9.1	7.8	7.4	7.2	6.9	6.6	6.3	6.0
Net Debt	26.0	28.9	43.2	40.8	40.4	40.6	40.2	39.4	38.6	37.9	37.3
Memorandum Items:											
Net Debt as defined under SFRL 4/	40.4	45.1	69.7	61.9	58.6	57.5	56.2	54.6	53.0	51.4	49.9

Source: Ministry of Finance and IMF staff calculations.
1/ Includes staff adjustment for accumulated obligations related to unrecorded expenditure in 2014-2019. These estimates are preliminary.
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, 2018–28[1]

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

					Est.			Projections			
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(in millions of balboa at end of period)										
Net Foreign Assets	**542**	**2,547**	**10,729**	**10,854**	**11,801**	**12,504**	**13,194**	**13,912**	**14,666**	**15,457**	**16,292**
Short-term foreign assets, net	542	2,547	10,729	10,854	11,801	12,504	13,194	13,912	14,666	15,457	16,293
National Bank of Panama	2,218	3,646	8,485	7,580	8,500	9,126	9,705	10,297	10,925	11,590	12,298
Rest of banking system	-1,677	-1,099	2,244	3,274	3,301	3,378	3,489	3,614	3,742	3,867	3,995
Long-term foreign liabilities	0	0	0	0	0	0	0	0	0	0	0
Net Domestic Assets	**40,744**	**38,669**	**36,799**	**39,872**	**42,643**	**45,943**	**48,951**	**52,012**	**55,265**	**58,726**	**62,401**
Public sector (net credit)	-6,929	-9,431	-9,643	-7,894	-7,858	-7,858	-7,858	-7,858	-7,858	-7,858	-7,858
Central government (net credit)	-305	-1,507	-3,369	-1,989	-1,953	-1,953	-1,953	-1,953	-1,953	-1,953	-1,953
Rest of the public sector (net credit)	-6,624	-7,924	-6,273	-5,905	-5,905	-5,905	-5,905	-5,905	-5,905	-5,905	-5,905
Private sector credit	53,631	54,901	53,465	54,281	57,196	60,419	64,113	68,011	72,146	76,533	81,186
Private capital and surplus	-10,676	-11,384	-10,890	-10,856	-12,170	-13,064	-13,891	-14,735	-15,631	-16,582	-17,590
Other assets (net)	4,718	4,583	3,866	4,341	5,475	6,447	6,587	6,595	6,609	6,634	6,664
Liabilities to Private Sector	**41,690**	**42,631**	**46,667**	**48,569**	**54,444**	**58,447**	**62,145**	**65,923**	**69,931**	**74,183**	**78,694**
Total deposits	41,475	42,239	45,703	47,811	53,594	57,534	61,174	64,894	68,839	73,025	77,465
Demand deposits	8,710	7,892	9,100	9,526	10,679	11,464	12,189	12,930	13,716	14,550	15,435
Time deposits	22,368	23,849	24,264	24,416	27,369	29,381	31,240	33,140	35,155	37,292	39,560
Savings deposits	10,398	10,498	12,339	13,868	15,546	16,689	17,745	18,824	19,968	21,182	22,470
Bonds	215	392	964	759	850	913	971	1,030	1,092	1,159	1,229
Deposit as % of private sector credit	77.3	76.9	85.5	88.1	93.7	95.2	95.4	95.4	95.4	95.4	95.4
	(12-month change in relation to liabilities to the private sector at the beginning of the period)										
Net foreign assets	-3.0	4.8	19.2	0.3	2.0	1.3	1.2	1.2	1.1	1.1	1.1
Net domestic assets	5.9	-5.0	-4.4	6.6	5.7	6.1	5.1	4.9	4.9	4.9	5.0
Public sector credit (net)	1.2	-6.0	-0.5	3.7	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	5.7	3.0	-3.4	1.7	6.0	5.9	6.3	6.3	6.3	6.3	6.3
Private capital and surplus	0.7	1.7	-1.2	-0.1	2.7	1.6	1.4	1.4	1.4	1.4	1.4
Other assets (net)	-0.3	-0.3	-1.7	1.0	2.3	1.8	0.2	0.0	0.0	0.0	0.0
Liabilities to the private sector	2.8	2.3	9.5	4.1	12.1	7.4	6.3	6.1	6.1	6.1	6.1
	(12-month percent change)										
Memorandum Items:											
M2 1/	2.8	2.3	9.5	4.1	12.1	7.4	6.3	6.1	6.1	6.1	6.1
Net domestic assets	6.3	-5.1	-4.8	8.4	7.0	7.7	6.5	6.3	6.3	6.3	6.3
Public sector credit (gross)	21.3	2.6	39.8	3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	4.5	2.4	-2.6	1.5	5.4	5.6	6.1	6.1	6.1	6.1	6.1
Share of demand deposits in total deposits (in percent)	21.0	18.7	19.9	19.9	19.9	19.9	19.9	19.9	19.9	19.9	19.9
	(In percent of GDP)										
Total deposits	63.9	63.1	84.7	75.2	75.2	75.2	75.2	75.2	75.2	75.2	75.2
Credit to private sector	82.6	82.0	99.1	85.3	80.2	78.9	78.8	78.8	78.8	78.8	78.8

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, 2015–2022-Q3

(In percent, end-of-period)

	2015	2016	2017	2018	2019	2020	2021	2022Q1	2022Q2	2022Q3
Core FSIs										
Regulatory capital to risk-weighted assets	14.9	15.3	16.0	15.7	15.2	15.7	15.8	15.3	14.9	15.0
Tier 1 capital to risk-weighted assets	14.3	16.3	17.0	16.9	16.4	17.1	16.8	16.2	15.8	15.8
Nonperforming loans net of provisions to capital	8.4	8.8	10.5	8.6	-0.3	-5.2	-8.7	-7.7	-6.2	-6.6
Capital to assets (leverage ratio)	10.2	11.4	12.5	12.5	12.7	11.8	12.2	11.9	11.6	11.7
Nonperforming loans to total gross loans	2.2	2.5	3.1	3.3	2.0	2.0	2.3	2.5	2.7	2.6
Provisions to nonperforming loans	35.9	41.2	38.3	53.7	102.4	148.0	173.7	157.5	141.4	144.4
Return on assets	1.5	1.3	1.6	1.6	1.5	0.7	1.0	1.2	1.3	1.3
Return on equity	14.0	11.8	13.4	13.1	11.5	6.4	9.1	10.9	12.2	11.9
Interest margin to gross income	62.9	62.9	60.4	61.5	61.3	62.0	56.9	55.4	56.8	58.7
Noninterest expenses to gross income	50.1	50.0	46.9	46.4	47.7	48.6	48.7	49.4	48.9	48.1
Liquid assets to total assets [1/]	12.0	11.9	13.2	10.3	10.0	10.7	11.4	10.8	10.6	10.2
Liquid assets to short-term liabilities [1/]	29.8	29.9	35.1	29.6	29.0	28.5	32.4	31.1	30.5	31.4
Additional FSIs										
Gross asset position in financial derivatives to capital	0.1	0.1	0.2	0.1	0.2	0.6	0.2	0.4	0.3	0.4
Gross liability position in financial derivatives to capital	0.8	1.3	0.9	0.7	0.4	0.4	0.4	0.5	0.7	1.0
Trading income to total income	0.9	1.6	0.7	0.3	1.9	2.8	2.7	0.1	-0.6	-0.3
Personnel expenses to noninterest expenses	46.7	46.2	46.8	46.4	45.8	46.2	44.2	42.6	42.4	43.1
Customer deposits to total (noninterbank) loans	85.3	83.1	82.5	80.8	81.5	89.4	111.5	110.7	107.3	101.2

Source: IMF Financial Soundness Indicators.

1/ The statutory Legal Liquidity Index (LLI) used by the authorities defines a 30 percent minimum requirement on liquid assets (including cash and certain debt securities) as a share of qualifying deposit with a time horizon of 186 days whereas these two indicators ("liquid assets to total assets" and "liquid assets to short-term liabilities") are standard indicators based on the IMF's Financial Soundness Indicators Guide, which defines short-term liabilities as liabilities falling due within three months or less plus the net market value of the financial derivatives position.

Table 7. Panama: Summary Balance of Payments, 2018–28
(In percent of GDP, unless otherwise stated)

					Est.	Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					(In percent of GDP)						
Current Account	**-7.6**	**-5.0**	**-0.4**	**-3.2**	**-3.9**	**-4.0**	**-3.5**	**-3.0**	**-2.8**	**-2.7**	**-2.5**
Merchandise trade excluding Colón Free Zone, net	-16.7	-14.1	-8.3	-8.1	-11.6	-11.1	-11.2	-11.0	-10.5	-10.4	-10.3
Exports, f.o.b.	7.7	8.9	8.5	12.8	13.2	13.1	12.8	12.5	12.3	12.1	11.9
Of which: Copper	0.0	1.2	2.0	4.4	4.2	4.4	4.3	4.2	3.9	3.5	3.2
Of which: Gold	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.2	0.2
Imports, f.o.b.	24.4	22.9	16.8	20.9	24.8	24.2	24.0	23.5	22.8	22.5	22.2
Of which: Oil	8.1	7.5	3.3	5.9	7.8	6.4	5.9	5.4	5.0	4.7	4.4
Merchandise trade from Colón Free Zone, net	2.5	2.7	3.1	2.5	2.2	2.2	2.2	2.3	2.3	2.4	2.4
Re-exports, f.o.b.	15.0	13.0	13.0	13.5	13.1	13.4	13.8	14.1	14.5	14.7	15.0
Imports, f.o.b.	12.5	10.3	9.9	11.0	10.9	11.3	11.6	11.8	12.1	12.4	12.6
Services, net	13.6	12.9	9.2	10.2	11.4	10.8	11.2	11.2	11.4	11.6	11.6
Travel, net	5.3	4.6	1.2	2.5	4.0	3.9	4.1	4.2	4.2	4.2	4.3
Transportation, net	7.4	7.6	7.5	6.9	6.8	6.5	6.7	6.8	6.8	6.9	6.9
Of which: Canal	4.6	4.7	6.4	6.3	6.5	6.0	5.9	5.8	5.7	5.6	5.5
Other services, net	1.0	0.6	0.5	0.8	0.5	0.5	0.3	0.3	0.4	0.4	0.5
Income, net	-7.1	-6.5	-4.4	-7.8	-5.9	-5.8	-5.7	-5.6	-6.0	-6.3	-6.2
Primary, net	-7.0	-6.5	-4.5	-8.1	-6.2	-6.1	-5.9	-5.8	-6.2	-6.4	-6.4
Of which: Direct investment	-5.1	-4.7	-0.4	-4.6	-4.0	-5.0	-4.6	-4.0	-4.0	-4.2	-4.2
Secondary, net	-0.1	0.0	0.1	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Of which: Workers' remittances	-0.5	-0.5	-0.2	-0.1	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5
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	**-9.4**	**-7.0**	**0.1**	**-1.7**	**-3.9**	**-4.0**	**-3.5**	**-3.0**	**-2.8**	**-2.7**	**-2.5**
Foreign direct investment, net	-7.5	-5.6	-0.1	-2.6	-4.0	-4.3	-4.3	-4.2	-4.1	-3.9	-3.8
Of which: Reinvested earnings	-2.8	-2.6	1.3	-3.4	-1.5	-1.4	-1.4	-1.4	-1.3	-1.3	-1.2
Portfolio investment, net	-0.6	-4.7	-3.7	5.9	-1.8	0.9	0.5	1.4	1.3	1.0	1.1
Financial derivatives, net	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-0.4	1.2	-6.4	-3.2	0.6	-1.4	-0.5	-0.9	-0.7	-0.5	-0.4
Reserve assets, net	-1.0	1.8	10.3	-1.7	1.3	0.8	0.7	0.7	0.7	0.7	0.7
Net Errors and Omissions	**-1.8**	**-2.1**	**0.5**	**1.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items:											
Exports of goods and services (annual percent change)	5.1	0.3	-30.9	38.1	16.7	6.9	7.9	6.6	6.5	6.6	6.4
Imports of goods and services (annual percent change)	7.2	-4.5	-36.2	38.7	24.9	7.3	7.1	5.8	4.9	5.8	5.9
Oil trade balance (percent of GDP)	-4.4	-3.8	-1.7	-3.1	-4.2	-3.5	-3.2	-3.0	-2.8	-2.6	-2.5

Sources: INEC; and IMF staff calculations.

Table 8. Panama: External Vulnerability Indicators, 2018–24
(In percent, unless otherwise specified)

					Est.	Projections	
	2018	2019	2020	2021	2022	2023	2024
Financial Indicators							
Broad money (12-month percent change)	2.8	2.3	9.5	4.1	12.1	7.4	6.3
Private sector credit (12-month percent change)	4.5	2.4	-2.6	1.5	5.4	5.6	6.1
Deposit rate (6-month; in percent) 1/	2.0	2.2	1.9	1.6	1.6	4.9	4.4
External Indicators							
Merchandise exports (12-month percent change)	6.8	-0.7	-20.8	43.9	12.4	8.0	6.8
Merchandise imports (12-month percent change)	7.5	-7.1	-35.3	40.8	25.4	6.6	6.7
Current account balance (in percent of GDP)	-7.6	-5.0	-0.4	-3.2	-3.9	-4.0	-3.5
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)	-9.4	-7.0	0.1	-1.7	-3.9	-4.0	-3.5
Of which: direct investment	-7.5	-5.6	-0.1	-2.6	-4.0	-4.3	-4.3
Non-Financial Public Sector external debt (in percent of GDP)	31.1	35.2	54.1	50.6	50.9	50.8	51.1
In percent of exports of goods and services 2/	70.6	82.4	147.5	117.8	113.7	114.0	112.9
External interest payments							
In percent of exports of goods and services 2/	7.1	7.3	11.8	6.9	12.8	16.4	15.5
External amortization payments							
In percent of exports of goods and services 2/	146.5	147.7	209.8	155.7	144.6	135.7	133.8
REER, percent change (average) 6/	-1.7	0.7	-1.5	-2.7	…	…	…
Gross international reserves at end of period							
In millions of U.S. dollars 3/	3,149	4,375	9,930	8,832	9,752	10,379	10,958
In months of imports of goods and services	1.4	3.0	4.9	3.5	3.6	3.6	3.5
In percent of broad money 4/	7.6	10.3	21.3	18.2	17.9	17.8	17.6
In percent of short-term external debt 5/	8.1	11.9	25.8	20.8	22.7	22.7	22.9
Memorandum Items:							
Nominal GDP (in millions of US$)	64,929	66,984	53,977	63,605	71,299	76,540	81,383
Exports of goods and services (in millions of US$) 2/	28,548	28,622	19,792	27,338	31,914	34,111	36,812
Imports of goods and services (in millions of US$) 2/	28,903	27,599	17,614	24,424	30,497	32,717	35,033

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 transactions conducted in 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 2021, underpinned by strong economic recovery as the covid-19 shock receded. In particular, the authorities strengthened the credibility of their fiscal framework by improving tax transparency standards in line with best international practices. They continue making progress on the FATF action plan. However, more needs to be done to address the outstanding action items in the FATF action plan to strengthen the effectiveness of the AML/CFT regime and exit the FATF grey list.

1. Fiscal Policy. The Social and Fiscal Responsibility Law (SFRL)—streamlined in October 2018 and further modified in response to the covid-19 pandemic— continues to be the anchor, in line with IMF's recommendations. Recent initiatives include the authorities' efforts to bring tax transparency standards in line with best international practices. For example, the new tax transparency law (No. 254 of November 11, 2021) imposes additional requirements on legal entities regarding the provision of accounting records. In addition, Panama increased the tax rate on its Multinational Enterprise Headquarters regime (from zero to 5 percent), in line with IMF TA recommendations.

2. Financial Integrity and Tax Transparency. Since Panama was grey listed by the FATF, Fund advice provided on AML/CFT has been redirected at assisting the authorities—in particular the CNBC, the MEF, and the SSNF—in addressing selected outstanding action items on its action plan. IMF technical assistance touched upon many areas including (i) risk assessments; (ii) supervision of DNFBPs; and (iii) transparency of legal persons and legal arrangements. Accordingly, and in line with Fund advice, the authorities have made progress in these and other areas of their AML/CFT regime identified as deficient by the FATF.

3. Financial Sector Soundness and Reforms. The moratorium on loan service and grace period for the restructuring of these loans officially ended on June 30, 2021, and September 30, 2021, respectively. The authorities continued to undertake stress tests to guide the recalibration of provisions for modified loans and increase the level of provisioning on banks that are highly exposed and vulnerable. At the same time, prudential supervision on banks has been intensified. These are in line with Staff advice. The Basel III capital adequacy framework was implemented in 2018, and the Liquidity Coverage Ratio (LCR) was gradually phased-in.[1] The latest Financial Stability Report 2021 included an analysis on macroprudential issues, covering discussions on household and corporate vulnerabilities, in line with the recommendations of the Technical Assistance on Macroprudential Policy for Systemic Risks.

4. Data Adequacy. The authorities' National Statistical Plan 2021-25 is aligned with Fund advice provided in the ROSC and recent advances in the dissemination of fiscal and internal reserves and foreign liquidate data have addressed most of the pending requirements for Panama to

[1] The LCR is Based on Basel III whereby banks are required to hold an amount of high-quality liquid assets that is enough to fund cash outflows for 30 days whereas the Legal Liquidity Index (LLI) defines a 30 percent minimum requirement on liquid assets (including cash and certain debt securities) as a share of qualifying deposits, with a time horizon of 186 days.

subscribe to the Special Data Dissemination Service. Ongoing efforts to complete a GDP rebasing exercise will help reflect in national accounts the current economic structure and growth engines.

5. Structural Reforms. While phasing out covid-related support, the authorities have remained cognizant of the need to maintain targeted social transfer programs and have continued to sustain the consumption needs of the vulnerable, in line with Fund recommendations, with the use of a registry of beneficiaries. Other areas of public policy (education, healthcare, gender equity and social inclusion) have not seen much progress, delayed by the pandemic. Infrastructure development has resumed somewhat, with the construction of the third Panama City metro line currently underway.

Annex II. Prospects and Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact		Policy Response
			External Risks		
Intensifying spillovers from Russia's war on Ukraine.	High	ST	High	Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	• Ensure adequate liquidity and fiscal buffers to safeguard macroeconomic and financial stability.
Abrupt global slowdown or recession.	High	ST	High	Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. Sharp tightening of global financial conditions combined with volatile commodity prices leads to spiking risk premia, widening of external imbalances and fiscal pressures, capital outflows, sudden stops, and debt and financial crises across EMDEs.	• Build liquidity and fiscal buffers to safeguard macroeconomic and financial stability. • Enhance safety net and crisis preparedness for the financial sector. • Ensure that social transfers and subsidies are well targeted to the poor and needy, in a budget neutral manner.
Local covid-19 outbreaks.	Medium	ST	Medium	Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	• Ensure adequate health care response; build fiscal buffers to procure new vaccines/ boosters and health-related equipment.

[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
Commodity price shocks.	High	ST	High	A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	• Consolidate public finances to avoid a sudden, sharp increase in domestic rates and possible crowding out of private investment. • Current account to adjust through lower non-oil imports.
Deepening geo-economic fragmentation and geopolitical tensions.	High	ST, MT	High	Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth. Accelerating de-globalization would directly affect Panama through lower exports, Foreign Direct Investment (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.	• Continue efforts to diversify key export markets. • Advance structural reforms to improve productivity and strengthen competitiveness.
De-anchoring of inflation expectations and stagflation.	Medium	ST, MT	Medium	Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	• Continue to deepen domestic financial markets and rebalance public sector financing to domestic sources.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact		Policy Response
Cyberthreats	Medium	ST, MT	Medium	Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability and disrupt economic activities.	• 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.
Natural disasters related to climate change.	Medium	ST, MT	Medium	More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	• 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	High	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 and transactions with Panama.	• 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.	Medium	MT	Medium	Should fiscal imbalances continue (due to slow recovery in revenues, increasing expenditure needs, increase in subsidies, 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.
Systemic social unrest.	High	ST, MT	High	Rising inflation, declining incomes, and worsening inequality amplify social	• Ensure that social welfare and transfer programs are well

Source of Risks	Relative Likelihood	Time Horizon		Expected Impact	Policy Response
				unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).	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. • Ensure that heath care sufficiently reaches the vulnerable population and emergency facilities are adequate to save lives and tackle any new waves of the pandemic.
Disruption in copper production due to delays in completing a new mining contract with Minera Panama.	**Low**	**ST**	**Medium/ High**	The economic impact would depend on how long the disruption will last, and whether only shipments will be suspended or production as well.	• Develop clear communication and engagement strategy with affected parties, taking into full consideration their direct and indirect distributional effects in policy decisions. • Ensure sufficient fiscal buffers to support a continuing employment of the affected mine workers, especially if the government were to take over the operations of the copper mines. • Ensure that access to external financing sources remain adequate to minimize the risk of disruptions to funding needs.

Annex III. External Sector Assessment

Overall Assessment: *The external position of Panama in 2022 is assessed to be broadly consistent with the level implied by fundamentals and desirable policies. The current account deficit is estimated at 3.9 percent of GDP in 2022 (from 3.2 percent of GDP in 2021) on the back of strong economic recovery and rising food and fuel prices, supported by foreign direct investment and portfolio inflows. Over the last decade, the current account deficit improved significantly (from a deficit of 13 percent of GDP in 2011) with declining imports as the construction boom gradually eased.*

Potential Policy Responses: *Panama's external stability depends on continued financial stability and favorable 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 Net International Investment Position (NIIP) stood at -102 percent of GDP as of 2022Q2, up from -118 percent of GDP in 2020, while the nominal level of the NIIP decreased slightly by 9 percent. Gross assets reached 138 percent of GDP in 2022Q2, of which the majority is accounted for by banks in the form of foreign deposits and loans (66 percent of GDP) and debt securities (48 percent of GDP).

Gross liabilities reached 244 percent of GDP at the end of 2022 Q2 (268 percent of GDP in 2020), of which external debt is about 184 percent of GDP and non-debt FDI liabilities are about 60 percent of GDP. Banks account for the largest share of external debt (74.7 percent of GDP), followed by the government (51 percent of GDP), and FDI in the form of intracompany lending (38 percent of GDP). Banks' external debt is mostly in the form of deposits.

Assessment. The large share of banking sector liabilities reflects 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 Colon Free Zone (CFZ)), canal receipts, tourism, as well as increased copper production.

2022Q2 (% GDP)	***NIIP: -102.5***	***Gross Assets: 138.1***	***Debt Assets: 119.8***	***Gross Liabilities: 244.8***	***Debt Liabilities: 184.3***

Current Account

Background. The current account deficit continued to widen in 2022, estimated to reach 3.9 percent of GDP on the back of a strong recovery and high food and fuel prices. Exports were supported by strong cooper production, relatively resilient revenues from the canal and Colon Free Zone, and recovering tourism. As the economic recovery continues, the current account balance is expected to moderate to –2 ½ percent of GDP over the medium term as Panama expands its export capacity.

Assessment. The EBA CA model estimates a current account norm of -2.7 percent of GDP. After accounting for cyclical factors as well as covid-related and conflict related adjustment, the CA balance is adjusted to -3.2 percent of GDP. This leads to a current account gap of -0.5 percent of GDP, including a policy gap of 1.2 percent of GDP, given that Panama's fiscal balance deviation from its desirable level was smaller than the rest of the world's deviation. The CA model assesses Panama's external position to be broadly consistent with the level implied by fundamentals and desirable policies.

Panama: EBA-lite Model Results, 2022

	CA model 1/ (in percent of GDP)
CA-Actual	**-3.9**
Cyclical contributions (from model) (-)	0.1
COVID-19 adjustors (-) 2/	-1.0
Additional temporary/statistical factors (-)	0.0
Natural disasters and conflicts (-)	0.1
Adjusted CA	**-3.2**
CA Norm (from model) 3/	**-2.7**
Adjustments to the norm (-)	0.0
Adjusted CA Norm	**-2.7**
CA Gap	**-0.5**
o/w Relative policy gap	1.2
Elasticity	-0.3
REER Gap (in percent)	**1.6**

1/ Based on the EBA-lite 3.0 methodology

2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (1.9 percent of GDP).

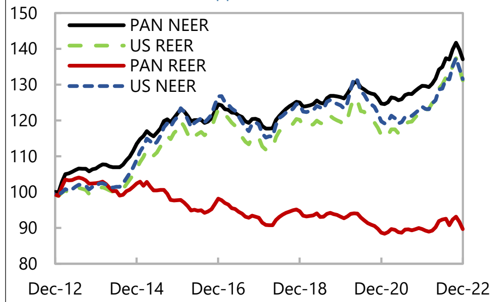
3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The real effective exchange rate (REER) remained broadly stable in 2022, appreciating by 2 percent on average relative to 2021, and depreciating by 0.3 percent relative to the 2019-21 average. Nominal Effective Exchange Rate (NEER) appreciated by 6.2 percent on average relative to 2021. Low inflation in Panama relative to peers led to a lower REER appreciation.

Assessment. The EBA-lite CA model implies a slight REER overvaluation of 1.6 percent. Overall, given that the REER has not depreciated much since 2017, staff assesses the 2022 REER gap to be in the range of 0 to -6 percent.

Nominal and Real Effective Exchange Rates [1/]
(Index, 2012=100, +appreciation)



Source: INS.
1/ Panama's NEER and REER exclude Venezuela.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI inflows are estimated to continue recovering, from 2.6 percent of GDP in 2021 to 4 percent of GDP in 2022, mainly due to lower outflows of reinvested earnings of large multinational companies. At the same time, portfolio investment inflows have decreased from 2021 as issuance by the government declined.

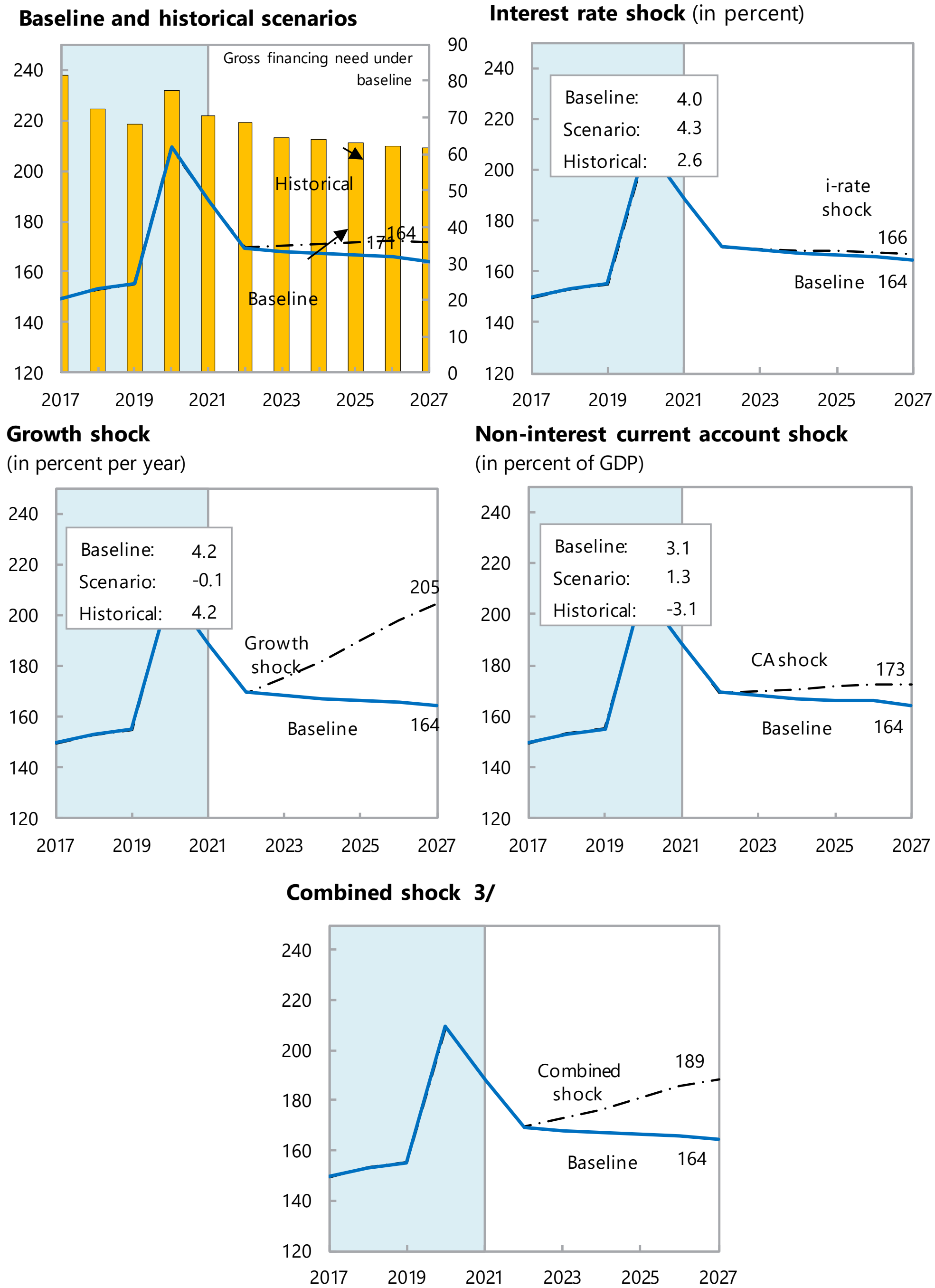
Assessment. Over the medium term, the current account deficit is expected to remain adequately financed by FDI. Panama's location as a maritime and air transportation hub as well as its position as a regional financial center paired with macroeconomic stability is expected to continue to attract substantial 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 decreased from 11.9 percent of GDP in 2021 to 6.7 percent of GDP in October 2022, reflecting the payment of external obligations.

Assessment. Panama's reserve level is adequate. The central government deposit at commercial banks corresponded to 2.6 months of central government expenditures in 2022, 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 57 percent of short-term deposits at end-2022 (nearly double the minimum statutory requirement of 30 percent), reinforcing the high level of liquidity buffer in the banking sector.

Figure AIII.1. Panama: External Debt Sustainability—Bound Tests 1/2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Table AIII.1. Panama: External Debt Sustainability Framework, 2017–28
(In percent of GDP, unless otherwise indicated)

	Actual							Projections							
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	149.6	153.0	155.0	209.4	188.3			**169.4**	**168.1**	**167.0**	**166.5**	**166.0**	**164.3**	**162.5**	**-8.2**
2 Change in external debt	-10.3	3.4	2.0	54.3	-21.0			-18.9	-1.3	-1.1	-0.6	-0.5	-1.6	-1.8	
3 Identified external debt-creating flows (4+8+9)	-12.1	-6.1	-5.3	37.6	-31.0			-15.2	-8.2	-7.1	-7.5	-7.6	-7.5	-7.5	
4 Current account deficit, excluding interest payments	1.8	4.5	1.9	-4.0	0.3			-1.9	-3.3	-3.5	-3.2	-2.8	-2.5	-2.5	
5 Deficit in balance of goods and services	-0.3	0.5	-1.5	-4.0	-4.6			-2.0	-1.8	-2.2	-2.5	-3.2	-3.5	-3.7	
6 Exports	43.6	44.0	42.7	36.7	43.0			44.8	44.6	45.2	45.4	45.6	45.8	46.0	
7 Imports	43.3	44.5	41.2	32.6	38.4			42.8	42.7	43.0	42.9	42.4	42.3	42.2	
8 Net non-debt creating capital inflows (negative)	-7.1	-7.5	-5.6	-0.1	-2.6			-4.0	-4.3	-4.3	-4.2	-4.1	-3.9	-3.8	
9 Automatic debt dynamics 1/	-6.8	-3.1	-1.6	41.7	-28.7			-9.3	-0.6	0.7	-0.1	-0.7	-1.0	-1.1	
10 Contribution from nominal interest rate	4.2	3.1	3.1	4.3	3.0			5.8	7.3	7.0	6.2	5.6	5.3	5.1	
11 Contribution from real GDP growth	-8.3	-5.3	-4.4	34.5	-27.2			-15.1	-7.9	-6.3	-6.3	-6.3	-6.3	-6.2	
12 Contribution from price and exchange rate changes 2/	-2.7	-1.0	-0.3	2.8	-4.4			...	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	1.9	9.6	7.3	16.7	10.0			-3.7	6.9	6.0	6.9	7.0	5.8	5.7	
External debt-to-exports ratio (in percent)	342.7	348.1	362.8	571.0	438.2			378.6	377.2	369.3	366.4	363.8	358.6	353.5	
Gross external financing need (in billions of US dollars) 4/	50813.2	46824.9	45677.6	41767.7	44687.1			48993.4	49391.6	52179.2	54566.7	56778.3	59727.7	61794.8	
in percent of GDP	81.7	72.1	68.2	77.4	70.3	10-Year	10-Year	68.7	64.5	64.1	63.2	62.0	61.5	60.0	
Scenario with key variables at their historical averages 5/								**169.4**	**170.6**	**170.8**	**171.4**	**172.1**	**171.5**	**170.7**	**-12.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation								
Real GDP growth (in percent)	5.6	3.7	3.0	-17.9	15.3	4.2	8.6	9.0	5.0	4.0	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	1.7	0.7	0.2	-1.8	2.2	2.3	2.4	2.9	2.2	2.2	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.8	2.2	2.1	2.2	1.7	2.6	0.6	3.4	4.6	4.4	4.0	3.6	3.4	3.3	
Growth of exports (US dollar terms, in percent)	7.7	5.1	0.3	-30.9	38.1	1.4	17.6	16.7	6.9	7.9	6.6	6.5	6.6	6.4	
Growth of imports (US dollar terms, in percent)	5.8	7.2	-4.5	-36.2	38.7	-0.4	18.7	24.9	7.3	7.1	5.8	4.9	5.8	5.9	
Current account balance, excluding interest payments	-1.8	-4.5	-1.9	4.0	-0.3	-3.1	3.4	1.9	3.3	3.5	3.2	2.8	2.5	2.5	
Net non-debt creating capital inflows	7.1	7.5	5.6	0.1	2.6	6.2	2.8	4.0	4.3	4.3	4.2	4.1	3.9	3.8	

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

Figure AIV.1. Panama: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Moderate	The overall risk of sovereign stress is moderate, reflecting a moderate level of vulnerability in the near-term and long-term, but low levels of vulnerability in the medium-term horizons and the sustainability of GFNs.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low against a mechanical signal. In 2020, a deep downturn and a strict lockdown led to a large fiscal balance drop and rapid debt build-up. In the medium term, following the amended SFRL fiscal rule and sustained growth will drive down the debt-to-GDP ratio. Possible global growth slowdown and tighter financial conditions add to the forecast uncertainty as downside risks.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	...	...	
Long term	...	Moderate	Long-term risks are moderate as uncertainty on the future sources of growth, de-globalization and climate change-related effects on Panama Canal's capacity, slowdown in fiscal management improvements and the materialization of social security risks may feed into financing and debt dynamics.
Sustainability assessment 2/		Sustainable	The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on strict adherence to the amended fiscal rule that sets a feasible target for the overall balance. Therefore debt is assessed as sustainable.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Panama is at moderate overall risk of sovereign stress and its public debt is sustainable. The amended fiscal rule continues to place public debt firmly on a declining path from its 2020 peak, underpinned by a continuous improvement in the primary balance and a consistently positive real growth-interest differential. Medium-term liquidity risks per the GFN Financeability Module are low, owing in part to the prevalence of medium- and long-term maturity instruments, such as global bonds and multilateral debt. External financing requirements and the share of debt held by non-residents will remain high, with Panama serving as a regional US-dollar-based financial center, but international market access at a low spread on US debt is expected to prevail. Over the longer run, Panama must keep rebuilding its fiscal buffers through revenue and spending efficiency measures, while funding an inclusive and sustainable growth amid ageing and the risk of de-globalization.

Source: Fund staff. Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure AIV.2. Panama: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

Coverage		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	Yes	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-government Debt Holdings

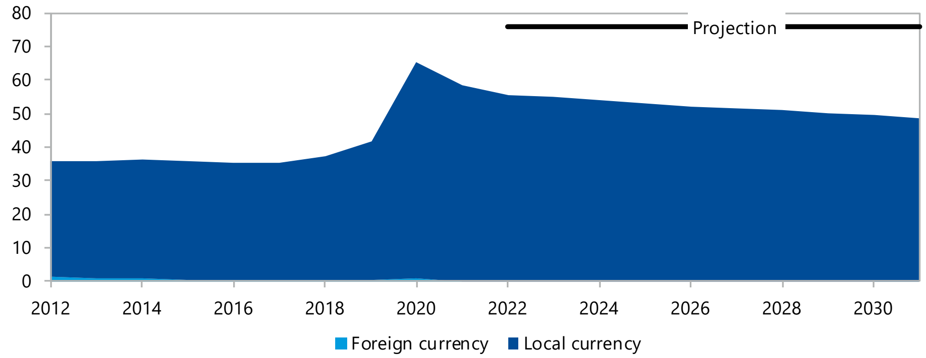
Coverage		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: in Panama, the non-financial public sector is defined by Law 31 of 2011 and primarily includes the central government, the social security agency (CSS), public enterprises, and consolidated government agencies. It excludes public enterprises such as ENA, ETESA, and AITSA, non-consolidated agencies, and the Panama Canal Authority.

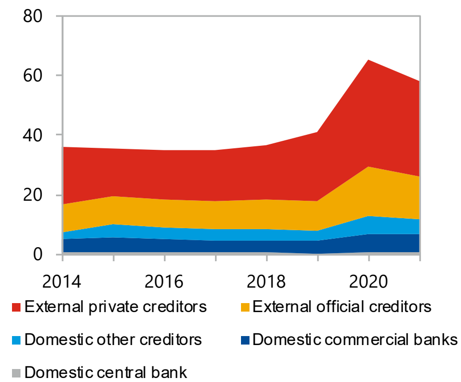
Figure AIV.3. Panama: Public Debt Structure Indicators

Debt by Currency (percent of GDP)

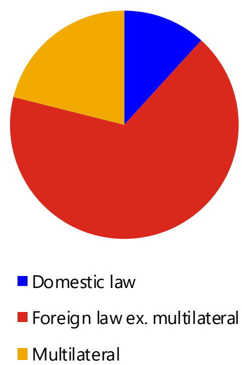


Note: The perimeter shown is nonfinancial public sector.

Public Debt by Holder (percent of GDP)

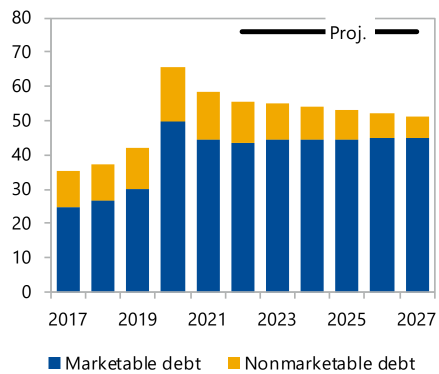


Public Debt by Governing Law, 2021 (percent)

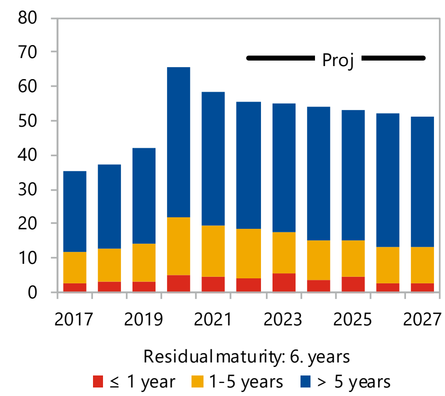


Note: The perimeter shown is nonfinancial public sector. Note: The perimeter shown is nonfinancial public sector.

Debt by Instruments (percent of GDP)



Public Debt by Maturity (percent of GDP)



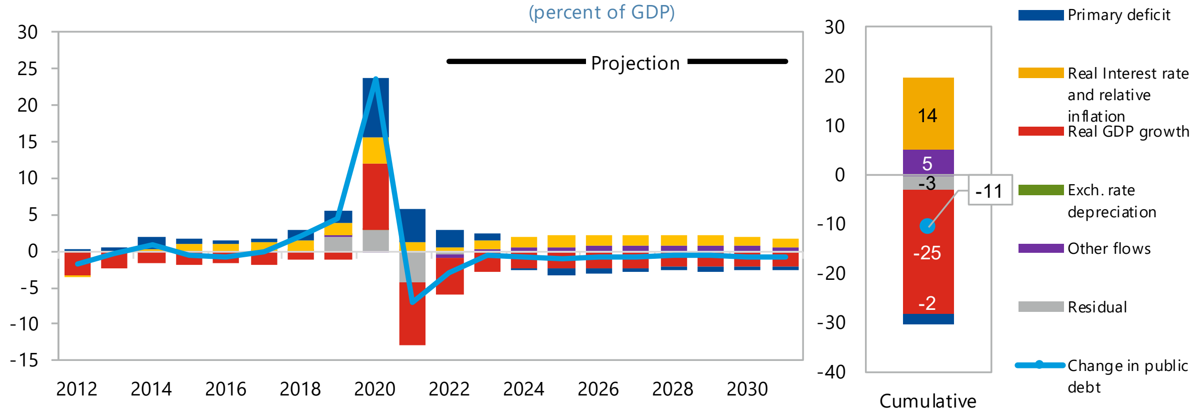
Note: The perimeter shown is nonfinancial public sector. Note: The perimeter shown is nonfinancial public sector.

Commentary: Panama is a dollarized economy and has held only U.S. dollar-denominated debt after 2021. The larger share of public debt is held externally, and it is expected to have mostly long-term maturity in the forecast horizon.

Figure AIV.4. Panama: Baseline Scenario
(In percent of GDP unless indicated otherwise)

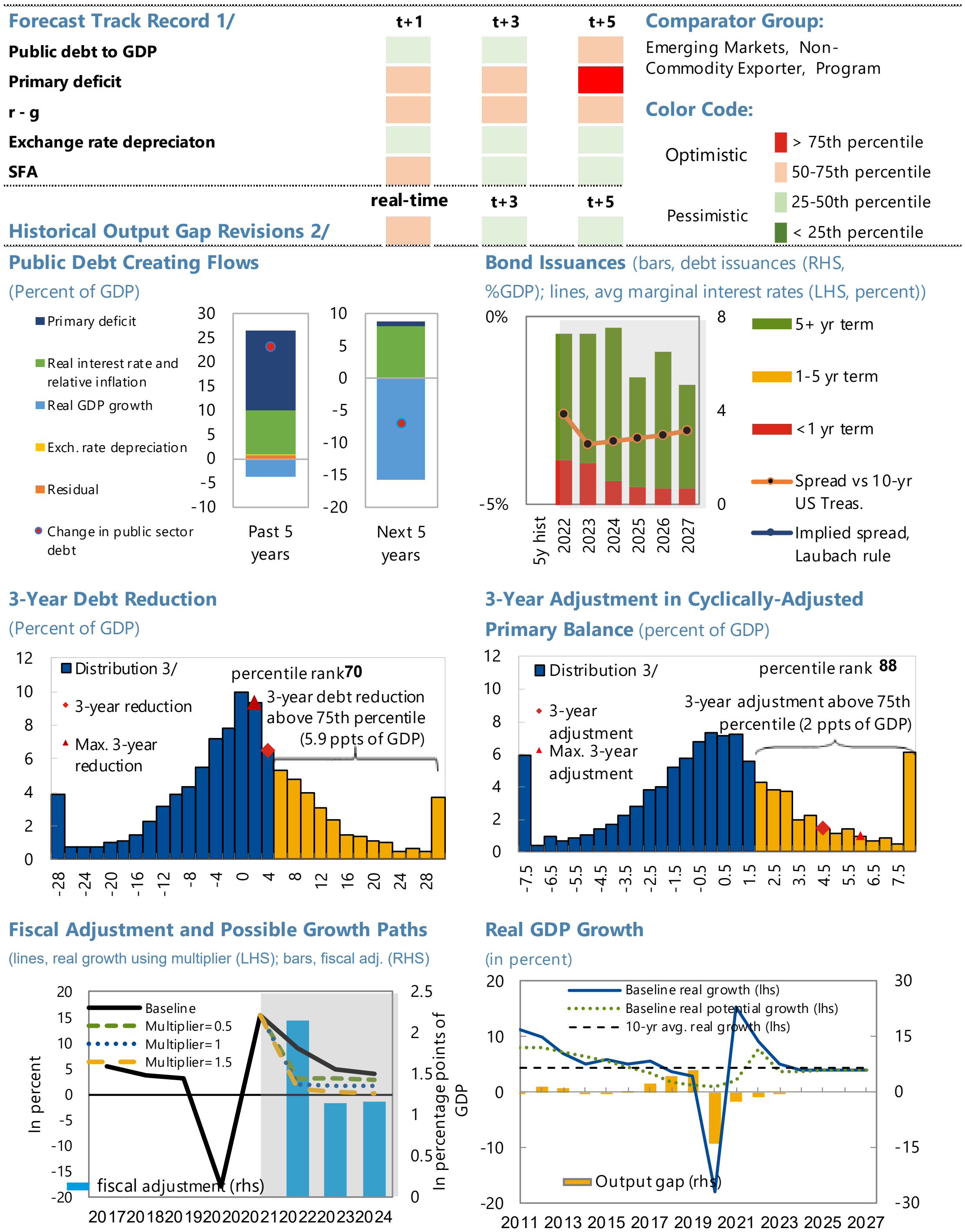
	Actual	Medium-term projection						Extended projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	58.4	55.4	54.9	54.0	53.0	52.2	51.4	50.9	50.3	49.5	48.6
Change in public debt	-7.1	-3.0	-0.5	-0.9	-1.0	-0.9	-0.8	-0.4	-0.7	-0.8	-0.9
Contribution of identified flows	-2.9	-2.7	-0.2	-0.6	-0.7	-0.6	-0.5	-0.2	-0.4	-0.5	-0.7
Primary deficit	4.6	2.3	0.9	-0.3	-0.9	-0.7	-0.6	-0.5	-0.5	-0.5	-0.5
Noninterest revenues	17.8	18.6	19.6	19.8	20.1	20.2	20.4	20.5	20.5	20.5	20.5
Noninterest expenditures	22.4	20.9	20.5	19.5	19.2	19.5	19.7	20.0	20.0	20.0	20.0
Automatic debt dynamics	-7.5	-4.2	-1.4	-0.7	-0.4	-0.5	-0.6	-0.4	-0.6	-0.7	-0.7
Real interest rate and relative inflation	1.2	0.6	1.2	1.4	1.7	1.5	1.4	1.5	1.4	1.3	1.2
Real interest rate	1.2	0.6	1.2	1.4	1.7	1.5	1.4	1.5	1.4	1.3	1.2
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-8.7	-4.8	-2.6	-2.1	-2.1	-2.0	-2.0	-2.0	-2.0	-1.9	-1.9
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.0	-0.7	0.3	0.4	0.6	0.7	0.7	0.7	0.7	0.6	0.6
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	-0.7	0.3	0.4	0.6	0.7	0.7	0.7	0.7	0.6	0.6
Contribution of residual	-4.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Gross financing needs	14.5	8.0	7.0	7.2	4.9	5.9	4.4	4.3	4.9	6.0	6.4
of which: debt service	10.3	6.0	6.4	7.8	6.0	6.9	5.3	5.0	5.6	6.7	7.1
Local currency	9.7	6.0	6.4	7.8	6.0	6.9	5.3	5.0	5.6	6.7	7.1
Foreign currency	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	15.3	9.0	5.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Inflation (GDP deflator; percent)	2.2	2.9	2.2	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	17.8	12.1	7.3	6.4	6.1	6.1	6.1	6.1	6.1	6.1	6.1
Effective interest rate (percent)	4.4	4.0	4.6	5.1	5.3	5.0	4.9	5.2	4.9	4.7	4.5

Contribution to Change in Public Debt
(percent of GDP)



Commentary: growth dynamics have contributed the most to the trajectory of debt since the beginning of the pandemic, but fiscal discipline will progressively increase its role in reducing the debt burden over the projection horizon. In the baseline, the authorities' commitment to the NFPS deficit target of 1.5% of GDP starting in 2025 per the SFRL will help to progressively reduce the debt-to-GDP ratio, albeit not to pre-pandemic levels. Interest rates and global financial tightening will contribute to slowing this adjustment.

Figure AIV.5. Panama: Realism of Baseline Assumptions



Commentary: the projected declining debt path is within the norm and past forecast errors do not reveal any substantial systematic biases, with the underlying consolidation resting on moderate fiscal surpluses.

Source: IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

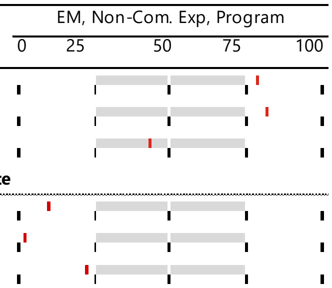
3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Figure AIV.6. Panama: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

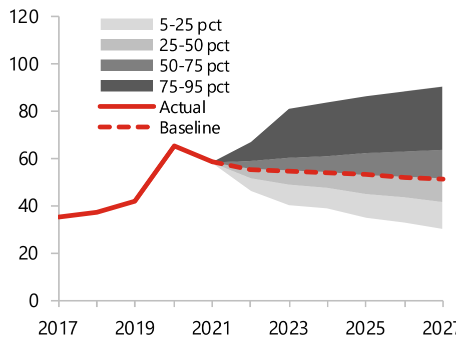
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	60.2	0.9	...
	Probability of debt not stabilizing (pct)	23.1	0.2	...
	Terminal debt level x institutions index	28.2	0.6	...
	Debt fanchart index	**...**	**1.7**	**Moderate**
GFN finance-ability module	Average GFN in baseline	6.2	2.1	...
	Bank claims on government (pct bank assets)	3.5	1.1	...
	Chg. in claims on govt. in stress (pct bank assets)	9.6	3.2	...
	GFN financeability index	**...**	**6.4**	**Low**

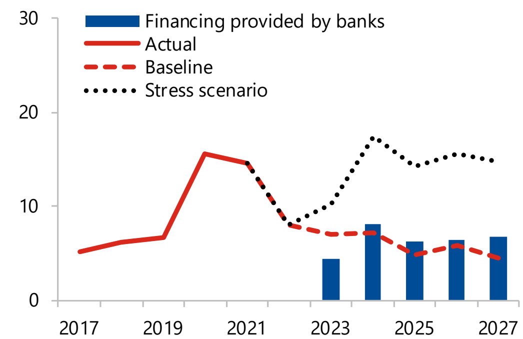


Legend: Interquartile range Panama

Final Fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

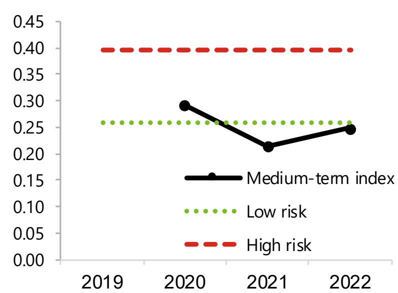


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index

(index number)



Medium-term Risk Analysis

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.4
GFN finaceability index	7.6	17.9	0.5	0.1
Medium-term index (MTI)	0.3	0.4	...	0.2, Low

Prob. of missed crisis, 2022-2027 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 42.0 pct.

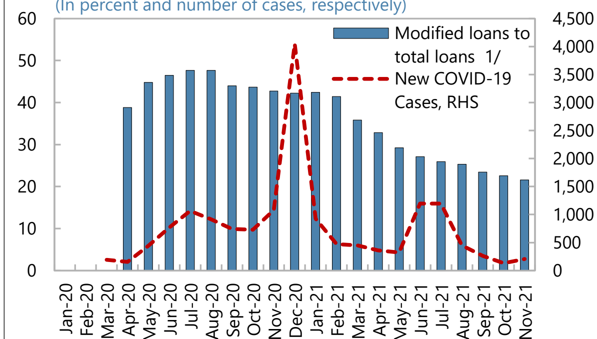
Commentary: the Debt Fanchart Module is pointing to a moderate level of risk mainly due to the volatility of projections, with debt-to-GDP ratios rising above their 2020 peak in the 75-95 percentile range of the simulation. On the other hand, the GFN Financeability Module suggests an overall low level of risk, although financing needs could increase significantly in a stress scenario with macro-fiscal shocks, a sudden shortening of debt maturity, and a debt-holder shock with domestic banks acting as residual creditors.

Annex V. Management of the Banking Sector During the Covid-19 Pandemic

1. Panama was severely affected by the covid-19 pandemic. To contain the spread of the virus, the authorities implemented stringent containment measures, which included—among others—curfews, mandatory quarantine, sanitary fence around affected areas, school closure, and suspension of commercial flights and construction projects except health-related ones. Along with a global recession, these containment measures had significantly reduced mobility and commercial activity, precipitating a sharp contraction of the economy (by 17.9 percent in 2020) and an increase in unemployment rate to 18.5 percent in September 2020 (from 7.1 percent in 2019). As a result, many borrowers who were affected by the pandemic had difficulty servicing their loans, putting pressures on bank's asset quality. The prospects of a significant increase in NPLs sparked concerns as it could jeopardize financial stability and further exacerbate the downturn in the domestic economy. This prompted the authorities to take temporary remedial actions to support affected borrowers and preserve the stability of banks.

2. To support borrowers who were affected by the pandemic, the authorities implemented a temporary moratorium on loan service. As borrowers affected by the pandemic were unable to service their loans due to loss of income, the government and the banking community agreed on a temporary moratorium on loan service, from March until the end of 2020, in the form of voluntary loan restructuring, grace periods, and in some cases interest rate reduction (Box A5.1). Under this temporary forbearance, loans that were modified under the moratorium (modified loans) would not be classified as nonperforming loans (NPL). As the recession deepened, the share of modified loans increased to a high of 47.6 percent in July 2020 (local portfolio), from 38.8 percent of total loans in April 2020. The moratorium was extended until June 30, 2021, following an announcement by President Cortizo in October 2020. The ratio of NPL to total loans stood at 2.0 percent in the fourth quarter of 2020 (1.7 percent in the first quarter). Since then, the NPL ratio rose to 2.7 percent in the second quarter of 2022, reflecting the recognition of credit losses following the end of the moratorium.

Modified to Total Loans Ratio and New COVID-19 Cases
(In percent and number of cases, respectively)



Sources: Johns Hopkins University CSSE COVID-19 Data, and SBP.
1/ Based on the local portfolio.

3. To safeguard financial stability, the authorities released banks' dynamic provisions and implemented an *ad hoc* provisioning requirement. The SBP allowed the use of dynamic provisions made by banks during periods of economic prosperity amounting to US$1.3 billion (about 2 percent of GDP) to absorb write-offs, where needed. Only five banks used such provisions. At the same time, an *ad hoc* regulatory requirement was implemented, requiring banks to create a provision equivalent to 3 percent of the gross modified loan portfolio. This helped to increase total loan-loss provision to 148 percent of NPL in 2020 (from 102 percent of NPL in 2019). Throughout the pandemic, the total regulatory capital adequacy ratio in the banking sector remained high, averaging 15.7 percent in 2020, partly supported by these ad hoc measures along with the moratorium on loan service.

4. **As more sectors of the economy started to reopen, economic activities began to recover, and the share of modified loans started to decline.** After peaking at 47.6 percent of total loans in July 2020, the share of modified loans gradually delined to 42.2 percent at the end of 2020. The government's vaccination campaign, which started in January 2021, helped to accelerate the recovery further. By November 2021, 70 percent of Panama's population had been vaccinated with at least one dose of the covid-19 vaccine. As Panama's economy continued to rebound strongly in 2021, loan service improved significantly, anchoring a further reduction in modified loans to 16.8 percent of total loans at the end of 2021. Modified loans that are serviced for six consecutive months were reclassified as normal loans.

5. **The authorities' approach in managing the banking sector during the covid-19 crisis has been successful in safeguarding financial stability.** The moratorium formally ended in June 2021, and a three-month window period (July 1 to September 30, 2021) was designated for banks and the remaining affected borrowers to negotiate and restructure their modified loans. As the economic recovery gains momentum, the share of modified loans was reduced further to 11.9 percent of total loans at the end of the first quarter of 2022. Banks remain well capitalized and liquid. At end-2021, total regulatory capital adequacy ratio stood at 15.9 percent (compared to 15¾ percent as of end-2020), against a minimum requirement of 8 percent. Liquidity remained high as short-term assets covered 60 percent of short-term deposits as of end-December 2021 (63½ at the end of 2020), double the regulatory minimum of 30 percent. Moreover, no banks had used the liquidity facility under the FES. To ensure adequate recognition of credit risks within the modified portfolio, Rule 3 2021 was established by the SBP to guide the classification of these loans based on the loan service by affected borrowers and progress of the restructuring (Table A5.1 provides further details).

Table AV. 1. Categorization of Modified Loans (Rule 3, 2021)

Modified Normal	Modified Special mention	Modified Subnormal	Modified Doubtful	Modified Irrecoverable
• Bank has agreed to modify the terms and conditions of the loan until June 30, 2021 in line with Agreement 2, 2021. • Borrower is in compliance with its new terms and conditions.	• Bank has agreed on the grace periods for capital, interest or other terms, in line Agreement 2, 2021. • Borrower is in compliance with the grace period.	• Bank agreed to the new terms and conditions following the restructuring during the period from July 1 to September 30, 2021. • Borrower is in compliance with these terms.	• Affected borrowers have contacted the bank as of June 30, 2021, and their current financial conditions do not allow them to meet the terms and conditions for restructuring. • Bank continues to maintain contact and discussion with the affected borrower.	• Affected borrowers have totally or partially breached the terms and conditions agreed in the modified loans. • In addition, this category encompasses modified loans from affected borrowers who, as of June 30, 2021, have not contacted the bank to establish a payment agreement.

Source: SBP.

6. As of January 2023, the categorization of modified loans will migrate back to its original pre-pandemic regulation. In November 2022, the SBP adopted a resolution (Rule 12-2022) to re-classify modified loans based on the original regulation before the pandemic (Rule 4-2013), with effect from January 2023, with the following parameters (Table A5.2):

Table AV.2. Reclassification of Modified Loans According to Rule No. 4-2013

Classification of credits (Rule No. 4-2013)	Corporate Sector		Households			
			Consumption		Mortgage loan	
		(with collateral) Loan less than 50% of value of the collateral		(with collateral) Loan less than 50% of value of the collateral		(with collateral) Loan less than 70% of value of the collateral
Normal	from 0 to 30 days	from 0 to 30 days	from 0 to 60 days	from 0 to 60 days	from 0 to 60 days	from 0 to 60 days
Special mention	from 31 to 90 days	from 31 to 180 days	from 61 to 90 days	from 61 to 180 days	from 61 to 90 days	from 61 to 180 days
Subnormal	from 91 to 180 days	from 181 to 270 days	from 91 to 120 days	from 181 to 270	from 91 to 180 days	from 181 to 270 days
Doubtful	from 181 to 270 days	from 271 to 360 days	from 121 to 180 days	from 271 to 360 days	from 181 to 360 days	from 271 to 360 days
Irrecoverable	More of 270 days	More of 360 days	More of 180 days	More of 360 days	More of 360 days	More of 360 days

Source: SBP.

Box AV.1. Moratorium on Loans During the Covid-19 Pandemic

Temporary moratorium on loan service. The Panamanian Government enacted Law 156 on June 30, 2020, as a relief measure for borrowers who are economically affected by the covid-19 pandemic. The Law—gazetted on July 1, 2020 and was made effective retroactively as of March 1, 2020—established a moratorium period until December 31, 2020, for certain credits granted by banks, finance companies, and cooperatives.

- "Affected borrowers" are those whose employment contract has been suspended or terminated, independent workers, and business entities whose activity has been affected by the containment measures established by the government following the declaration of the national state of emergency. The moratorium includes residential mortgages, personal loans, car loans, credit cards, loans to small and medium-sized companies, commercial loans, consumer loans, and loans to the transportation and agricultural sectors.
- During the moratorium, banks, finance companies and cooperatives were forbidden to increase interest rates or collect surcharges or any other interest for loans included in the moratorium. In addition, the credit history of affected borrowers will not be affected throughout the national state of emergency, and up to 60 days after its conclusion.

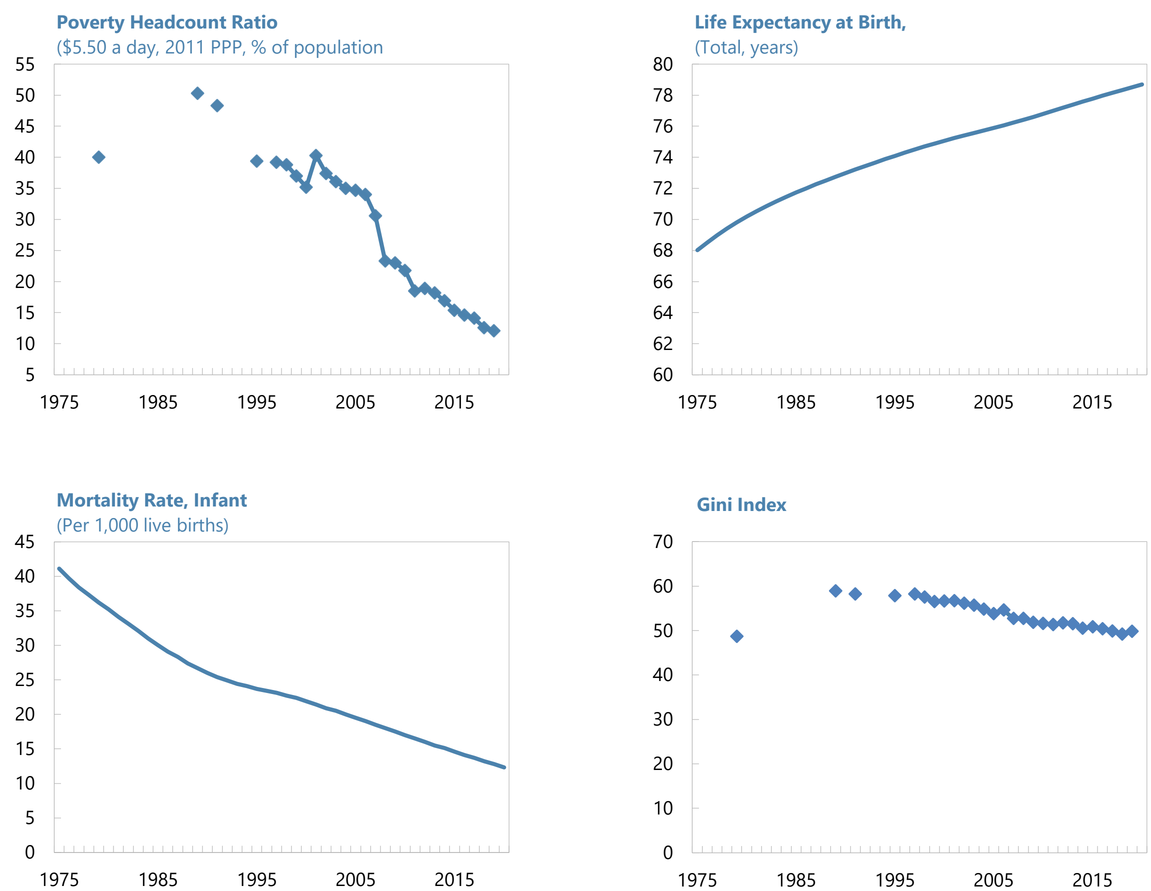
Post moratorium. The Law also establishes that once the period of the moratorium expires, the creditors and affected borrowers will negotiate a refinancing or pro-rating of the loan, based on mutual agreement, without charging any fees for late payment or any other administrative expense, and the credit references of the affected borrowers will remain unaffected.

Annex VI. Social Issues and Recent Protests

Despite its rapid growth in the recent years and relatively high level of economic development and income per capita, Panama faced a multitude of socioeconomic challenges before 2020, which were exacerbated by the pandemic-related economic shock. Labor markets are recovering albeit unevenly across population segments and incomes declined below pre-pandemic levels for a large share of workers. In addition to these issues, consumer prices soared spurred by the impact of Russia's invasion of Ukraine, triggering a country-wide wave of protests, which highlighted the need for more focused social policies.

Social Indicators Prior to Covid-19

1. Social indicators in Panama have improved markedly over the last few decades. The poverty rate declined from 35 percent in 2000 to 12 percent in 2019—a much faster pace than elsewhere in the region. At the same time, the Gini index, a measure of inequality, dropped from 56.6 to 49.8, pointing to a more equitable income distribution. Life expectancy and infant mortality also improved dramatically.



Source: World Development Indicators.

2. Despite this progress, Panama's social indicators are still weak relative to peers. Panama lags the peers in its income group in many aspects of social policy, such as education, health, gender equality and social inclusion[1].

3. Panama's human capital index score is low relative to its income level. Panama's 2020 Human Capital Index, which measures the amount of human capital that a child can expect to attain by age 18 given the country's health and education systems, was on par with countries with much lower level of economic development and per-capita income. In the latest 2018 Program for International Student Assessment (PISA),[2] Panama ranked 71 out of 77 countries.

Social Indicators During the Pandemic

4. Panama's unemployment rose sharply during the pandemic, reaching its highest rate since 1989. The World Bank survey showed that 35 percent of those employed before the pandemic either became unemployed or left the labor force altogether[3].

5. Moreover, the share of formal employment in total employment declined sharply. While nearly all the countries in Latin America and the Caribbean saw a decline in formal employment as a share of total employment during the pandemic, that change was the most pronounced in Panama, at 22.7 percentage points relative to pre-pandemic levels. Already-vulnerable groups, including women, the elderly and the less educated, were most affected.

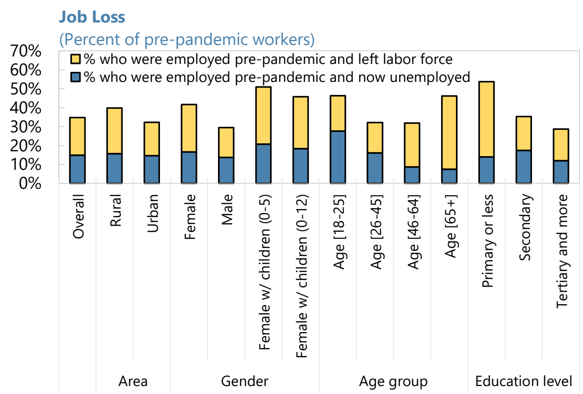
6. Social assistance programs did not fully compensate for pandemic-related income losses, leading to an increase in poverty. The World Bank estimates that Panama's emergency social assistance program (*Panama Solidario*) was insufficient to compensate for pandemic-related income losses. Even though nearly 70 percent of households reported receiving emergency transfers by mid-2021, household income remained below pre-pandemic levels for 58 percent of households, according to a survey, and a quarter of the responding households reported running out of food.

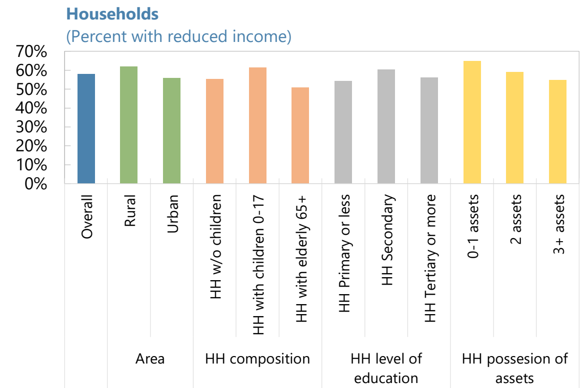
7. Gender gaps widened during the pandemic. The female population was disproportionately affected by the increased burden of care, with 39.3 percent more women than men reporting an increase in time spent attending to children's education needs during the pandemic. Increased household burdens coupled with a higher incidence of job losses placed Panamanian women at an even more disadvantaged position to men than before the pandemic.

[1] See Social Issues in Panama: Background and Policies (IMF Country Report No. 20/125).

[2] The 2021 PISA was rescheduled to 2022 due to the covid-19 pandemic.

[3] According to a World Bank survey, over one in every three workers lost their jobs. (World Bank and UNDP LAC 2021 High Frequency Phone Surveys, Phase II, Wave 1.0 (collected between May and July 2021, with findings reported in April 2022). The jobless disproportionately included those with low education levels, females with young children, and the elderly. The pandemic also affected job quality, with more than one out of five formal workers becoming informal in 2021. The poverty headcount increased from 12.1 percent of the population before the pandemic to 14.8 percent in 2020.





Sources: World Bank and UNDP LAC High Frequency Phone Surveys, Phase II, Wave 1.

8. The pandemic also led to a deterioration of human capital and widened the gap in educational attainment between the poor and the wealthy students, the result of the limited reach of remote learning, differences in teaching quality and in-home learning support. The World Bank reports that the pandemic-related gap in school attendance between children coming from high-educated and low-educated households was almost 20 percentage points.

Recent Protests

9. Rising fuel and food prices triggered large-scale protests across the country in July 2022. On July 4, 2022, a group of teachers from ANADEPO (representing over twenty educational, civil, farming, transportation, and student associations) and AEVE (a teachers' union) blocked key transportation routes between eastern and western Panama, with their key complaints being the high cost of gasoline at the pump (Panama is a fuel importer), and rising food and medicine prices. Organizations such as SUNTRACS, a construction workers' union, and COONAPIP, a group of indigenous organizations, joined the nationwide strike by mid-July, with various civic groups, organizations and private individuals following suit. Protesting groups eventually united into a single table for dialogue with the government (*Mesa de Diálogo*), proctored by the Catholic Church.

10. In response, the government lowered gasoline prices and introduced selected price freezes. The Cortizo Administration announced a fuel price freeze at US$3.95 per gallon for gasoline and diesel, effective July 15, and on July 17, agreed to reduce fuel prices further, to US$3.25 per gallon.[4] It also agreed to freeze the prices of 72 staple products, suspend tariffs on targeted goods which included food and healthcare-related items, and extend pandemic-related social support transfers beyond their scheduled expiration in June 2022.

11. The protesters' other concerns include addressing corruption (especially in the Legislative Assembly) and government wastefulness, and compliance with the law mandating 6 percent of GDP spent on education in 2023 (which has been historically low compared to peers and estimated around 4.5 percent of GDP for 2022).

[4] At the end of June, a gallon of gasoline cost between US$4.80 and US$5.25, while diesel cost US$4.75 per gallon.

12. Protests of this magnitude are atypical for Panama. The recent episode of social unrest is estimated to be the most significant one in Panama over the last three decades. It affected the entire country and was fueled by populist support (according to a public poll, 74 percent of respondents approved of the protests by mid-July). While official reasons for public discontent included rising inflationary pressures, some analysts point out that general uncertainty in the world economy, languishing labor markets and cumulating dissatisfaction with socioeconomic conditions in the aftermath of the pandemic "provide the breeding ground for popular uprisings" and may have also motivated protesting activity.[5]

[5] "Three weeks into the social uprisings: causes, consequences, and perspectives" by Marco Fernandez (Global Source Partners).

Annex VII. What Caused Panama's Sharp 2020 Contraction?

1. **Panama experienced one of the world's sharpest GDP contractions.** Panama's output shrank by 17.9 percent in 2020 – its largest contraction in recorded history and the first since 1988 (when output fell by 13.4 percent amid a major political crisis preceding the 1989 US invasion). Compared to regional peers, Panama's GDP shrank by the most. Moreover, from the global perspective, Panama's pandemic-related output loss was among the 10 largest.

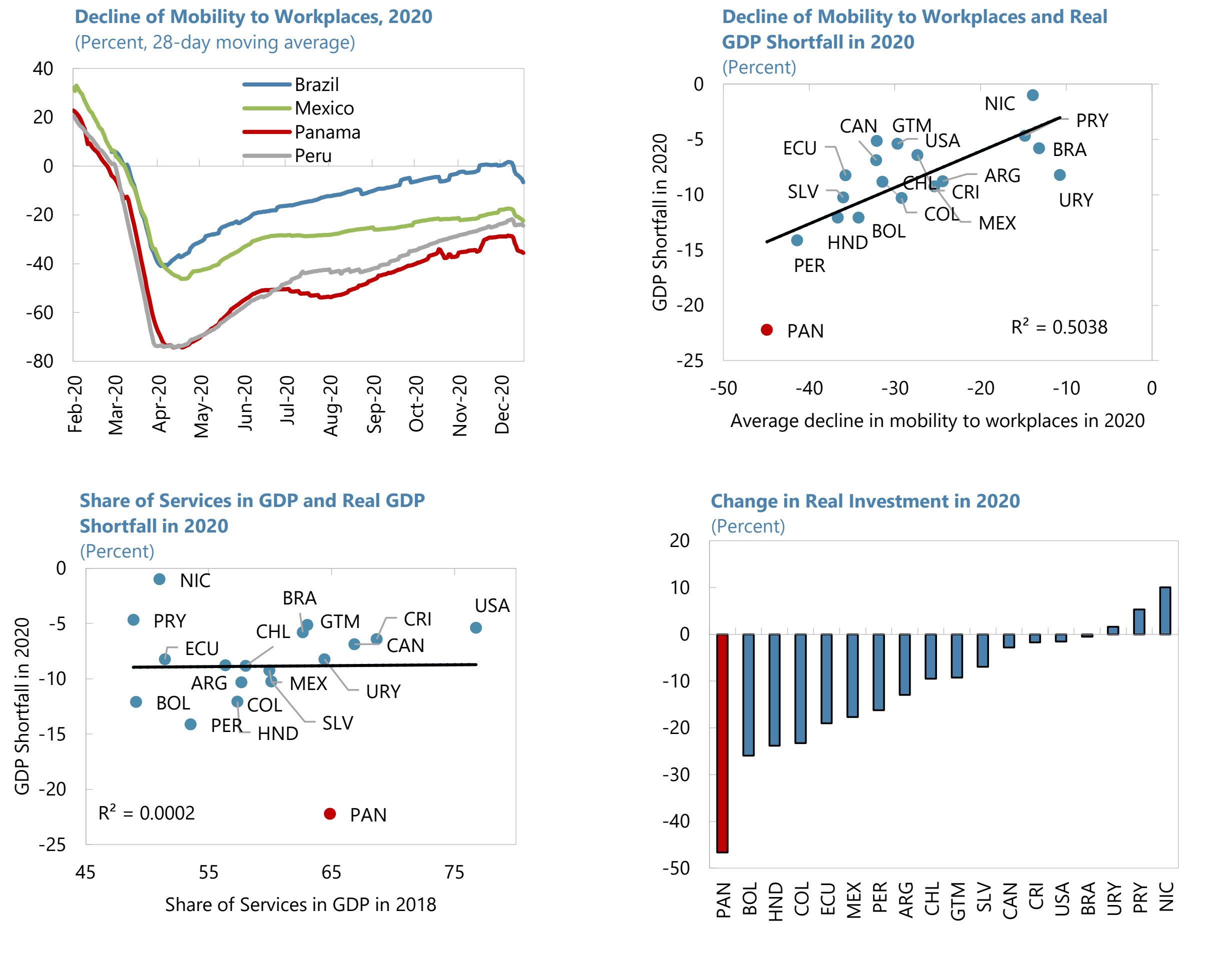
2. **The decline was not the result of the large share of services in Panama's GDP.** Panama's GDP decline was much larger than in countries with similar or higher shares of services in their GDP. Moreover, the link between the share of services and the shortfall of GDP was very weak. While some types of services, including those related to hospitality and food services, travel, retail and other contact-intensive services (beauty, indoor recreation and culture, group childcare, etc.) were severely affected by pandemic-related containment measures and temporary closures, other services shifted to online platforms (including education, telemedicine, counseling, religious services, etc.) and yet others thrived during covid (health services, in-home care, shipping and delivery, digital infrastructure design and support, etc.).

3. **An important factor behind the deep slump was the sharp drop in investment**. Growth rates of gross domestic investment and output in Panama appear to be fairly well correlated and drops in the former coincide with pronounced declines in the latter. Investment declined by 50 percent in 2020—a massive collapse both relative to Panama's own history and by international standards: a rate usually observed in deep capital account crises.

4. **This drop in investment was in large part the result of a drop in construction activity which was severely affected by pandemic-related closures.** In response to public health concerns, the authorities promptly declared a national emergency, ordered mandatory quarantine with a curfew and movement restrictions, suspended all construction projects except for health-related, closed schools, canceled public events, and banned all commercial flights (except cargo and humanitarian). Monthly working hours were reduced by half. Notably, the pandemic forced the government to suspend all construction activity—Panama's engine of investment and growth since the 2000s—for about six months. In contrast, in some countries construction was considered "essential business" and was not considerably interrupted by counter-covid measures.

5. **It is likely that not all of the slump in construction activity was due to covid-related containment measures.** The construction boom started to wane before the pandemic, in 2018-19, as investment levels declined slightly along with the number of building permits and major infrastructure projects came to completion. Construction activity was also impacted by rising input costs and supply bottlenecks as well as labor shortages. According to the Bureau of Labor Statistics, price increases for inputs to construction and goods industries were much larger during the pandemic than were price increases for inputs to services industries. For example, input costs for wood products climbed by 22.6 percent between May 2020 and April 2021, while output costs surged by 44.6 percent over the same period, spurred by increased demand amid limited capacity to meet this demand.

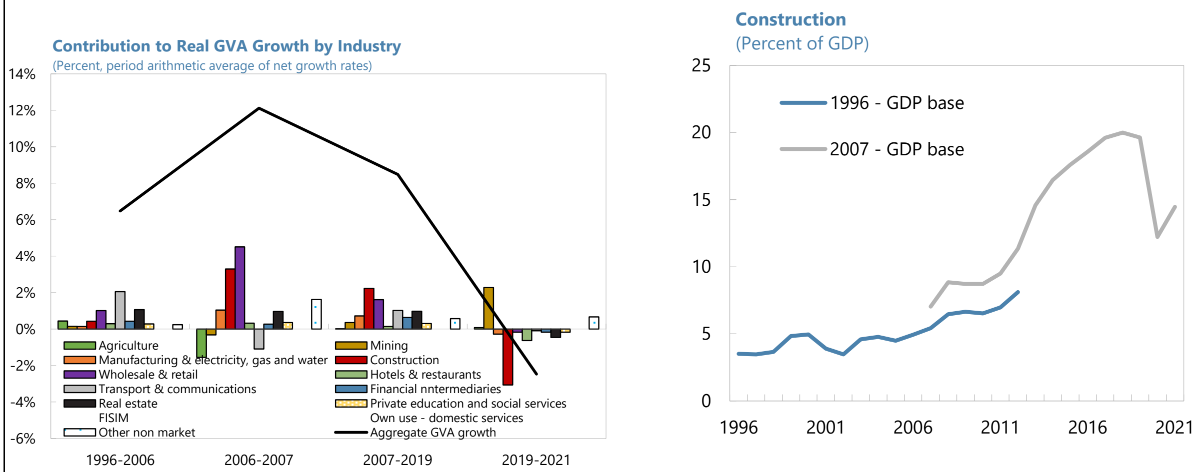
Factors behind the Large Decline in GDP in 2020



Sources: Johns Hopkins, World Economic Outlook, World Bank and IMF staff calculations.

6. **Construction activity has been recovering but remains well below pre-pandemic levels** (investments for building works in the first nine months of 2021 were 40 percent above 2020 levels over the same period, but still 39.2 percent below what was reported in 2019). Some of the recovery may be due to the re-initiation of postponed projects, with the rest representing new demand for construction. It remains to be seen whether construction regains its pre-pandemic role as the engine of Panama's growth and investment but the slowdown in activity before the pandemic may signal that the "construction supercycle" has come to an end, calling for a shift of labor and capital inputs into other high value-added sectors.

Panama's Construction Industry: Contributions to GVA Growth and GDP Share



Sources: CEIC database, INEC and IMF staff calculations.

7. An increase in mining activity only partly offset the impact of the decline in construction. Panama's copper mine, *Cobre Panama*, is the biggest private investment project in the nation's history, surpassing the Canal expansion, and one of the world's top copper-producing mines. Its commercial production started in September 2019; since then, the share of mining and quarrying in the country's output increased to 2.5 percent of GDP in 2019 (from 1.9 percent in 2018), 3.7 percent of GDP in 2020 and 5.8 percent of GDP in 2021. The expansion of mining activity offset some of the output losses due to the slump in construction, but only to a limited extent as construction shares in Panama's GDP ran in double digits since 2012, peaking at 18.3 percent in 2018, and declining to 13.2 percent in 2021 – still more than double the share of mining.

Annex VIII. Panama's Climate Policy Options

1. **Panama remains committed to climate policy.** The authorities made an allocation of US$100 million in 2020 to support its population affected by natural disasters following Hurricane Eta and tropical storm Iota, and continue to build resilience through various adaptation and mitigation strategies.[1] In addition, they have a committed amount of US$100 million from The World Bank through a with a Catastrophe Deferred Drawdown Option (Cat-DDO) which supports technical and institutional capacity to manage disaster risks from the adverse effects of climate change and disease outbreaks.[2]

2. **Effective management of water resources will become a strategic priority for Panama.** To the extent that climate change increases rainfall volatility, Panama will need more careful management of the fresh water it derives from precipitation. Key sectors of the economy, most prominently agriculture and transit through the Panama Canal, crucially rely on a constant supply of fresh water. Yet, the two main reservoirs that supply the Canal and a large share of the population have occasionally reached worryingly low levels, and the local distribution system is estimated to lose more than 40 percent of the transported water due to widespread leakages. A combination of actions could help stabilize the amount of available fresh water for business use and household consumption: the desalinization of sea water, the construction of a third reservoir, efficiency improvements and repairs to the existing distribution network, as well as a revision of public water fees, which have been kept unchanged at a low level since 1982.[3]

3. **Panama has set an ambitious net-zero target for carbon emissions in 2050**. To this end, multiple policies and coordination among both private and public stakeholders will be needed as the country makes this historic transition. Figure A8.1 focuses on the effects of one such policy instrument that could achieve both a gain in revenues and a reduction in emissions. Using IMF's new Climate Policy Assessment Tool (CPAT), staff estimated that the introduction of a carbon tax in 2024 gradually bringing the price of carbon to 50 real US$ per ton of CO2 equivalent by 2030 could raise between 0.1 and 0.6 percent of GDP in government revenues each year over the following decade, while reducing baseline emissions by up to 5 million tons in CO2 equivalent and raising net welfare by 0.6 percent of GDP by the end of the same period.

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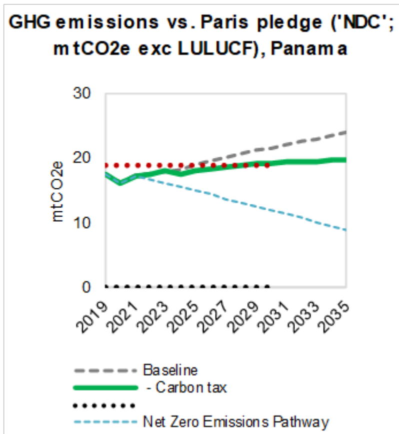
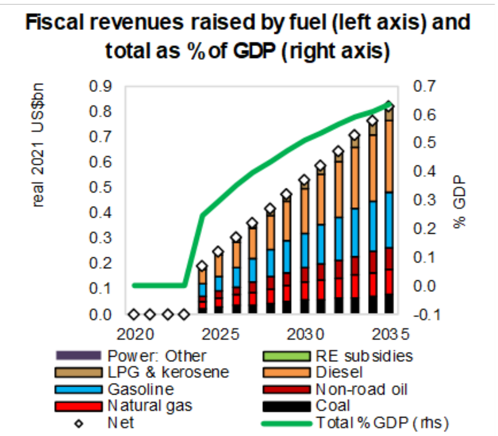
[1] Panama's geographic location exposes it to the increasing frequency and intensity of multi-hazard events, including El Niño and La Niña. Annex 10 of the 2021 Article IV provides further details on mitigation and adaption strategies.
[2] The World Bank Cat-DDO instrument enables countries to immediately access a prearranged amount of funding upon declaration of a State of Emergency due to a natural or climate-related hazard or health emergency.
[3] See April 2020 Selected Issues Paper "Structural Policies in Panama: Background and Policy Recommendations" by Julia Faltermeier, IMF Country Report No. 20/125.

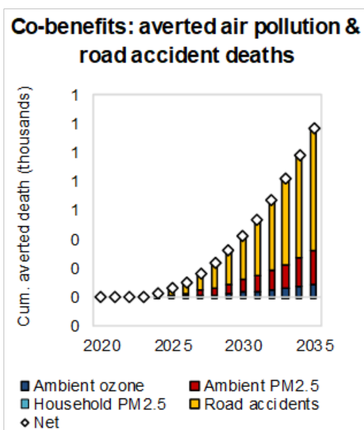
Figure AVIII.1. Panama: Effects of a Carbon Tax that Gradually Brings Carbon Prices from 20 to 50 Real US$ per tCO2e between 2024 and 2030



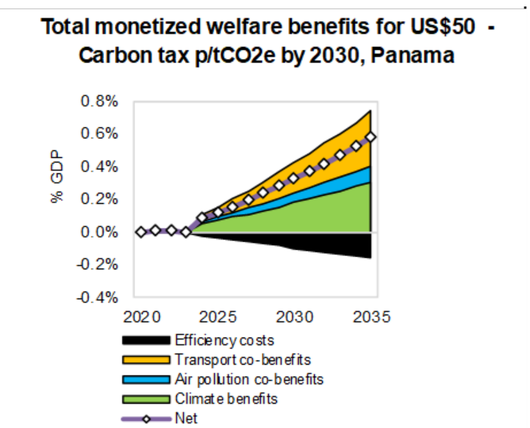
Latest NDC is a conditional target of 12% reduction vs. business as usual in 2030. Policy achieves 11.1% vs. BAU in 2030, which is 92.5% of the emissions reductions vs. BAU for NDC. Net-zero target for 2050 is in policy document (illustrative linear pathway shown).



Shows total additional (vs. baseline) fiscal revenues from the policy net of renewable energy subsidies.



Shows averted deaths from improved air quality (all fuels) and road safety (for motor fuels).



Shows monetized net welfare benefits. Economic costs are deadweight losses from the tax before revenue recycling. Economic costs do not include revenue recycling and tax interaction effects.

Source: IMF calculations based on the Climate Policy Assessment Tool (CPAT).

Annex IX. Recent Progress towards Exiting the FATF Grey List

1. **Addressing the deficiencies in Panama's AML/CFT regime is a key policy priority for the authorities.** To move the agenda forward, the government made new key appointments on the national AML/CFT team in 2021-22. Steps taken by the authorities to address FATF's concerns (identified in the action plan) included (i) applying risk-based supervision to the designated non-financial business and professional sector; (ii) using the Practical Guide for Parallel Financial Investigations; (iii) approving Law 254, which resolved certain legal impediments to implementing several remaining action items in the FATF action plan; (iv) updating the sectoral risk assessment; (v) implementing the SSNF[1] Supervision Manual; (vi) enhancing risk-based monitoring and supervision of corporate sector; (vii) focusing on money laundering investigations in high-risk areas; and (viii) designing and implementing a digital platform to collect ultimate beneficial ownership (UBO) information for active firms incorporated in Panama.

2. **To exit the FATF grey list, three action items remain to be upgraded to "largely addressed."** Specifically, remaining action items on Panama's action plan include:

- ensuring adequate verification of up-to-date UBO information by reporting entities and timely access by competent authorities;
- establishing effective mechanisms to monitor the activities of offshore entities and further implementing the specific measures to prevent the misuse of nominee shareholders and directors; and
- demonstrating the country's ability to investigate and prosecute money laundering involving foreign tax crimes.

3. **To address these three remaining items, specific actions have been taken.**

- As of February 8, 2023, the UBO registry contained UBO information on 78,637 companies, or close to 33 percent of total active firms. Notably, the two largest law firms have uploaded over 90 percent of their registered companies, representing important progress from a risk-based perspective. The digital platform has already entered verification phase in 2022-Q4[2], and competent national authorities have been granted access to the UBO information.
- On July 28 2022, the SSNF issued Resolución JD-02-2022, applicable to lawyers and certified public accountants, addressing the AML/CFT preventive measures and obligations applicable to

[1] The Superintendency of Nonfinancial Subjects (SSNF by its Spanish acronym) was created in 2020 to regulate the designated nonfinancial businesses and professions.
[2] On November 7th, SSNF approved a risk-based approach mechanism for validation and verification of UBO information, implemented through the creation of a task force, composed by 4 supervisors of the Supervision Directorate and 2 analysts of the UBO Directorate. A specialized unit has been created solely within the Supervision Directorate for BO verification purposes.

these professionals. The Resolución also establishes specific measures of control to prevent the misuse of nominee shareholders and directors, when lawyers operating in PAN render these services.

- Within the last two years, the authorities started nine investigations related to foreign tax crimes. Out of these nine cases, seven remain at preliminary investigation stages, while one advanced significantly, and one resulted in an international warrant.

4. The SSNF expanded its resources and supervisory activities. To hasten the UBO registration and verification process, the SSNF expanded its budgetary and human resources: its 2023 budget rose to US$10.7 million from US$2.4 million in 2019 (by 4.5 times), with special funds (US$3.6 million in 2023) earmarked for the UBO registry. In 2022, staffing to support the UBO platform increased from one in April to six in December (and a projected rise to 13 in 2023). New staff members have been tasked with training law firms/resident agents and uploading company and related UBO information to the registry. As a result, the pace of registering new companies in the platform increased in 2022-Q3 and Q4. The number of supervisions and sanctions also increased this year. Onsite supervisions conducted by SSNF as of November 2022 increased 96 percent relative to 2021, while offsite supervisory activities increased by 1571 percent over the same period. The number of sanctions rose from 1 (in the amount of US$5,000) in 2019 to 16 in 2022 (US$491,845).

Annex X. The Risks of Disruptions in Mining Activities

Background

1. **The Cobre Panamá copper mine project was started in 1997 by Minera Panamá, currently the local subsidiary of the Canadian firm First Quantum Minerals.** In February 1996, the Government of Panama and Minera Panamá , agreed on a 20-year mining concession for the Cobre Panamá copper mine project.[1] The National Assembly approved Contract-Law No. 9 in February 1997, conveying the status of national law to the mining concession. The duration of the concession was extended by ministerial resolution in December 2016 for an additional 20-year period. Total investment so far has been at least 10 billion dollars, according to Minera Panamá's Financial Statements.

2. **In December 2017, the Supreme Court of Panamá ruled that Law No. 9 was unconstitutional** as the National Assembly had failed to consider whether it complied with applicable legislation at the time.[2] The government presented a new Law to comply with the Court's ruling, but it has not yet been approved by the National Assembly.

3. **The project continued despite the legal and political uncertainties.** Production began in June 2019 and reached full capacity in 2021, with plans for further expansion. The mine is estimated to produce 400,000 tons of copper, 150,000 oz of gold, and 3,500 tons of molybdenum each year for at least the coming 10 years, gradually declining afterwards, with a mine life of more than 30 years. According to INDESA, an economic advisory firm, Minera Panamá's direct contribution to Panama's GDP is about 3.2 percent, and its indirect contribution another 1.6 percent. Copper exports accounted for 4.4 percent of GDP in 2021.

4. **Under the Law-9 concession, the company is required to pay a 2 percent royalty on a net smelter return basis[3]**, but is exempt from most other taxes (except for social security contributions on employee wages) as long as it has an outstanding debt related to the project.

Recent Developments

5. **The government is of the view that Minera Panamá has been paying less than its fair share due to the tax holiday and has reopened negotiations about the concession.** To ask for fairer terms, the government reopened negotiations with Minera Panamá about the concession, proposing a new contract in January 2022 ending the tax holiday and reinstating corporate income

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[1] This mine project was owned by Inmet Mining until 2013 when this company was taken over by First Quantum Minerals Ltd. Inmet originally owned Minera Panamá. In 2012, it sold a 20 percent stake to a Korean holding company (KPMC). In 2013, First Quantum acquired Inmet through a hostile takeover bid, which gave it the remaining 80 percent stake in Minera Panamá and control over the Cobre Panamá project. In 2017, First Quantum raised its ownership stake to 90 percent.

[2] The case had been filed in 2009. The Court made the ruling public in September 2018. It became effective in December 2021, when it was published in the Official Gazette.

[3] The base for the royalty is defined in Law No. 9 as "the gross amount received from the buyer due to the sale (of concentrates) after deduction of all smelting costs, penalties and other deductions, and after deducting all transportation costs and insurances incurred in their transfer from the mine to the smelter".

taxes at the standard 25 percent rate, the general withholding regimes, and royalties of 12-16 percent of the operating margin with some cost deduction exclusions. A required yearly minimum payment would seek to guarantee that the sum of corporate income taxes, withholding taxes, and royalties is always greater than or equal to US$375 million.

6. According to Minera Panamá, the current royalties at 2 percent of revenues are above the average royalty rate expected from a mine of the same ore grade, based on an analysis from KPMG on mines in the Americas. The company also argues that since it still has outstanding debt, the original contract conditions should remain unchanged.

7. Negotiations failed to meet the deadline set for December 14, 2022. On December 15, 2022, the government asked Minera to prepare a "care and maintenance" plan for the suspension of mining activities to be presented within 10 business days. Negotiations resumed in late December.

Disruption of mining activities and economic implications

8. Thus far, there has not been any impact on copper production. Copper mining activities continue as negotiations are ongoing and the "care and maintenance" plan has not been implemented pending the government's decision on Minera's appeal.

9. However, the conflict has increased the risk of disruptions to mining activity and shipments.

- Using INDESA's estimates of the direct contribution of Minera to GDP, a one quarter suspension of mining activity would reduce annual GDP growth by 0.8 percentage point. The provinces of s of Coclé and Colón would be particularly affected.

- Cobre Panamá is estimated to provide around 41 thousand direct and indirect jobs and interact with 1,800 suppliers.

INTERNATIONAL MONETARY FUND

PANAMA

February 8, 2023

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of December 31, 2022)

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	558.16	100.00
Holdings	468.60	83.95

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):

	2023	2024	2025	2026	2027
Principal	94.20	188.40	94.20		
Charges/Interest	16.85	11.20	4.20	2.62	2.62
Total	111.05	199.60	98.40	2.62	2.62

Implementation of HIPC Initiative: Not applicable

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

Implementation of Catastrophe Containment and Relief (CCR): 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. The BNP has implemented all of the recommendations from the assessment. In particular, the legal framework for operationalizing the FES has been approved, the criteria for selection and appointment of external auditors have been strengthened, and investment practices were enhanced through revised policy and governance arrangements.

Non-Financial Relations

Exchange Rate Arrangement

The exchange rate arrangement is an arrangement with no separate legal tender. Panama uses the U.S. dollar as the primary means of payment in the local economy. The US dollar is legal tender and circulates freely in Panama. 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 and multiple currency practices.

Last Article IV Consultation

The 2021 Article IV consultation was concluded on June 14, 2021. 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. An FSAP Review is currently underway and expected to be completed in mid-2023.

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, STA TAs were focused on the real and financial sectors with the aim of improving national accounts and monetary and financial statistics. MCM also delivered TAs on banking sector stress test, Basel III implementation, and macroprudential framework and policies.

Resident Representative

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

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

(As of December 31, 2022)

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 and IIP

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 December 31, 2022)

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 2007-19. Quarterly data from the production approach are available until 2022Q3 and from the expenditure approach until 2021Q4. The monthly economic activity index has benefited from the use of administrative source data; improvement areas include upgrading the index to the current base year 2007 and improved by implementing 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. Currently, only growth rates of seasonally adjusted quarterly GDP are available. 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, 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 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. From January to March 2023, the 2023 Census of Population and Dwelling will be conducted.
Government Finance Statistics: Further efforts would improve the quality of fiscal data in support of surveillance. Since January 2018, the authorities have received regular 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 2020 to STA for publication in the GFS database. 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. Other financial corporations (OFCs) data reported comprise offshore banks, insurance corporations, and pension funds. OFCs data exclude Banco de Desarrollo Agropecuario and Banco Hipotecario Nacional.

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 mobile and internet banking, mobile money, gender-disaggregated data, and 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. 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). rt. 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. The ongoing authorities' National Statistical Plan 2021-25 aims to advance the ROSC recommendations and subscribe to the SDDS among other targets.

Table 1. Panama: Common Indicators Required for Surveillance
(as of December 31, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates[7]	N/A	N/A	N/A	N/A	N/A
International Reserve Assets and Reserve Liabilities of the Monetary Authorities	11/2022	01/2023	M	M	M
Reserve/Base Money	11/2022	01/2023	M	M	M
Broad Money	11/2022	01/2023	M	M	M
National Bank of Panama Balance Sheet	11/2022	01/2023	M	M	A
Consolidated Balance Sheet of the Banking System	11/2022	01/2023	M	M	M
Interest Rates[1]	10/2022	12/2022	M	M	M
Consumer Price Index	12/2022	01/2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[2] – General Government[3]	9/2022	11/2022	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[2]–Central Government	9/2022	11/2022	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[4]	12/2022	12/2022	M	M	M
External Current Account Balance	6/2022	1/2023	Q	Q	Q
Exports and Imports of Goods and Services	6/2022	1/2023	Q	Q	Q
GDP/GNP	9/2022	12/2022	Q	Q	Q
Gross External Debt	6/2022	1/2023	Q	Q	Q
International Investment Position [5]	6/2022	1/2023	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).

7/ Panama is a fully dollarized economy.

Statement by Mr. Afonso Bevilaqua, Executive Director for Panama, Mr. Eloy Arturo Fisher Hogan, Advisor to the Executive Director, and Mr. Frank Fuentes, Advisor to the Executive Director

February 22, 2023

1. On behalf of our Panamanian authorities, we thank Management and the Executive Board for their continued support to Panama. We also thank Mr. Bakker and his team for their open dialogue during the Article IV consultation mission and for their informative report on Panama's economic outlook and policies. The authorities reiterate their appreciation for the Fund's continued technical assistance and valuable policy advice, which helped to support a strong post-pandemic recovery.

2. **The authorities reaffirm their commitment to sound economic policies.** Since the beginning of the pandemic, the authorities have maintained fiscal discipline through rigorous adherence to the Social and Fiscal Responsibility Law (SFRL), leading to a substantial consolidation process that helped to reduce the budget deficit from 10 percent of GDP in 2020 to the 4 percent of GDP threshold in 2022, thereby ensuring debt sustainability over the medium term. In addition, the authorities have redoubled their efforts to exit the FATF gray list in 2023, with significant progress since last October on the only remaining item in the FATF Action Plan.

Recent Developments and Economic Outlook

3. **A strong post-pandemic recovery continues.** The authorities expect Panama's real GDP growth in 2022 at around 9 percent, above staff estimates. Economic activity for the year is expected to have exceeded the level observed in 2019, driven mainly by domestic consumption, trade, and tourism. Inflation remains lower than regional peers and inflation expectations are well anchored. This good performance is supported by the government's fuel and food price subsidies aimed to shield particularly the most vulnerable population from high international food and energy prices caused by the residual effects of the global pandemic and the war in Ukraine. The authorities will maintain a proactive approach to

social protection and will gradually phase out subsidies in line with their fiscal stability objectives.

4. **Economic activity is expected to slow down in 2023.** The authorities expect real GDP growth to reach 5 percent in 2023, in line with staff's estimates, amid protracted global supply chain disruptions and a slowdown in global trade. Economic activity will benefit from strong public investment, as infrastructure projects gather pace, and from steady growth in the services sector, especially tourism. The authorities plan to implement a long-overdue update in the GDP base year to reflect structural changes in the economy that took place before the pandemic.

Fiscal Policy and Public Financial Management

5. **The authorities have responded with sound and decisive policies to significantly improve the overall fiscal balance.** The government is on track to meeting the 4 percent of GDP fiscal deficit target, and between 90 percent and 97 percent of tax revenue goals for 2022. In addition, the creation of the Large Taxpayers Department at the National Tax Service is expected to increase tax contributions from larger companies by 4 percent to 9 percent over the next two years, with renewed focus on speedy processing, monitoring, and auditing. Large taxpayers account for more than 60 percent of total tax revenue in Panama. Higher tax collections will allow capital investments to be paid for with more limited reliance on debt financing.

6. **Panama's public debt remains sustainable.** Adherence to the amended fiscal rule continues to place public debt firmly on a declining path, supported by improved primary fiscal balances and a positive real growth-interest differential. Despite the challenging environment of rising global interest rates, only 18 percent of Panama's public debt is at floating rates. This provides a fiscal buffer against further monetary tightening. A recent 2035 bond was issued at a discount, with a coupon of 6.5 percent, 150 bps below regional peers. Amid volatile market conditions in the short- to medium-term, Panama's sovereign bonds are generally oversubscribed (by about 3 times based on recent experience), and the authorities expect to comfortably meet next year's financing needs of about US$ 4.1 billion, including US$ 1.9 billion to offset redemptions.

Financial Stability and AML/CFT regulation

7. **The financial sector continues to show resilience.** Banks remain well capitalized, liquid, and profitable, with only a modest increase in non-performing loans. The share of pandemic-modified loans fell from 48 percent of total loans at the peak of the pandemic to just 5 percent, with only about one-third of those considered high-risk accounts. In fact, most

of these loans are expected to migrate to regular categories soon, as required by a recently-issued banking regulation. Moreover, the pass-through of higher interest rates to existing borrowers remains low. With ample sources of funding from depositors, most banks plan to narrow net interest margins to reduce external pressure on new lending rates. Indeed, stress tests suggest that banks have adequate capital buffers even under the most adverse scenarios.

8. **The authorities have made substantial progress on the remaining items of the FATF Action Plan and have intensified their efforts to exit the gray list in 2023.** In this process, they have maintained close contact with the IMF Legal Department (LEG) as a sounding board on their progress. There were resolutions in both investigations and convictions, with ten and two high-profile cases, respectively. Progress has also been made in providing timely information in line with Egmont Group standards. In addition, the Financial Intelligence Unit is currently working with FINCEN and other international institutions to respond promptly to requests for information well within the established timeframes for reporting suspicious activity, particularly in the areas of illicit trafficking and deforestation.

9. **The process of uploading ultimate beneficial ownership information into the new system is progressing steadily.** The Superintendency of Non-Financial Institutions has stepped up verification efforts, which have helped to reduce the universe of companies from over 755 thousand to nearly 235 thousand active entries. Data uploads now account for 32 percent of the total number of companies, a significant increase since October 2022. The four largest law firms with offshore operations are currently working with the Superintendency to scale up efforts. The authorities are confident that they can reach a much higher percentage of registered entities by April this year, ahead of the FATF plenary in June.

Structural reforms

10. **Negotiations with Minera Panama continue.** The authorities are working to find an amicable solution to the impasse with the mining company regarding taxes and royalties that are commensurate with the size and nature of the company's operations in the country. In addition to boosting exports and employment, the mining and construction sectors will benefit from Minera Panama while supporting the diversification of the economy.

11. **The Social Security Administration is working to address the deficit in the pension system.** The reserves in the defined-benefit component of the system are under pressure, as current revenues cover only 55 percent of annual pension expenditures (as of October 2022). The shortfall is now being covered by reserves, but these are expected to be depleted on a cash-flow basis in late 2024 or early 2025. The authorities reconvened the National Dialogue in January to build consensus to address this issue.

12. **Finally, government agencies are finding new ways to address climate sustainability.** The Panama Canal Authority plans to become carbon neutral by 2030 and replace its tugboat fleet with hybrid vehicles. They are also preparing to spend US$1.5 billion on water management and conservation projects as rainfall in the Panama Canal basin has decreased over the past 20 years. From the financial markets' perspective, the Superintendency of Banks approved Regulation 11-2022 to address climate risks in the sector. In addition, the National Bank of Panama inaugurated its National Climate Risk Management Department and will implement IFC performance standards for financial operations, particularly in agriculture.