INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/188

PANAMA

June 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

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 2024 Article IV consultation with Panama, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 3, 2024 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 a lapse of time basis, following discussions that ended on March 1, 2024, with the officials of Panama on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 16, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the IMF staff.

The documents listed below have been separately released.

Selected Issues

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org

International Monetary Fund
Washington, D.C.

© 2024 International Monetary Fund

IMF Executive Board Concludes 2024 Article IV Consultation with Panama

FOR IMMEDIATE RELEASE

Washington, DC – **June 27, 2024:** On June 3, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.[1] The Board considered and endorsed the staff appraisal without a meeting, on lapse-of-time basis.

Panama grew very rapidly in the two decades preceding COVID-19 but was hit very hard by the pandemic. Between 1994 and 2019, GDP per capita increased from 33 percent of US GDP per capita to 48 percent. Rapid growth was driven by an unprecedented construction and investment boom that included major construction projects, such as the enlargement of the Panama Canal and the Tocumen airport, and the expansion of the services and logistics sectors that benefited from those projects. From the supply side, convergence was in large part supported by a sharp increase in the employment-to-population rate. This was the result of a demographic transition, an increase in female labor force participation, and a significant drop in unemployment. In 2020, GDP fell by 17.7 percent, a much larger decline than in other countries. A strict lockdown, with a six-month shutdown of the construction sector resulting in a 50 percent decline in investment, was a key factor behind the sharp decline.

The strong post-pandemic rebound continued in 2023. For the third year in a row, real GDP growth surprised on the upside, reaching 7.3 percent in 2023. Rapid growth was driven by a rebound in construction, retail and wholesale trade, transportation, and logistics. From the expenditure side, growth was driven by very strong fixed capital information, while private consumption growth lagged GDP growth. GDP is now well above pre-COVID 19 levels, and unemployment is near pre-crisis levels. GDP has grown by 39 percent since 2020 and 14 percent since 2019 and surpassed pre-crisis levels in 2022. However, private consumption is still below 2019 levels. Unemployment, which had surged from 7.1 percent in 2019 to 18½ percent in 2020, has since fallen back to 7.4 percent in August 2023. The fiscal deficit declined from 10.0 percent of GDP in 2020 to 3.0 percent in 2023, in line with the Social and Fiscal Responsibility Law. Panama exited the FATF grey list in November 2023.

Amidst several headwinds, the economy is expected to slow and the outlook is uncertain. GDP growth is projected to decrease to 2.5 percent in 2024, largely as a result of the closure of the Cobre Panamá copper mine. The mine contributed, directly and indirectly, about 5 percent of Panama's GDP. Growth in the non-mining sector is likely to slow as well, as the strong rebound from the pandemic has likely run its course and Panama faces higher financing costs. The near-term economic outlook is subject to a large degree of uncertainty and the balance of risks is tilted to the downside. Key risks include the loss of investment grade, further social unrest, the fallout from the end of copper production (including from international arbitration proceedings),

[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.

and external risks. Over the medium term, GDP is expected to grow by around 4 percent, subject to considerable uncertainty, as construction and investment are unlikely to provide the same support as they did before the pandemic. In addition, the scope for a significant increase in the employment-to-population ratio (which was an important driver of rapid growth during the boom years) is limited.

Executive Board Assessment[2]

Panama has recovered strongly from the pandemic, but growth in 2024 is projected to decline and the balance of risks is titled to the downside. Key risks include the loss of investment grade status and a further rise in financing costs. Being a dollarized economy adds to the importance of maintaining fiscal sustainability and financial stability. The external position is assessed to be broadly in line with the level implied by fundamentals and desirable policies.

Panama has made significant progress in reducing its fiscal deficit. The fiscal deficit declined from 10.0 percent in 2020 to 3.0 percent of GDP in 2023, in line with the targets of the SFRL albeit also helped by one-off revenue sources.

Meeting the 2024 fiscal deficit target of 2.0 percent of GDP will require an unduly large compression of public investment. A fiscal deficit of 4 percent of GDP in 2024 would be adequate from a cyclical perspective, avoiding an overly large investment compression and allowing a more gradual adjustment to the permanent loss of fiscal revenues from Minera.

The SFRL goal of reducing the fiscal deficit over time to 1.5 percent of GDP remains appropriate. If the deficit stays around 4 percent of GDP in coming years, there would be no further decline in the debt ratio, leaving public finances vulnerable to renewed shocks. To ensure that public debt is on a firm downward trend, the public finances strategy for 2025 should contain a credible multi-year fiscal consolidation plan to reduce the deficit to the SFRL target of 1.5 percent of GDP by 2027. Without a credible plan, the risk of further sovereign downgrades is high, which would increase financing costs and exacerbate possible adverse debt dynamics.

With no lender of last resort and deposit insurance, it is imperative that the banking system remains well-capitalized and liquid. The Panamanian banking system appears broadly resilient against severe downturn scenarios, but risks have increased amidst higher interest rates and a slowing economy. 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. The recent FSAP outlined a reform agenda that will help underpin financial stability and foster further financial development. All Fintech companies that carry out financial activities as defined by the FATF should be subject to AML/CFT regulation and supervision.

For income convergence to continue, labor productivity growth will need to accelerate. The demographic transition has largely run its course, and labor force participation in Panama already exceeds the average in the region and in high-income countries. Continuing to attract

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

FDI, improving the quality of education and governance, and reducing the share of informal employment will be key to foster labor productivity and growth.

Panama: Selected Social and Economic Indicators, 2020-26

Population (millions, 2023)	4.4	Poverty line (percent, 2019)	21.5
Population growth rate (percent, 2023)	1.3	Adult literacy rate (percent, 2019)	95.7
Life expectancy at birth (years, 2021)	76.2	GDP per capita (US$, 2022)	17,411
Total unemployment rate (percent, August 2023)	7.4	IMF Quota (SDR, million)	376.8

	2020	2021	2022	2023	2024	2025	2026
						Projections	
			(Percent change)				
Production and Prices							
Real GDP (2007 prices)	**-17.7**	**15.8**	**10.8**	**7.3**	**2.5**	**3.0**	**4.0**
Consumer price index (average)	-1.6	1.6	2.9	1.5	1.9	2.0	2.0
Consumer price index (end-of-year)	-1.6	2.6	2.1	1.9	2.4	2.0	2.0
Output gap (percent of potential)	-17.9	-7.1	-1.0	0.0	-2.0	-1.0	0.0
Demand Components (at constant prices)							
Public consumption	**11.9**	**6.0**	**3.6**	**2.6**	**5.2**	**-2.5**	**-0.2**
Private consumption	-10.1	5.3	-1.2	1.3	2.5	3.0	4.0
Public investment [1/]	-65.9	38.9	9.5	7.0	-13.7	-5.5	-9.7
Private investment	-44.7	30.1	25.5	11.0	2.5	3.0	4.0
Exports	-21.6	29.6	26.2	-1.5	22.9	-1.8	-7.7
Imports	-31.8	34.0	34.8	19.7	-23.4	3.3	3.0
Financial Sector							
Private sector credit	**-2.6**	**1.5**	**6.4**	**3.4**	**4.5**	**5.0**	**6.1**
Broad money	9.5	4.1	-1.9	2.1	4.8	5.0	6.1
Average deposit rate (Percent)	1.8	1.4	1.8	5.1			
Average lending rate (Percent)	7.7	7.6	7.7	9.8			
			(In percent of GDP)				
Saving-Investment Balance							
Gross domestic investment	**24.8**	**32.4**	**41.2**	**48.5**	**26.6**	**29.6**	**34.9**
Public sector	2.4	3.0	2.8	2.8	2.4	2.2	1.9
Private sector	22.4	29.4	38.4	45.6	24.2	27.4	33.0
Gross national savings	24.5	29.3	37.3	35.7	36.6	37.2	37.1
Private sector	-2.2	-0.1	1.9	2.6	0.7	1.7	2.6
Public sector	26.7	29.4	35.4	33.0	35.9	35.5	34.5
Public Finances [1/]							
Revenue and grants	**20.3**	**20.2**	**19.8**	**21.1**	**20.6**	**20.6**	**20.8**
Expenditure	29.2	25.4	23.0	23.3	23.7	22.6	21.5
Current including interest	22.0	19.5	17.4	17.7	19.0	18.3	17.8
Capital	7.2	5.9	5.6	5.6	4.7	4.3	3.7
Overall balance, including ACP	-8.9	-5.2	-3.2	-2.2	-3.2	-2.0	-0.7
Overall balance, excluding ACP	-10.0	-6.4	-4.0	-3.0	-4.0	-3.0	-2.0
Total Public Debt							
Debt of Non-Financial Public Sector [2/]	**62.0**	**55.6**	**53.7**	**52.2**	**54.1**	**55.1**	**54.3**
External	51.1	48.7	47.7	47.2	47.7	47.0	46.0
Domestic	10.9	6.9	6.0	5.0	6.4	8.0	8.3
Debt of ACP	4.0	3.1	2.4	1.9	1.6	1.2	0.9
Other [3/]	4.8	4.7	4.3	3.9	3.8	3.6	3.4
External Sector							
Current account	**-0.3**	**-1.2**	**-4.0**	**-12.6**	**10.1**	**7.6**	**2.2**
Net exports from Colon Free Zone	1.2	0.2	-1.8	-13.7	8.0	6.0	0.6
Net oil imports	1.6	2.9	4.8	3.5	3.3	3.0	2.8
Net foreign direct investment inflows	0.1	2.4	3.5	1.8	1.9	2.0	1.9
External Debt	197.1	177.0	167.8	159.9	159.5	158.2	156.3
Memorandum Items:							
GDP (in millions of US$)	57,087	67,407	76,523	83,382	87,347	91,731	97,309

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.
1/ Includes Panama Canal Authority (ACP).
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 2024 ARTICLE IV CONSULTATION

May 16, 2024

KEY ISSUES

Background. GDP growth in 2023 was strong (7.3 percent), exceeding expectations for the third year in a row since the downturn in 2020. Unemployment is near pre-crisis levels while inflation has moderated. Government bond spreads increased in the second half of 2023 as markets became concerned that failure to meet the fiscal targets would lead to a loss of investment grade status. However, the overall fiscal deficit dropped from 4.0 percent of GDP in 2022 to 3.0 percent in 2023, and the Social and Fiscal Responsibility Law (SFRL) target was met. Following a Supreme Court ruling that the new contract with copper mine Minera was unconstitutional, the government ordered the closing of the mine. Banks are, on average, well capitalized and liquid, and stay broadly resilient in an adverse scenario.

Outlook and Risks. Over the medium-term, GDP is projected to grow at 4 percent—slower than during the pre-Covid boom, as construction is unlikely to provide the same boost and the scope for a further sharp increase in the employment to population rate is limited. Key risks include an abrupt global slowdown, market dislocations triggered by continued high global interest rates and risk premia as well as asset repricing, the possible loss of investment grade, and resulting pressures on the rollover of external corporate and sovereign debt. Renewed social unrest and lower-than-expected rainfall causing delays in the planned restoration of Canal traffic could also pose risks. Potential adverse outcomes from the copper mine arbitration entail significant medium-term risks to the public finances.

Policy Advice. The government aims to reduce the fiscal deficit to 2.0 percent of GDP in 2024. As budgeted spending is not consistent with this target, the government intends to meet the target by keeping public investment well below the budget, but this would require an unduly large compression of investment when unemployment is expected to increase and growth to slow down. A more moderate reduction would be preferable, even if this would lead to a higher deficit in 2024 on a transitory basis. To anchor market expectations, a credible multi-year fiscal consolidation plan, anchored in concrete measures, should seek to reduce the deficit to 1.5 percent of GDP by 2027. To maintain room for investment, increased revenue mobilization is needed. To safeguard financial stability, it is essential that banks remain well capitalized and liquid. Strengthening human capital and governance will help sustain convergence. Continued implementation of the national statistical plan will improve the quality and timeliness of key macroeconomic data.

Approved By
Ana Corbacho (WHD) and Eugenio Cerutti (SPR)

Discussions were held in Panama City during February 19-March 1, 2024. The in-person mission comprised Bas Bakker (head), Wim Fonteyne, Diane C. Kostroch, Ana Sofia Pessoa (all WHD), Maylin Sun (SPR), and José Daniel Rodríguez-Delgado (STA). Eloy Fisher (OED) also participated. Toyosi Ojo (WHD) and Francisco Figueroa (LEG) participated remotely in part of the meetings. Richard Stobo (FSAP mission chief, MCM) participated in the concluding 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

ANNEXES

Acronyms

ACP	Autoridad del Canal de Panamá (Panama Canal Authority)
AE	Advanced Economy
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ANA	National Customs Authority
ARA	Assessing Reserve Adequacy
BASEL III	International Regulatory Framework for Banks
BCIE	Banco Centroamericano de Integración Económica (CABEI)
BNP	Banco Nacional de Panamá (National Bank of Panama)
CABEI	Central American Bank for Economic Integration
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CCF	Consejo de Coordinación Financiera (Financial Coordination Council)
CFZ	Colon Free Zone
CIT	Corporate Income Tax
CNBC	Comisión Nacional Contra el Blanqueo de Capitales
CSS	Social Security System
DGI	Dirección General de Ingresos (Tax Authority)
DIS	Deposit Insurance Scheme
DPL	Development Policy Loan (of the World Bank)
DRS	Disaster Resilience Strategy
DSA	Debt Sustainability Analysis
DSTI	Debt Service to Income
DTI	Debt to Income
D-SIB	Domestic Systemically Important Bank
EAT	IMF FAD Expenditure Assesment Tool
EBA	External Balance Assessment
EMDE	Emerging Market and Developing Economies
ENSO	El Niño-Southern Oscillation
FAP	Sovereign Wealth Fund
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FES	Fund for Economic Stimulus
FSI	Financial Soundness Indicator
FSR	Financial Stability Report
GALIFAT	Financial Action Task Force of Latin America
GHG	Greenhouse Gas
HtM	Held-to-Maturity
IDAAN	Instituto De Acueductos y Alcantarillados Nacionales (Panama's main water utility)
IDB	Inter-American Development Bank
INEC	National Institute of Statistics and Census
IO	Immediate Outcome
IRRBB	Interest Rate Risk in the Banking Book
ISA	Instituto de Seguro Agropecuario (Agricultural Insurance Institute)
ITBMS	Impuesto de Transferencia de Bienes Muebles y Prestación de Servicios (VAT)

KOMIR	Korea Mine Rehabilitation and Mineral Resources Corp.
LAC	Latin America and the Caribbean
LCR	Liquidity Coverage Ratio
LLI	Legal Liquidity Index
LOLR	Lender of Last Resort
LTU	Large Taxpayers Unit
LTV	Loan to Value
MEF	Ministry of Economy and Finance of Panama
MiAMBIENTE	Ministerio de Ambiente (Ministry of the Environment)
MPPC	Macroprudential Policy Committee
MNCP	National Carbon Market of Panama
MSME	Micro, Small and Medium Enterprises
MTFF	Medium-Term Fiscal Framework
NAP	National Adaptation Plan
NDC	Nationally Determined Contribution
NEER	Nominal Effective Exchange Rate
NFPS	Non-Financial Public Sector
NIIP	Net International Investment Position
NPLs	Non-performing Loans
OECD	Organization for Economic Co-operation and Development
PFM	Public Financial Management
PIT	Personal Income Tax
PLL	Precautionary and Liquidity Line
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
RFI	Rapid Financing Instrument
ROSC	Report on the Observance of Standards and Codes
RPP	Registro Público de Panamá (Public Registry Office)
SBP	Superintendencia de Bancos de Panamá (Superintendency of Banks of Panama)
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Rights
SFRL	Social and Fiscal Responsibility Law
SMV	Superintendencia del Mercado de Valores (Superintendency for Securities Markets)
SSRP	Superintendencia de Seguros y Reaseguros de Panamá (Superintendency of Insurance and Reinsurance)
SSNF	Superintendencia de Sujetos No Financieros (Superintendency of Non-Financial Entities)
SWF	Sovereign Wealth Fund
TA	Technical Assistance
UAF	Unidad de Análisis Financiero (Financial Intelligence Unit)
UBO	Ultimate Beneficiary Owner
VASP	Virtual Asset Service Provider
WDI	World Development Indicators

BACKGROUND

1. Panama grew very rapidly in the two decades preceding COVID-19 but was hit very hard by the pandemic.

- Between 1994 and 2019, GDP per capita increased from 33 percent of US GDP per capita to 48 percent.

- Rapid growth was driven by an unprecedented construction and investment boom that included major construction projects, such as the enlargement of the Panama Canal and the Tocumen airport (see IMF Country Report No. 23/122), and the expansion of the services and logistics sectors that benefited from those projects. From the supply side, convergence was in large part supported by a sharp increase in the employment-to-population rate. This was the result of a demographic transition, an increase in female labor force participation, and a significant drop in unemployment.

- In 2020, GDP fell by 17.7 percent, a much larger decline than in other countries. A strict lockdown, with a six-month shutdown of the construction sector resulting in a 50 percent decline in investment, was a key factor behind the sharp decline.

2. 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 the SDR allocation. The PLL, which the authorities treated as precautionary, expired on January 18, 2023.

IMF Support, 2020-23

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 3/	361 (512)	95.8 (0.9)	23-Aug-21 (Unused)
Total	**2,622 (3,740)**	**695.8 (6.3)**	

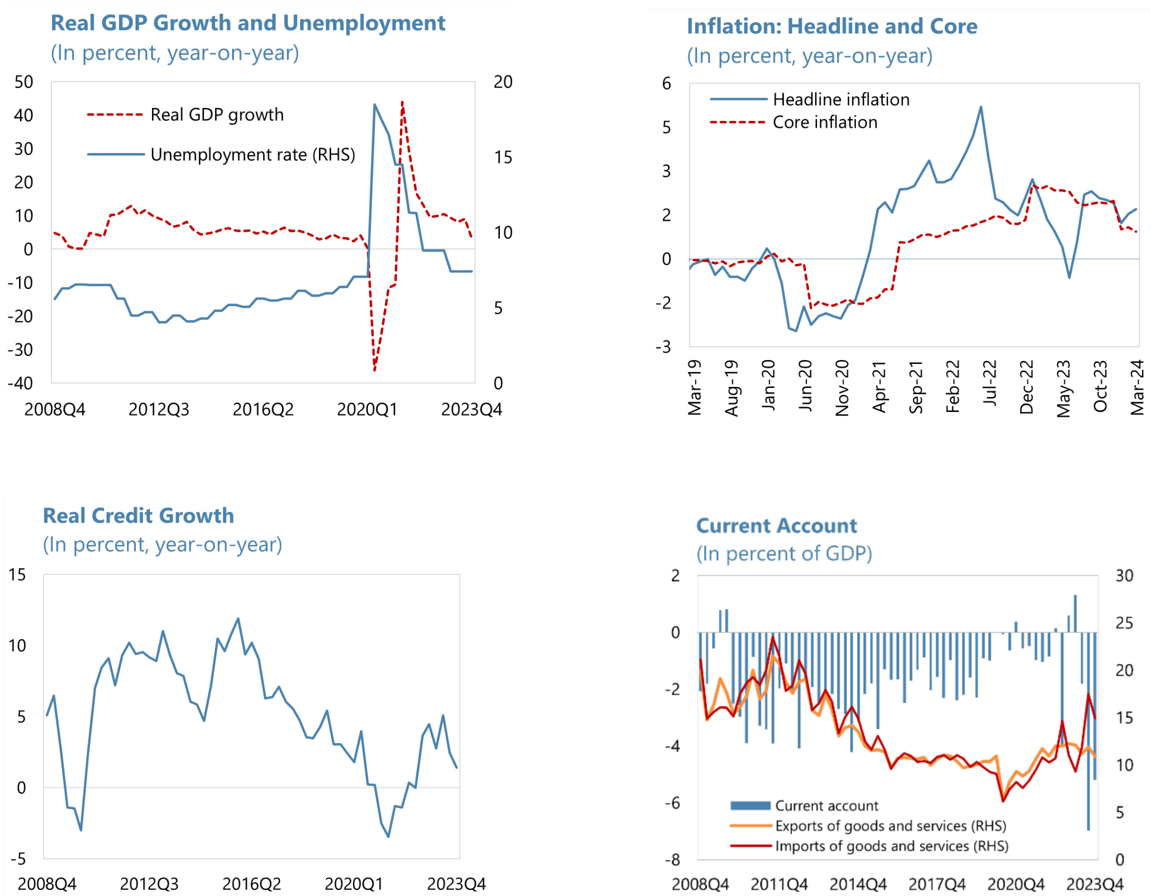
Source: IMF.
1/ Rapid Financing Instrument.
2/ Precautionary and Liquidity Line.
3/ Special Drawing Rights.

STRONG RECOVERY BUT FISCAL SLIPPAGES AND SOCIAL UNREST

3. For the third year in a row, GDP growth in 2023 surprised on the upside. Real GDP grew by 7.3 percent in 2023 (see next chart), 2.3 percentage points faster than projected in last year's Article IV Staff Report. Rapid growth was driven by a rebound in construction, retail and wholesale trade, transportation, and logistics. From the expenditure side, growth was driven by very strong fixed capital information, while private consumption growth lagged GDP growth. There was a sharp deterioration of the trade balance—the result of a large build-up of imported inventories in the

Colon Free Zone (CFZ) and export-processing zones,[1] but the balance of *domestic* exports[2] and imports improved. The impact of the deterioration of the trade balance on growth was limited as it was offset by a large increase in inventories.[3]

Business Cycle - A Recovery from Unprecedented Shock



Sources: INEC, SBP, and IMF staff calculations.

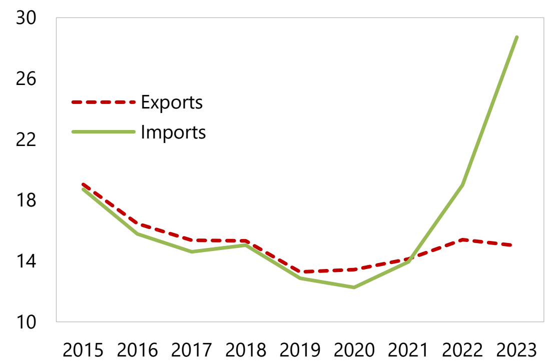
---

[1] Traditionally, these zones have a small trade surplus as imports are re-exported with a markup, but in 2023 they had a deficit of almost 14 percent of GDP. According to CFZ authorities, the high deficit stems in large part from imports by an international pharmaceutical company that has stockpiled raw materials in the CFZ for processing by its facilities in other Latin American countries. In 2023, the imports by this company amounted to 11 percent of GDP.

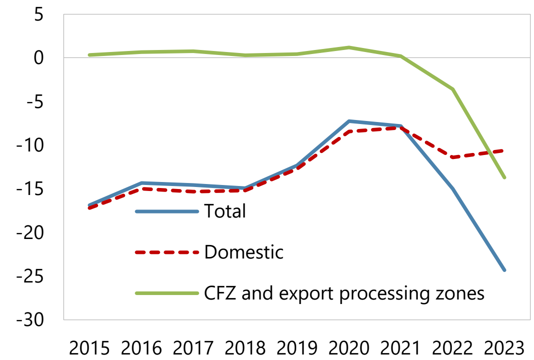
[2] Domestic exports are exports of goods that were produced in Panama.

[3] Inventory accumulation in the first three quarters contributed 12.3 percentage points to 2023 GDP growth. Fourth quarter expenditure-side GDP data are not yet available.

CFZ and Re-exporting Zones
(In percent of GDP)



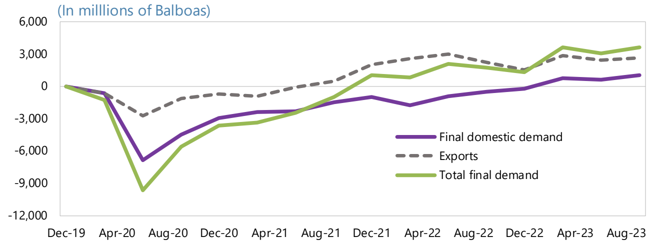
Trade Balance
(In percent of GDP)



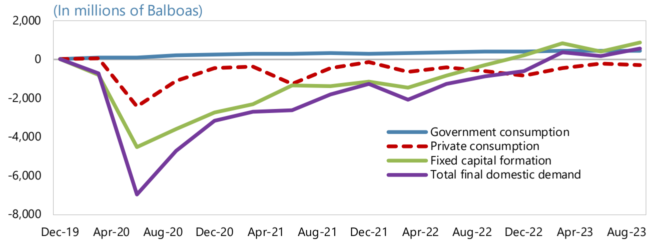
Source: Haver Analytics.

4. GDP is well above pre-COVID 19 levels, and unemployment is near pre-crisis levels. GDP has grown by 39 percent since 2020 and 14 percent since 2019 and surpassed pre-crisis levels in 2022. However, private consumption is still below 2019 levels. Unemployment, which had surged from 7.1 percent in 2019 to 18½ percent in 2020, has since fallen back to 7.4 percent in August 2023. Staff estimates that the output gap, which widened to almost -18 percent during the pandemic, closed in 2023.

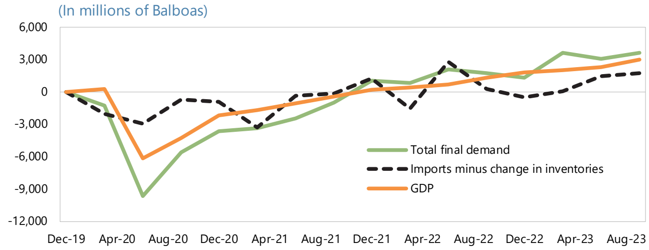
Change in Final Demand from 2019 Q4
(In milllions of Balboas)



Change in Final Domestic Demand from 2019 Q4
(In millions of Balboas)



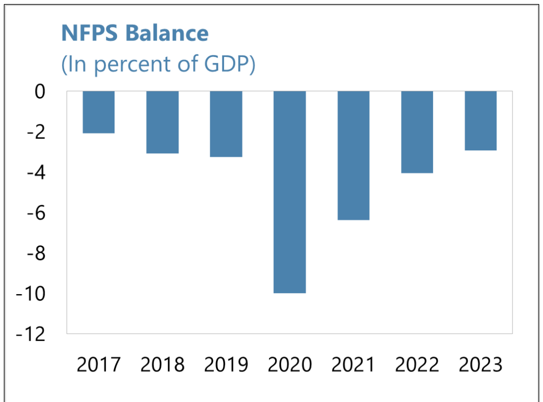
Change in Final Demand, Imports and GDP from 2019 Q4
(In millions of Balboas)



Source: Haver Analytics.

5. Inflation decreased in 2023 and remained well below other countries in the region. Average inflation declined from 2.9 percent in 2022 to 1.5 percent in 2023. The food and fuel subsidies introduced in July 2022, after social protests sparked by the rising costs of living, partially contributed to keeping inflation low compared to other countries in the region.[4] Average core inflation declined from 2.8 percent in 2022 to 1.4 percent in 2023.

6. In late November, Panama's Supreme Court ruled that the new mining contract with copper mine operator Minera was unconstitutional. In August 2023, parliamentary discussion of the revised contract led to widespread protests, with protesters arguing that the contract jeopardized national sovereignty, local communities' rights, and the environment (Annex VIII). The contract was subsequently revised, but the approval of the revised contract by parliament on October 20 triggered renewed protests and strikes, and the filing of several suits at Panama's Supreme Court. After the ruling, the government announced its plan to close the mine, which has stopped operating. The mine contributes, directly and indirectly, about 5 percent of Panama's GDP and accounts for about 1.5 percent of global copper production.



Sources: National authorities and IMF staff calculations.

7. Since the height of the pandemic, there has been significant fiscal consolidation. The non-financial public sector (NFPS) overall fiscal deficit declined from 10.2 percent of GDP in 2020 to 4.0 percent of GDP in 2022[5] and 3.0 percent in 2023, in line with the SFRL.

8. Sovereign bond spreads increased in the second half of 2023 as markets became concerned that failure to meet the fiscal targets in 2023 and 2024 would lead to a loss of investment grade status. By the third quarter of 2023, the deficit had risen to 4.8 percent of 2023 GDP—well above the full year target. In September 2023, Fitch revised Panama's outlook to negative. In October 2023, Moody's downgraded Panama from Baa2 to Baa3. The downgrade reflected Moody's view about Panama's lack of an effective policy response to structural fiscal challenges that have been rising over time.

9. Nevertheless, the fiscal deficit dropped further to 3.0 percent in 2023, and the SFRL target was met. The reduction in the deficit-to-GDP ratio was the result of higher revenues,

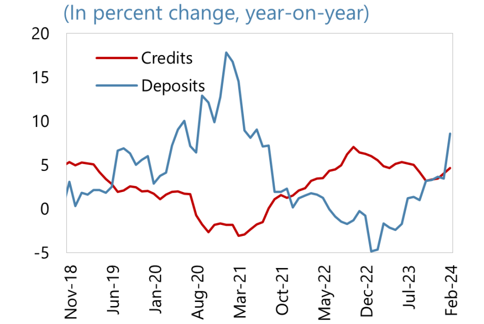
[4] The fuel subsidies were extended multiple times until January 2024. Their elimination is expected to have a limited impact on inflation as fuel prices have come down significantly since July 2022, when the subsidy was first introduced.

[5] In 2022, meeting the target was helped by an interest rate swap and the shifting of tax revenues from the first two weeks of 2023 to 2022. Under the swap, a foreign bank paid the government's interest obligations (0.5 percent of GDP) on issued debt securities in return for future government payments to the bank. The transaction reduced the fiscal balance in 2022. Interest payable was not recorded in 2022 but during 2024-26. Excluding the Executive Decree No. 1, which extended the fiscal year 2022 to January 13, 2023 (generating tax revenues of about 255 million), the deficit in 2022 would have been about 0.4 percentage points higher.

including payments by Minera and the sale of land to the Panama Canal Authority (ACP), and lower public investment. Interest payments increased sharply. Tax revenue growth disappointed as the increase in the tax revenue-to-GDP ratio expected in the 2023 Staff Report did not materialize.

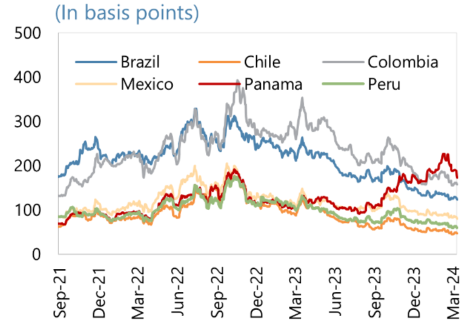
10. Government financing remains ample, but financing costs have increased. In late February, the government issued US$3.1 billion in new bonds (3.7 percent of GDP)–its largest bond issuance ever. The bonds were six times oversubscribed, but the yields were high (7.875-8.25 percent), with the markets already pricing in an expected future loss of investment grade.[6]

Local Credits and Deposits
(In percent change, year-on-year)



Sources: Haver analytics and IMF staff calculations.

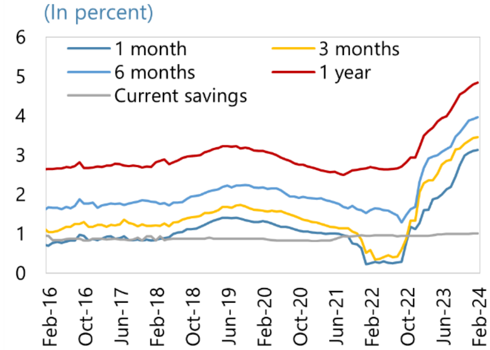
5-year CDS Spreads: Panama vs. Regional
(In basis points)



Source: Bloomberg.

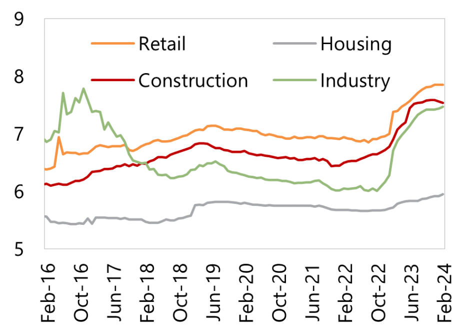
11. Rising interest rates have reduced credit growth. Local bank rates have increased significantly since the second half of 2022, although they have not seen a full pass through of the rise in international market rates. Term deposit rates have gone up by around 200 bps over the past year. Lending rates have increased less, especially for households (see chart). Domestic credit growth has slowed, and domestic deposit growth has accelerated, to 3.8 and 3.5 percent y-o-y respectively at end-2023, well below the rate of nominal GDP growth.

Deposit Rates
(In percent)



Source: Haver Analytics.

Lending Rates
(In percent)



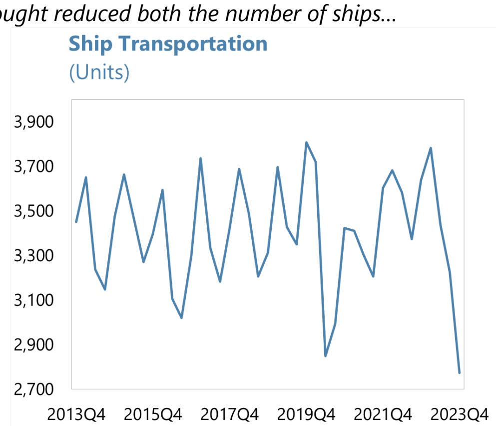
[6] Panama sold US$1.1 billion in bonds maturing in 2031 with a 7.5 percent coupon; US$1.25 billion bonds due in 2038 at 8 percent; and US$750 million bonds maturing in 2057 at 7.875 percent. The 2031 and 2038 bonds were priced at par, whereas the 2057 ones were priced to yield 8.25 percent.

12. The banking sector remains resilient, with liquidity and solvency buffers well above regulatory requirements, healthy profitability, low levels of NPLs, and growing balance sheets. At end-2023, the capital adequacy ratio stood at 15.3 percent while liquidity[7] stood at 57.8 percent, both almost twice the regulatory minimum requirements of 8 and 30 percent, respectively.[8] Profitability has rebounded, benefiting from higher net interest income (especially on deposits and investments) and lower provisions. However, profitability may have peaked, as rising funding costs are compressing interest margins and loan portfolios may increasingly be affected by tighter financial conditions and slowing economic growth. NPLs remain low overall, but higher than before the pandemic, and there has been an uptick in NPLs in the construction sector linked to post-pandemic inventories of high-end apartments, commercial real estate, and office space. Over a longer perspective, between the 2011 and 2023 FSAPs, systemic vulnerability has been stable. The size of the banking system has trended downward relative to GDP, capital ratios have trended upward, and portfolios have become more susceptible to market risk.

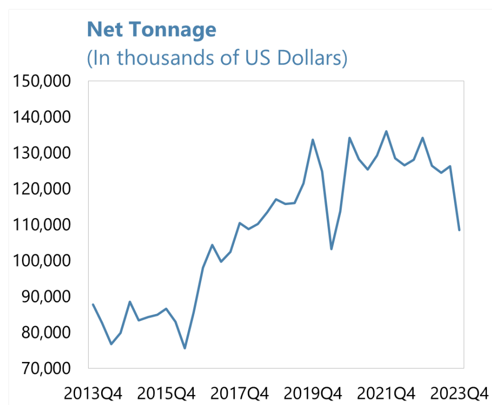
13. A historic drought has led to a reduction in the Panama Canal transits. Because of the low water levels (resulting from the lowest October rainfall in nearly 75 years), the number of daily transits has declined from 36 in normal times to 24 in February (see next chart).[9]

Panama Canal

Transportation through the Panama Canal recovered after the sharp drop during the pandemic, but a historic drought reduced both the number of ships…



… and the tonnage in Q2 2023.



[7] Measured using the Legal Liquidity Index (LLI). See Annex I.

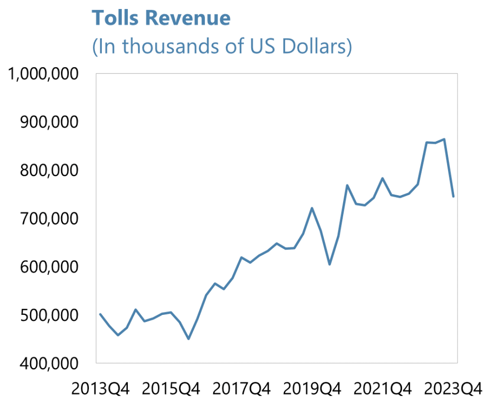
[8] One small bank, Atlas Bank, was intervened in September 2023, without contagion to the rest of the system. The bank had placed most of its assets with a Panamanian securities firm that failed due to apparent fraud. After the shareholders failed to deliver on their promises to bring in fresh capital, the bank was put into liquidation at end-February 2024.

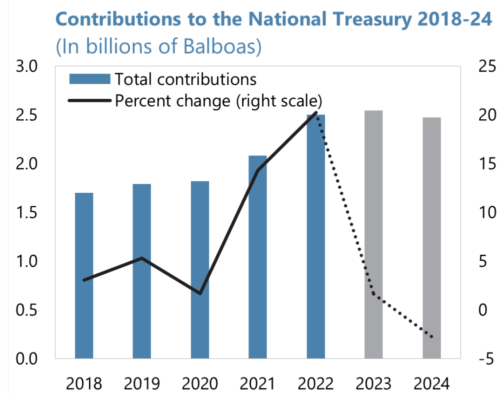
[9] The droughts also led to a trade-off between using water for Panama City, generating hydro-energy generation, and feeding into the Panama Canal. See Annex X for an analysis of the global spillovers of the Panama Canal drought.

Panama Canal (Concluded)

This impacted revenues from tolls toward the end of 2023 but dynamic pricing[1] helped buffer the impact. For 2024 the ACP estimates a revenue shortfall of 0.5 percent of GDP…

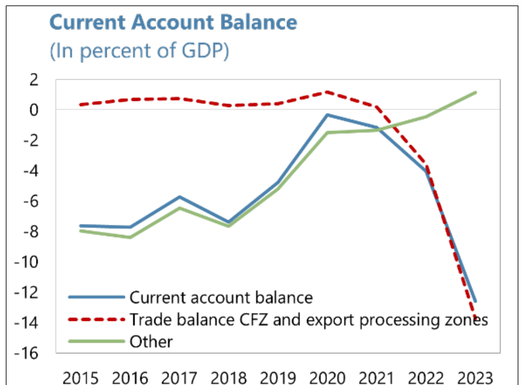
…with ACP total contributions to the central government expected to decline by 3 percent.





Sources: Panama Canal Authority, Haver analytics and IMF Staff calculations.
Note: Gray bars are values estimated by the Panama Canal Authority. Contributions include Fee per Net Ton and Public Services Fees.
[1] Dynamic pricing refers to the practice of setting flexible prices for products or services based on current market demand.

14. Between 2021 and 2023, the *headline* current account deficit deteriorated from 1.1 to 12.6 percent of GDP, but the *underlying* current account improved. The deterioration of the current account was entirely the result of deterioration of the trade balance of the CFZ and export-processing zones (from +0.2 percent of GDP in 2021 to -13.7 percent in 2023). The remainder of the current account *improved* slightly. Canal revenues remained strong, despite the decline in volumes, as prices increased. The counterpart of the current account deficit were errors and omissions of almost 10 percent of GDP, and foreign direct investment and portfolio inflows. The external position is assessed to be broadly in line with the level implied by fundamentals and desirable policies (Annex III).[10]



Sources: Haver.

15. The ongoing drought highlights Panama's vulnerability to natural disasters and the need to build resilience. In its latest Nationally Determined Contributions (NDCs) of December 2020, Panama increased its mitigation ambitions and included adaptation priorities for the first time.[11] Adaptation priorities include the management of watersheds, designing climate-resilient

[10] The External Balance Assessment (EBA)-lite model shows a current account norm of -1.6 percent of GDP.

[11] Panama is currently updating its NDC and its National Socioeconomic, Inclusive, Low Emission, and Climate Change Resilient Strategy to 2050. This update, along with the issuance of the first biennial transparency report, aims to provide a comprehensive overview of Panama's climate action progress while steering the nation's vision toward

(continued)

communities and eco-systems, developing risk mitigation measures for affected communities and public health systems, and fostering sustainable Infrastructure. This is particularly important for Panama as it is considered vulnerable to climate impacts such as droughts, intense and protracted rainfall, and floods.[12] From its side, the ACP is planning investments to support the Canal's operations during future droughts. Panama's sustainable finance market has seen significant progress, as it has become a major player in the green bond market.

16. In October 2023, Panama was removed from the FATF grey list. In June, the plenary session determined that Panama had largely addressed the two remaining action items. A subsequent on-site visit determined that the process of implementing the required reforms and actions is fully in place and is being sustained. On March 14, 2024, the EU also removed Panama from its list of high-risk third countries. Panama remains on the EU's list of non-cooperative jurisdictions for tax purposes but is working to achieve its removal.

17. A new President and Government will take office on July 1 following the May 5 General Elections. The elections were won by José Raúl Mulino of the Realizing Goals party of former President Martinelli. However, the new National Assembly is fragmented, with eight parties and 21 independent Deputies. Realizing Goals and an allied party together won only 15 seats in the 71-member Assembly. There is a widespread expectation of policy continuity, but also concern that the divided political landscape and Assembly may complicate necessary reforms.

OUTLOOK AND RISKS

18. With the closure of the copper mine, GDP growth is projected to slow to 2.5 percent in 2024. The mine contributed, directly and indirectly, about 5 percent of Panama's GDP.[13] Growth in the non-mining sector is likely to slow as well, as the strong rebound from the pandemic has likely run its course. A negative output gap is projected to open in the near term, and inflation is projected to remain low at 2.4 percent (y/y) by end-2024. Staff expects that the fiscal deficit will remain around 4 percent of GDP in 2024, above the level set in the SFRL (see policy section).

Macroeconomic Framework
(In percent of GDP unless otherwise indicated)

		Projections		
	2023	2024	2025	2026
GDP growth 1/	7.3	2.5	3.0	4.0
Inflation (avg) 1/	1.5	1.9	2.0	2.0
Credit growth 1/	3.4	4.5	5.0	6.1
Fiscal Balance	-3.0	-4.0	-3.0	-2.0
Public debt (NFPS)	52.2	54.1	55.1	54.3
Current account	-12.6	10.1	7.6	2.2

Source: IMF staff calculations.
1/ Percent change

inclusive economic development. The objective is to decrease emissions, enhance resilience, and promote social welfare.

[12] For further information, see the accompanying selected issues paper on "Building Resilience to Natural Disasters and Climate Change".

[13] See Annex VIII for more details.

19. The current account balance is projected to show a large surplus of 10 percent of GDP in 2024, as the large inventory build-up in the CFZ and export-processing zones gets re-exported. This will only partly be offset by a reduction of copper exports following the closure of the mine.

20. The near-term economic outlook is subject to a large degree of uncertainty and the balance of risks is tilted to the downside. Specifically:

- ***A loss of investment grade*** would raise Panama's external borrowing costs and increase refinancing risks.[14] Panama will face significant gross financing needs in the coming years (see Annex IV).[15] Panama has traditionally obtained a significant part of its financing through external commercial borrowing (accounting for 72 percent of public debt).[16] While the Panamanian domestic market has some absorption capacity, its depth is shallow. Following the mission, on March 28, Fitch downgraded Panama to below investment grade (BB+) for the first time since 2010, citing fiscal and governance challenges that have been aggravated by the events surrounding the mine closure.

Panama Credit Ratings

Credit Rating Agency	Rating	Outlook	Notches Above Cutoff
Moody's	Baa3	STABLE	1
S&P	BBB	NEG	2
Fitch	BB+	STABLE	0

Source: Bloomberg.

- ***Social unrest.*** Renewed social unrest could affect economic growth by disrupting transportation and supply chains.

- ***Fallout from the end of copper production.*** Significant fiscal risks may arise from arbitration proceedings over the mine closure. Minera's parent company First Quantum has announced it would seek damages of at least US$20 billion (24 percent of GDP).[17] The mine closure also poses risks to investor sentiment and the business climate, which may affect medium-term growth prospects.

- ***External risks.*** An abrupt global slowdown or recession 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.

[14] A country is considered investment grade if at least two of the three major rating agencies rate it as such. Losing investment grade means that a country is excluded from certain sovereign bond indices and may trigger forced selling from investors that are barred from holding sub-investment grade bonds.

[15] The impact on financing costs will be mitigated by the fact that much of the maturing debt carries high interest rates.

[16] Multilateral financing accounts for 18 percent of public debt.

[17] For more details see Annex VIII. So far, around US$10 billion (12 percent of Panama's GDP) has been invested in the mine.

- ***Financial stability risks.*** Further rising interest rates in the U.S. or a further widening of Panama's sovereign spreads could trigger borrower defaults and affect bank profitability. A real estate price correction would compound such problems.

- ***Cybersecurity and climate risks.*** Cyberattacks could bring significant disruptions to digital infrastructure, while more frequent and severe natural disasters could adversely affect Canal activity, agriculture, and tourism.

Medium-Term Macroeconomic Outlook

					Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					(In percent)					
Macroeconomic Developments										
Real GDP growth	-17.7	15.8	10.8	7.3	2.5	3.0	4.0	4.0	4.0	4.0
Output gap	-17.9	-7.1	-1.0	0.0	-2.0	-1.0	0.0	0.0	0.0	0.0
Unemployment rate	18.5	11.3	8.8	7.4	8.4	8.0	7.7	7.7	7.7	7.7
CPI inflation (average)	-1.6	1.6	2.9	1.5	1.9	2.0	2.0	2.0	2.0	2.0
Private credit growth	-2.6	1.5	6.4	3.4	4.5	5.0	6.1	6.1	6.1	6.1
					(In percent of GDP)					
Fiscal Accounts										
Overall balance	-10.0	-6.4	-4.0	-2.9	-4.0	-3.0	-2.0	-1.5	-1.5	-1.5
Structural primary balance	-4.1	-3.2	-2.1	-0.4	-0.5	-0.1	0.6	0.9	0.8	0.6
Public debt (gross) 1/	62.0	55.6	53.7	52.2	54.1	55.1	54.3	53.0	51.9	50.8
Public debt (net) 2/	40.8	38.1	39.9	39.4	41.6	42.6	42.1	41.2	40.3	39.5
External Sector										
Current account balance	-0.3	-3.0	-3.9	-12.8	10.0	7.6	2.2	2.0	2.0	1.9
Foreign direct investment	-0.1	-2.4	-3.5	-3.7	-1.9	-1.9	-1.9	-1.9	-1.8	-1.8

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.

21. Over the medium term, staff expects GDP to grow by around 4 percent, subject to considerable uncertainty. Growth is projected to remain below the 6 percent prevailing in the two decades preceding the pandemic. Construction and investment are unlikely to provide the same support as they did before the pandemic, when construction activity increased by 250 percent between 2009 and 2019. In addition, the scope for a significant increase in the employment-to-population ratio (which was an important driver of rapid growth during the boom years) is limited.

22. The direct impact of the closing of the mine on medium-term growth should be limited, but there could be indirect effects. The production of the mine was projected to remain constant in the next decade, which implied that the mine was not projected to contribute to *growth*. However, to the extent that the closing of the mine could increase fiscal risks, deter future FDI, reduce investment, or affect the business climate, it could reduce medium-term growth.

Authorities' Views

23. The authorities broadly concurred with staff on the outlook and risks. They also projected the economy to grow by 2.5 percent in 2024 and saw the slowdown from 2023 as the result of the closing of the mine rather than a broad-based phenomenon. They were more optimistic than staff about the medium-term and expect growth of 5 percent. They noted that several important multi-year investment projects—including the construction of a fourth bridge over the Canal and a Canal tunnel—would boost activity. The ACP is also planning major investments to improve water management and prevent transit restrictions during future droughts.

Main Investment Projects with Disbursements in 2024

(In millions of US Dollars)

Project Description [1/]	Type	Status	Total Investment	Total Public Investment	Public Disbursement				
					2023	2024	2025	2026	2027
1 Metro line 3	Transportation	In progress	2,841	2,841	199	285	457		
2 Fourth Bridge	Transportation	In progress	2,139	2,139				300	300
3 Metro line 2	Transportation	Completed	2,063	2,063	177	172	177		
4 Gatún Power Plant	Power and water	Feasibility studies	1,185	51	42	4	5		
5 IDAAN Projects (Water Treatment Plants)	Power and water	Redesign; financial feasibility studies	877	877	5	20	47		
6 4th Electric Transmission Line	Power and water	Feasibility studies	696	696					
7 Hospital construction (Ciudad Hospitalaria)	Health	In progress	608	608	128	148	152		
8 Support program for MSMEs	MSMEs	In progress	460	460	50	60	50		
9 Eastern Pan-American Highway (Panamericana Este)	Transportation	Feasibility studies	425	1361				72	95
10 Extension of the Bridge of the Americas until Arraiján	Transportation	In progress	384	384	58	58	58		
Other infra-structure projects w/ disbursements			3,385	3,839	660	716	367	70	34
Total			15,063	15,319	1,319	1,463	1,313	442	429

Sources: National authorities, and IMF staff calculations.

1/ This table shows the largest investment projects with public disbursements in 2024. Most projects are financed through both national and international banks, with some exceptions. Projects 7 and 10 are financed through national banks; Project 4 is financed through partnerships of capital contribution; Project 8 through the IDB; and Project 9 through the financial sector.

POLICIES

In 2024, the government aims to further reduce the fiscal deficit to 2.0 percent of GDP. Given over-optimistic revenue projections, staff estimates that public investment would need to be compressed to about 2 percent of GDP, from 4.8 percent of GDP in 2023, to meet the deficit target. A more moderate reduction in public investment would be preferable to avoid exacerbating the economic shock of closing the mine. To anchor market expectations, the next government should adopt a credible multi-year fiscal consolidation plan to reduce the deficit to 1.5 percent of GDP by 2027. To maintain room for investment, increased revenue mobilization is needed. To underpin Panama's role as a regional financial center, it is essential that banks remain well capitalized and liquid. Being a dollarized economy adds to the importance of Panama maintaining fiscal sustainability and financial stability. Strengthening human capital and governance will help sustain convergence. Implementing the national statistical plan will improve the quality and timeliness of key macroeconomic data.

A. Strengthening Fiscal Sustainability

24. In 2024, the government aims to further reduce the fiscal deficit to 2.0 percent of GDP. Including the loss of the one-time 2023 revenues from Minera and the land sale to ACP of 1.3 percent of GDP, this would require an adjustment of 2.3 percent of GDP. However, the 2024 budget does not include measures to reduce the spending-to-GDP ratio. It authorizes an increase in spending of 3.2 percentage points of GDP compared to 2023, with the bulk of the increase going to higher investment, interest payments, and a mandated increase in education spending.[18]

25. To meet the deficit target, the government aims to keep spending 3.6 percentage points of GDP below the approved budget—mostly by under-executing public investment. However, this compression may not be enough. The budget assumes that the ratio of central government revenue to GDP will increase, even though the payments by Minera and the sale of land to the ACP will not be repeated in 2024. To meet the target, the government aims to under-execute public investment.

26. Staff estimates that public investment would need to be compressed to about 2 percent of GDP, from 4.8 percent of GDP in 2023 and 6.6 percent of GDP in the 2024 budget. Such a large compression may prove infeasible. It would also require an abrupt adjustment to the fiscal revenue loss from the closing of the mine. From a cyclical perspective, with a sharp slowdown in growth and a widening of the output gap, this is unduly pro-cyclical. Moreover, curtailing public investment would not provide a sustainable solution to preserve fiscal sustainability.

27. A more moderate reduction in public investment to 4 percent of GDP would be preferable, even if this would lead to a higher deficit in 2024 on a transitory basis. Staff assesses that a fiscal deficit of 4 percent of GDP would be adequate from a cyclical perspective, allowing a more gradual adjustment to the permanent loss of fiscal revenue from Minera.

28. The SFRL goal of reducing the fiscal deficit over time to 1.5 percent of GDP remains appropriate. Panama's overall risk of sovereign stress is assessed as moderate and public debt considered sustainable subject to significant downside risks (Annex IV). If the deficit stays around 4 percent of GDP in coming years, there would be no further decline in the debt ratio, leaving public finances vulnerable to renewed shocks. Without a credible plan to firmly reduce the deficit, the risk of sovereign downgrades is high, which would increase financing costs and further exacerbate possible adverse debt dynamics. Panama has traditionally obtained a significant part of its financing through external commercial borrowing. Debt dynamics will be further affected when the social security pension fund reserves run out, and its deficit will need to be financed by debt issuance.[19]

29. To ensure that public debt is on a firm downward trend, the public finances plan for 2025-29 should contain a credible multi-year fiscal consolidation plan. The plan to be developed in the fall should aim to reduce the deficit to the SFRL target of 1.5 percent of GDP by 2027. It should be anchored by explicit multi-annual revenue forecasts and expenditure limits consistent with the deficit target and include identified measures to ensure that the revenue

---

[18] Panama's education law mandates that the government allocates 7 percent of last year's GDP to education, a target the government envisages to reach in 2024. In 2023, education spending increased to 5.8 percent of the 2022 GDP from 5.4 percent of the 2021 GDP.

[19] There are two pension systems within the social security system: (i) a defined benefit plan, closed for new participants in 2008; and (ii) a newer, mixed system (largely defined contributions). The defined benefit plan is running deficits since 2018, which are financed through the pension fund's reserves and a government escrow fund established in 2004. However, reserves are expected to run out in late 2025.

forecasts and expenditure limits will be met. In addition, the timely parliamentary approval of the General Budgetary Administration Law (originally expected in the first half of 2023) would further strengthen the fiscal framework[20] and improve governance, while implementing recommendations from the recent Fiscal Transparency Evaluation would improve fiscal transparency and strengthen the credibility of the authorities' multi-year fiscal consolidation plan.[21] During this adjustment process, targeted social support to protect the most vulnerable should be prioritized.

30. Boosting revenues would reduce the need to cut capital expenditure. Panama's central government tax-to-GDP ratio is low at only 7.7 percent in 2023. Tax revenues are low due to low tax rates (such as Panama's ITBMS (VAT)), numerous exemptions, high tax expenditures, and weak tax collection efficiency. Low tax revenues are partly compensated by non-tax revenues (mainly contributions from the ACP), but total general government revenue is low as well (Annex VI).

31. Improving tax and customs collection efficiency will help. The Internal Revenue Directorate (DGI) and Customs Administration (ANA) undertook modernization reforms, including the improvement of data gathering processes for personal income tax collection; the adoption of the electronic invoice; the creation of a data analysis unit to improve cross-checking of data and detect tax non-compliance; the launch of a new Large Taxpayers Unit (LTU); and new, state-of-the-art, scanners at customs checkpoints. To continue the modernization, a comprehensive risk management framework should be adopted. It is also necessary to increase the autonomy and resources of ANA, including to overcome limitations in managing its own budget and HR policy. Experiences in other countries suggest that improvements in the overall strength of a country's tax administration, particularly by introducing LTUs, could potentially raise tax revenues after several years by up to 1.8 percentage points of GDP.[22]

32. There is also scope for broadening the tax base. Broadening the tax base could be achieved by reducing inefficient exemptions, deductions, and other tax expenditures. Many of these exemptions are regressive—they mainly benefit higher income levels. More specifically, staff suggests that the government rationalizes tax exemptions by (i) streamlining ITBMS tax

[20] TA in the area of public financial management focuses on multi-annual budget preparation and management of fiscal risks. Work priorities for 2024 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.

[21] The IMF's Fiscal Affairs Department finalized a Fiscal Transparency Evaluation in November 2023. Recommendations focused on three areas: i) improving fiscal reporting by publishing existing internal and discontinued fiscal reports, widening their scope to include *fideicomisos*, conducting external financial audits on central government Consolidated Statements and publishing the statements and audit findings; ii) strengthening macro-fiscal forecasting and budgeting by publishing a yearly fiscal strategy report with forecasts, narrative and analytical discussion on the government's key medium-term priorities and enacting the General Budget Administration Law to legislate the requirement for a medium-term budget framework; iii) establishing fiscal risk management practices by including a chapter on fiscal risks in each fiscal strategy report that discusses macroeconomic fiscal risks and specific fiscal risks.

[22] Adan, H., Atsebi, J., Gueorguiev, N., Honda, J., Nose, M. (2023). Quantifying the Revenue Yields from Tax Administration Reforms. IMF Working Paper, WP/23/231. International Monetary Fund, Washington, DC. https://www.imf.org/-/media/Files/Publications/WP/2023/English/wpiea2023231-print-pdf.ashx

exemptions[23] and the process for refunds; (ii) reviewing exemptions and deductions from the Personal Income Tax (PIT) base and (iii) reviewing tax incentives for the corporate income tax (CIT).[24] Such measures may yield an increase in tax revenues of about 2 percent of GDP. However, a comprehensive, annual tax expenditure review should be conducted to thoroughly assess the costs and benefits of these exemptions (SIP 2022 "Toward a Modern Tax System"). Legal provisions to reduce tax expenditures (such as sunset clauses, and ex-ante and ex-post evaluations) should also be considered.

33. Tax rates may need to increase as well. The government could consider increasing the ITBMS rate. Additionally, adjusting cigarette and fuel excises to account for the externalities they generate is also a viable option. Adopting a minimum CIT for companies that pay taxes in the countries where they are headquartered (in response to the introduction of an international minimum tax) could additionally enhance revenue generation.

Non-Financial Public Sector Budget and Staff Fiscal Projections

	NFPS budget (In millions of US dollars)				NFPS budget (In percent of GDP)			Staff Projections 2/ (In percent of GDP)		
	2022	2023	2024	2024 %y/y	2022	2023 1/	2024 1/	2022	2023	2024
Revenues	**15,322**	**16,638**	**17,625**	**5.9**	**20.0**	**20.0**	**20.2**	**17.4**	**18.2**	**17.8**
Current revenue	14,725	16,346	17,329	6.0	19.2	19.6	19.8	17.4	18.2	17.7
Central government	9,686	10,638	11,835	11.3	12.7	12.8	13.5	12.1	12.8	12.4
Tax revenue	5,893	6,538	7,282	11.4	7.7	7.8	8.3	7.7	7.7	7.9
Non-tax revenue	3,656	4,178	4,390	5.1	4.8	5.0	5.0	4.3	5.0	4.3
o/w: Panama Canal	2,495	2,030	2,082	2.6	3.3	2.4	2.4	3.3	3.0	3.0
Other current revenue	5,039	5,708	5,494	-3.7	6.6	6.8	6.3	5.4	5.5	5.4
Other revenue	607	292	296	1.4	0.8	0.4	0.3	0.0	0.0	0.1
Expenditures	**18,311**	**19,811**	**22,457**	**13.4**	**23.9**	**23.8**	**25.7**	**21.4**	**21.1**	**21.7**
Current primary expenditures	12,032	12,752	13,383	4.9	15.7	15.3	15.3	14.2	13.7	14.5
Interests	2,057	2,220	2,774	25.0	2.7	2.7	3.2	1.7	2.6	3.2
Capital expenditures	4,222	4,839	6,300	30.2	5.5	5.8	7.2	5.4	4.8	4.0
Unadjusted primary balance	-922	-954	-2,057	115.6	-1.2	-1.1	-2.4	-2.3	-0.4	-0.8
Unadjusted overall balance	-2,979	-3,174	-4,832	52.2	-3.9	-3.8	-5.5	-4.0	-3.0	-4.0
Budgeted adjustment	484	981	3,121	218.1	0.6	1.2	3.6			
Adjusted budgeted balance	**-2,494**	**-2,193**	**-1,711**	**-22.0**	**-3.3**	**-2.6**	**-2.0**			

Sources: IMF staff calculations.

1/ Using actual 2023 GDP data as GDP data in the budget was prior to the last rebasing of national accounts. For 2024, staff's projected 2024 GDP data is used.

2/ Staff projections show historical data for 2022, an estimate for 2023, and projections for 2024.

[23] The revenue loss from ITBMS exemptions is estimated at 1.29 percent of GDP (SIP 2022 "Toward a Modern Tax System").

[24] In 2019, CIT tax expenditures accounted for 0.83 percent of GDP and 68.2 percent of CIT revenue (SIP 2022 "Toward a Modern Tax System").

34. Action must also be taken to address the deficit in the defined benefit component of the social security system (CSS). The CSS will run out of resources in late 2025 and faces deficits in the order of magnitude of 1.5-3.0 percent of GDP annually during the coming years. A combination of parametric and non-parametric reforms (including finding new funding sources) is needed.

Authorities' Views

35. The authorities contended that the anticipated underspending was consistent with patterns observed in previous election years. They elaborated that election years invariably witnessed substantial budget underspending, primarily because expenditure typically decreased in the latter half of the year, as it took time for a newly elected government, assuming office on July 1, to finalize its plans and fill senior level positions in the administration. They expected a similarly large underexecution of the budget this year, particularly of investment.

36. The authorities concurred on the necessity to increase revenue. They were committed to enhancing tax compliance and revenue collection and acknowledged the importance of reevaluating tax exemptions. They emphasized recent significant initiatives to bolster tax revenue, such as introducing electronic invoicing, refining data collection methods for PIT, establishing a data analysis division to enhance data verification and identify instances of tax evasion, and the launch of a new LTU. These measures have yielded some encouraging initial results, but their full impact on revenues is yet to be seen.

37. The authorities recognized the financial risks stemming from the arbitration over the copper mine. One idea under consideration is to announce that, should Panama lose in the arbitration, a dedicated tax would be implemented to cover the resulting liabilities.

B. Strengthening Financial Integrity

38. When the FATF removed Panama from the grey list in October, it encouraged the authorities to further strengthen the AML/CFT regime. Recommendations made during the on-site visit include (i) enhancing the searchability of the Ultimate Beneficiary Owner (UBO) registry to allow searches based on the name of the legal person or natural person, as well as on the name of the beneficial owner(s); and (ii) increasing the use of financial intelligence products (intelligence and strategic reports) by competent authorities.

39. In line with FSAP recommendations, sectoral risk assessments of Fintech institutions and virtual asset service providers (VASPs) should aim to identify and assess potential threats and risks from these sectors.[25] In May 2023, there were 20 Fintech companies authorized by the Ministry of Industry and Commerce and operating within the financial sector providing payments, investments, and credit services. However, not all Fintech companies that fall within the "financial institutions" definition of the FATF standard were subject to the full range of AML/CFT obligations as established by Law 23 of 2015. The sectoral risk assessments' results should give the authorities

[25] Panama underwent an FSAP during 2022-23. The findings and recommendations are summarized in Annex V.

the basis for defining what types of financial technology products or services should be subject to AML/CFT obligations. Also, the required regulatory framework for licensing VASPs together with a mechanism to continuously identify, measure, control, and monitor risks related to money laundering and the finance of terrorism need to be developed.

Authorities' Views

40. The authorities agreed that Fintech institutions and VASPs should be subject to adequate regulation and supervision. This should aim to ensure the effective implementation of the obligations imposed under Law 23 of 2015 (AML/CFT Law). In addition, they noted that amendments to the AML/CFT Law were needed to define the types of Fintech companies that should be subject to AML/CFT obligations and the competent supervisory authority with responsibility over these institutions.

C. Strengthening Financial Sector Resilience

41. The absence of a lender of last resort and deposit insurance necessitates well capitalized and liquid banks. Panama's large banking system (see "Banking Sector" chart) contributes around 6.5 percent to GDP each year.[26] To contain financial stability risks, Panama has relied on banks' self-insurance through capital and liquidity buffers as well as funding from foreign sources. Aggregate capital and liquidity buffers in Panama's banking sector are well above regulatory minima and all banks meet the regulatory requirements, although significant differences exist within the system. Among subgroups, international license banks[27] have higher than average capital ratios whereas foreign-owned private banks are the least well capitalized.

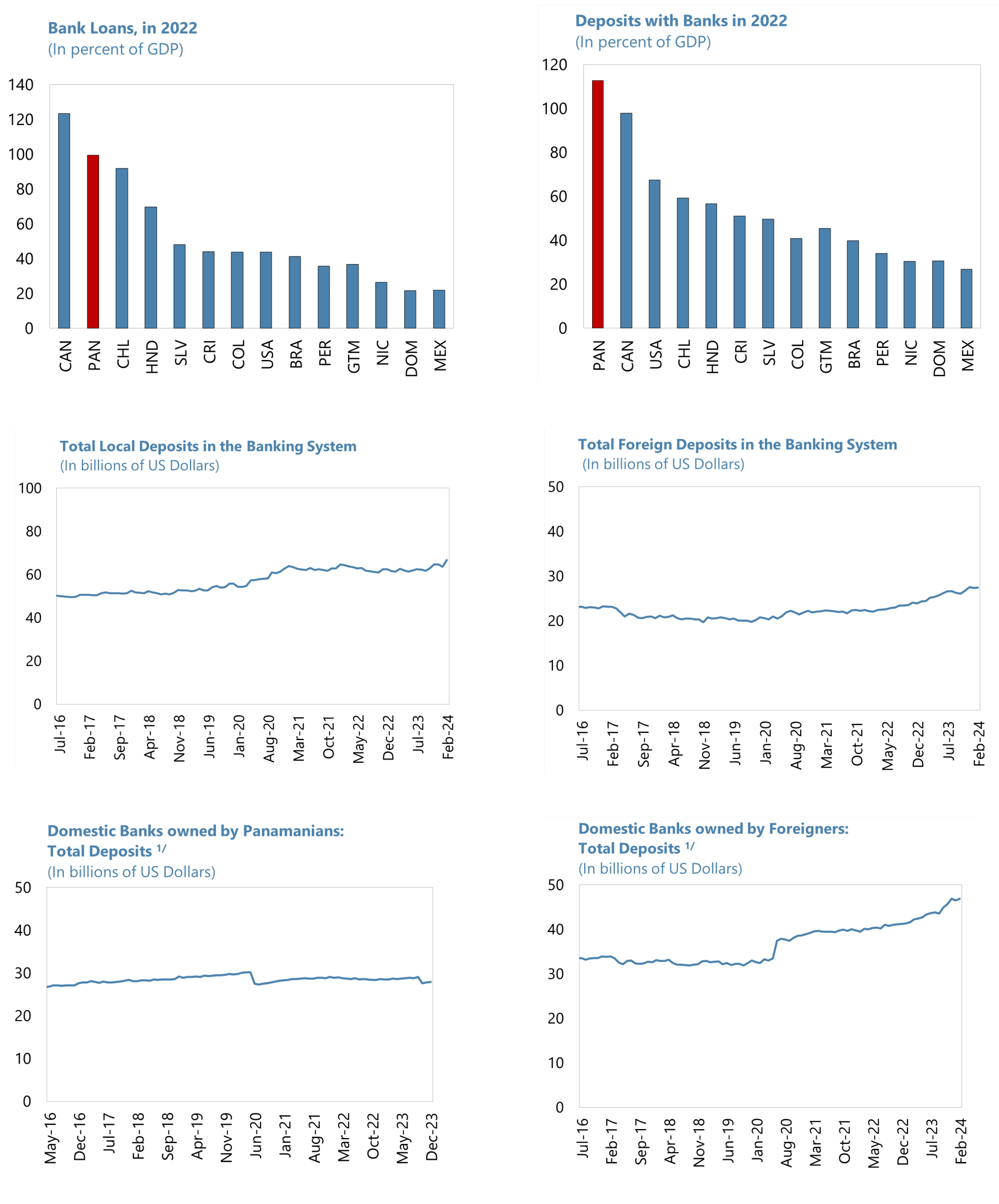
Distribution of Banks According to Capital Adequacy [1/]

Capital Adequacy Ratio	Actual *(as of end-2023)*	Stressed Scenario *(after 6 months)*
Below 8%	0	0
Above 8% - 10%	0	6
Above 10% - 12%	5	11
Above 12%	27	15

Source: SBP.
1/ Based on the 32 largest banks in the system.

[26] Total assets amount to 177 percent of GDP.
[27] International license banks cannot grant credit to, nor take deposits from, persons or entities in Panama.

Banking Sector

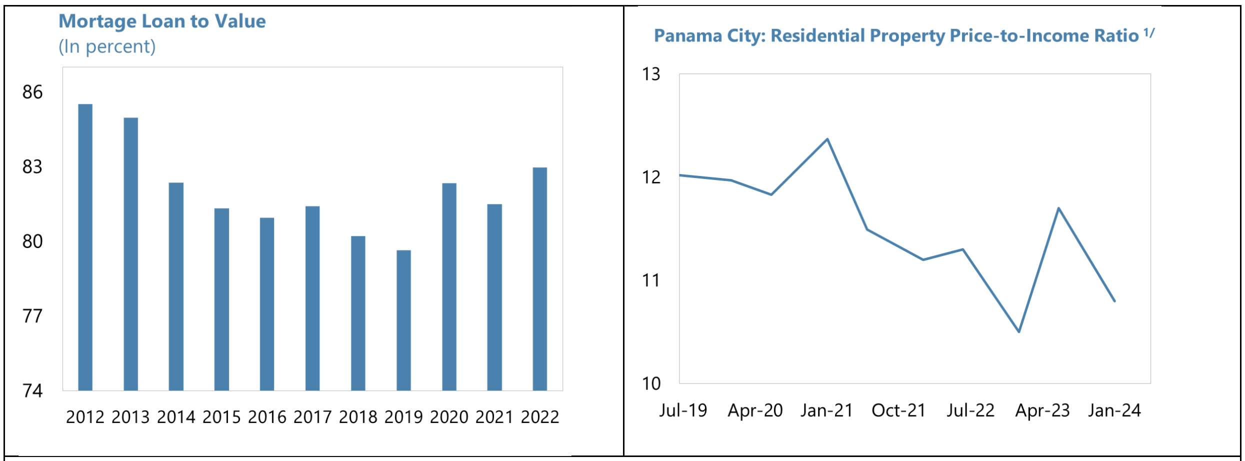


Sources: IMF Financial Access Survey, SBP and IMF staff calculations.
1/ Multibank was reclassified as a foreign-owned general license bank in June 2020 after its acquisition by a foreign bank.

42. **Stress tests conducted by the SBP and IMF staff show that the banking system would be broadly resilient in an adverse scenario.** The latest published SBP stress tests, based on end-June 2023 data, show that an adverse but plausible macroeconomic scenario would lead to a drop

in the CAR from 15.3 to 15.0 percent over 12 months.[28] Comprehensive stress tests were also conducted by IMF staff during the 2022-23 FSAP. The SBP and IMF tests both found the banking system to be broadly resilient against a severe macrofinancial downturn scenario, although some individual banks may be vulnerable.

43. Banks' exposure to the real estate sector is high but declining.[29] The share of mortgage and construction loans in banks' portfolios increased sharply in the last two decades, as bank lending helped fund the construction boom. However, the share has started to come down recently and stood at 42.0 percent of total loans at end-February 2024. While the mortgage loan portfolio has continued to grow steadily, loans to the construction sector have declined by about a quarter since end-2018, as construction activity has decreased. 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, although stress tests show that the impact would be modest in a plausible scenario. While house prices have risen substantially, this happened in a context of rapidly rising incomes and nominal GDP, which mitigates the risks. Recent loans would be most at risk, given a high average Loan-to-Value (LTV) ratio (over 80 percent) at origination.



Sources: Superintendencia de Bancos de Panamá (SBP) and Numbeo.
1/ The methodology is described in: https://www.numbeo.com/property-investment/indicators_explained.jsp.

44. The SBP continues to step up its prudential supervision and implement its regulatory agenda. SBP supervision is risk-based and focuses on assessing a bank and wider banking group's risk profile and the quality of governance and risk management to manage those risks. These categories also include risks related to technologies and climate change (Annex V). The SBP is also developing its macroprudential analysis and policies. It coordinates on macroprudential issues with the other financial sector regulators through the Financial Coordination Council (CCF). It has adopted a resolution to gradually introduce the Capital Conservation Buffer (CCB) during 2024-26.

[28] See the SBP's Financial Stability Report for the first half of 2023. The test covers the national banking system, i.e., excluding international license banks.

[29] Banks' exposures to the public sector are low. Panamanian Government bonds account for 2.4 percent of assets, and lending to the public sector accounts for 3.4 percent of the loan portfolio. These exposures are disproportionately situated in the State-owned banks.

45. While the financial system is broadly resilient, close monitoring and further reforms would further strengthen financial stability. In the context of less favorable economic developments and rising financing costs, banks should continue to maintain strong liquidity and capital buffers. Supervisors should continue to monitor developments closely, in particular at institutions identified as more vulnerable, and use the CCF to exchange information, jointly assess risks, and coordinate actions.[30]

46. Recommended reforms of the banking sector include:

- ***Mitigation of asset quality and liquidity risks:***
  - Develop the remaining components of a solvency bank stress test model suite to cover all relevant drivers. Once further developed, use the integrated stress test model suite to help inform the timing and calibration of macroprudential policy tools.
  - Develop a liquidity stress simulation model for banks to assess whether banks have sufficient funding sources to withstand unexpected market disruptions, particularly systemically important ones.
  - Enhance data collection, notably for house price and commercial property statistics.
  - Establish additional borrower-based macroprudential policy tools, such as caps on mortgage LTVs or on debt-to-income or debt-service-to-income ratios to limit the buildup of vulnerabilities in the household segment. Completing the ongoing initiatives to enhance data collection would enable the implementation of these borrower-based indicators.
- ***Resilience.*** Introduce capital surcharges for domestic systemically important banks (D-SIBs), as part of the new Basel III capital standards aligned capital buffer framework for internationally active banks.
- ***Crisis preparedness.*** Establish prudential requirements for all banks to develop recovery plans, with tailored requirements for international license banks, and develop resolution plans for systemic banks. Combined with further improvements of the resolution framework, this would help contain the costs of a potential crisis and create the preconditions to establish, in the medium term, a financial safety net comprising an industry-funded deposit insurance scheme and a Lender-of-Last-Resort (LOLR) facility.[31] Until these reforms have been implemented, the emergency liquidity window of the Fund for Economic Stimulus (FES) should be kept in place.[32]

---

[30] Non-bank financial institutions are numerous and diverse, but account for only 12 percent of the financial system's assets.

[31] Most dollarized economies have a deposit insurance system. Some also have a liquidity fund and/or a central bank that can provide limited LOLR support. For further information, see the accompanying selected issues paper "Financial Safety Nets in Dollarized Economies".

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

- ***Macroprudential oversight.*** Develop the CCF member agencies' capabilities for macroprudential analysis and policies. Ensure regular and timely discussions on macroprudential policy issues, including through quarterly meetings of the SBP and CCF macroprudential policy committees.

- ***Institutional framework.*** Facilitate the expeditious adoption of a law on payment systems and services that designates the SBP as the regulator of the national payment system. Separate BNP's clearing and settlement operations from its commercial banking business. Amend the Banking Law to make explicit that the SBP's primary objective should be to promote the safety and soundness of the banking system.

Authorities' Views

47. The authorities agreed that the banking system was broadly resilient. They noted that the banking system had performed strongly in 2023 and was seeing positive effects from the exit from the FATF grey list. This year would be more challenging due to rising interest rates, the risk of loss of investment grade, the political situation, and external factors. They assessed that the direct impact of the Minera closure on the banking system would be limited, although the indirect effects could be more significant.

48. They highlighted ongoing efforts to implement FSAP recommendations. Notably, the authorities are moving toward a Basel III-based capital structure, improving resolution arrangements, and further developing systemic risk analysis (including at the level of the CCF). They noted that the absence of a financial safety net has encouraged banks to be prudent and pursue self-sufficiency.

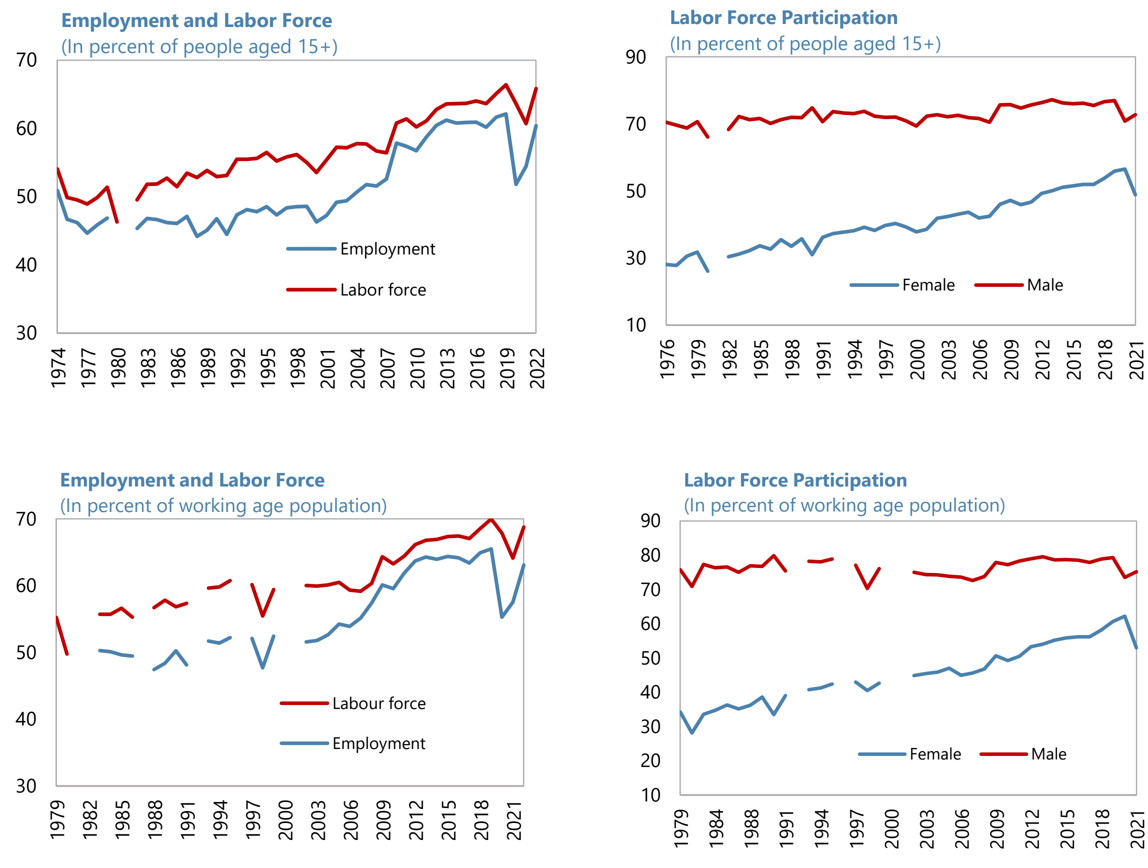
D. Sustaining Convergence

49. In the 25 years preceding the pandemic, about three quarters of the reduction in Panama's income differential with the US was the result of an increase in the employment rate, rather than faster labor productivity growth. The increase in the employment to population rate was the result of a demographic transition (the share of the population that was of working age rose), an increase in female labor force participation, and a drop in unemployment.

50. Going forward, the increase in the employment to population ratio is likely to be slower. The demographic transition has largely run its course, and labor force participation in Panama already exceeds the average in the region and in high-income countries. For income convergence to continue, labor productivity growth will need to accelerate.[33]

[33] See Selected Issues Paper "Unraveling Panama's Large Unemployment Fluctuations" for more details.

Labor Force Participation

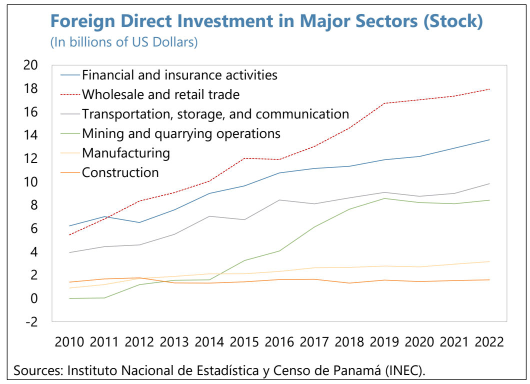


Sources: Internatuional Labor Organization (ILO) and World Bank.

51. **Further steps to incentivize formal employment and further boost labor force participation by women and indigenous groups would support growth.** Informality rates increased substantially during the pandemic and remained elevated at 47 percent in August 2023. Informal workers tend to have more volatile income and are less cushioned against shocks as they typically are not eligible for social insurance.[34] Informality tends to be higher in more rural provinces in Panama with a larger share of indigenous people employed informally. Reforms to help females and indigenous people enter (or re-enter) the formal labor force could include supporting childcare, improving infrastructure for commuting, providing training to help integration in the workforce, and formalizing entrepreneurial activities.

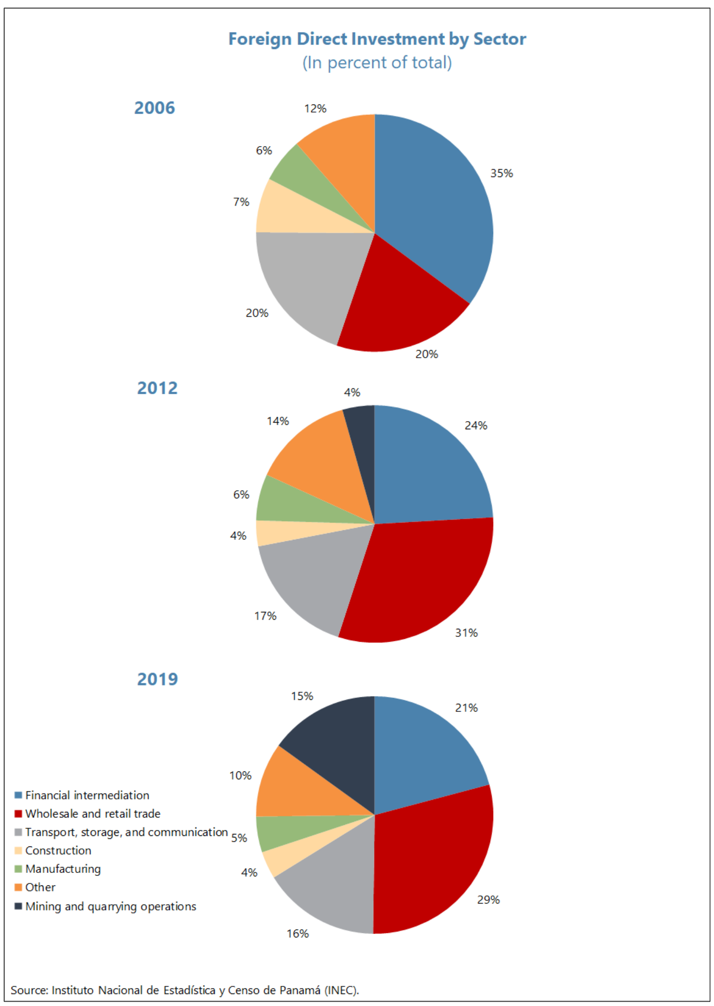
[34] See Background paper 1 of the October 2023 *Regional Economic Outlook: Western Hemisphere*, "Income Volatility and Social Insurance in Latin America".

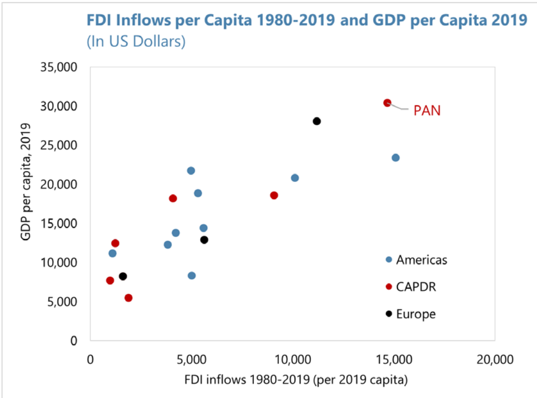
FDI



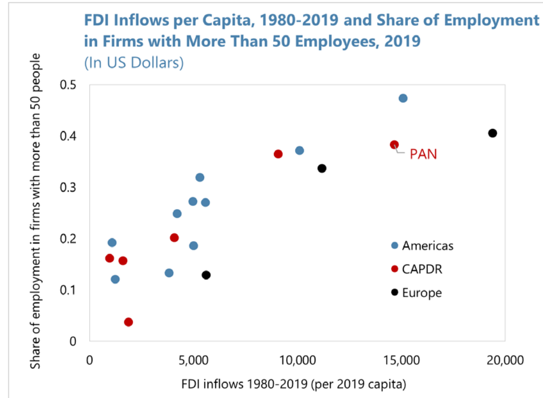
52. Continued attraction of FDI is key to labor productivity growth. In the past, Panama has received much larger FDI inflows than other CAPDR countries, primarily into the commerce, mining, financial, and logistics sectors. Larger FDI inflows have been associated with higher labor productivity, in part because countries with higher FDI inflows tend to have larger firms (see chart).

53. Attracting FDI will also help with economic diversification. The construction sector in Panama increased by 250 percent between 2009 and 2019, and at the peak of the construction boom in 2013 contributed 3.0 percentage points to annual growth. After the conclusion of major development projects, it is expected that construction levels will stabilize and their contribution to GDP growth will decrease over time. Other factors will need to take over to sustain rapid growth. Important growth opportunities lie in the logistics, transportation, and tourism sectors as well in export sectors.





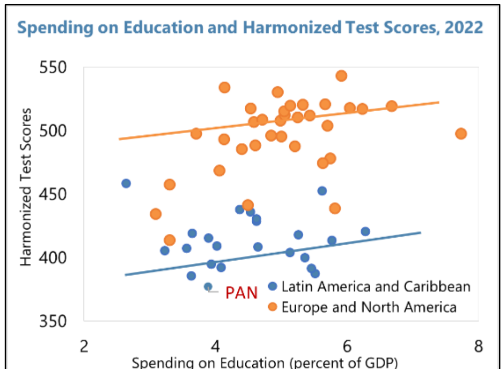
Sources: Penn World Tables and World Bank.



Human Capital and Governance

54. Improving human capital and governance will be key to increasing productivity. Countries tend to converge to levels consistent with their human capital and governance indicators (Bakker et al., 2020). Countries with high human capital and governance tend to be rich, and countries with low indicators in these areas stay poor (see charts). For its per capita income level, Panama scores poorly on governance and human capital indicators.[35]

55. Better education would boost human capital. Both harmonized test scores and education spending per student are low in Panama compared to other countries in the region. While the government plans to increase education spending to 7 percent of 2023 GDP in 2024, the key issue seems related not only to the amount of education spending but also to how efficiently it is spent (see charts). Panama already spends more on education than many countries with higher test scores and the link between spending on education and test scores is very weak.



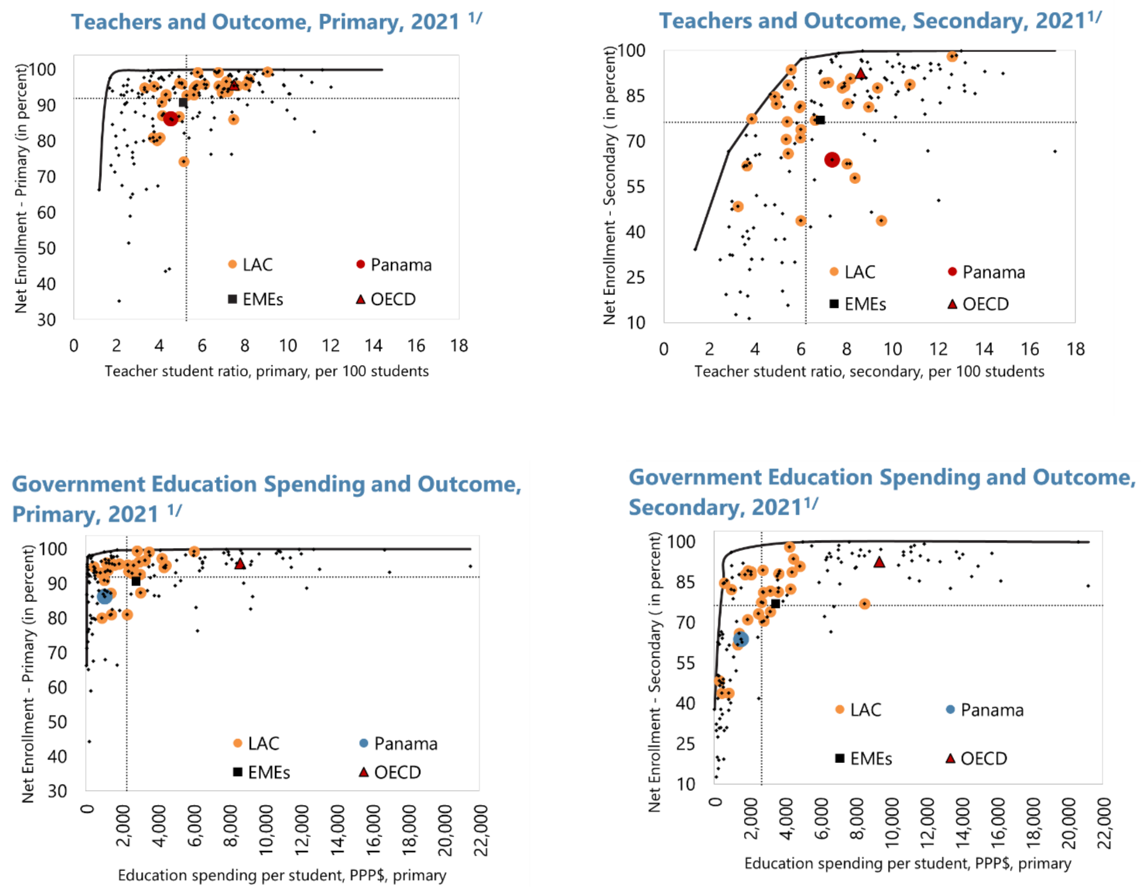
Sources: World Bank, and UNESCO.

56. Panama's educational institutions have limited autonomy to tailor academic curricula and meet hiring needs when compared to advanced economies. According to the OECD, in 2022, 26 percent of students in Panama attended schools with reported lack of teaching staff and 12 percent were in schools with inadequate or poorly qualified teaching staff. The reported lack of teaching staff seems to be in part related to resource management as Panama has equal or higher teacher-student ratios than many countries with higher test scores (see charts). Importantly, while many high-performing school systems tend to entrust schools with the responsibilities of hiring teachers and tailoring academic curricula, Panama's system does not. In 2022, only 16 percent of students attended a school where principals had the main responsibility for hiring teachers (while

[35] This reflects low scores on standardized tests.

the OECD average is 60 percent), and 58 percent were enrolled in a school where teachers had the main responsibility for choosing which learning materials are used (while the OECD average is 76 percent).[36]

Efficiency of Government Education Expenditure



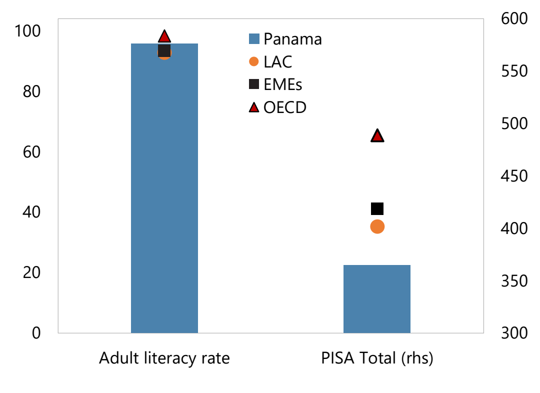
Sources: IMF FAD Expenditure Assesment Tool (EAT), and World Bank Penn World Tables 10.

1/ Dash lines are the averages of LAC.

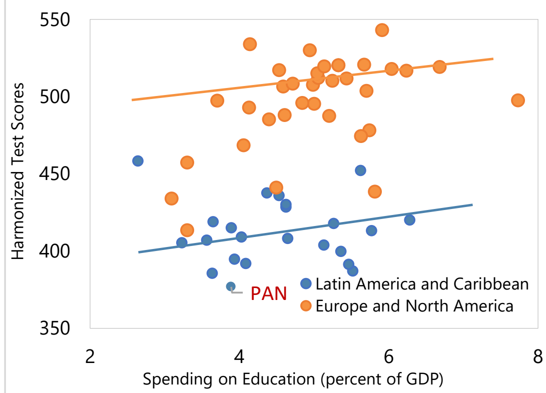
[36] More details about Panama's PISA results can be found here.

Education Indicators and Education Spending

Education Indicators, 2021



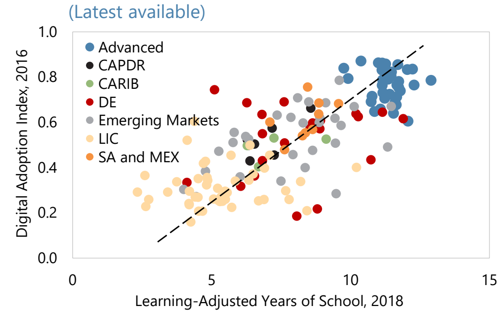
Spending on Education and Harmonized Test Scores, 2022



Sources: World Bank, UNESCO, and IMF FAD Expenditure Assessment Tool (EAT).

57. Aligning academic curricula with labor market needs and introducing a knowledge exchange with industry leaders would help prepare students for the new reality of the labor market. This includes embracing new technologies (see chart) and attaining high-skill jobs. Vocational and on-the job training (such as *Aprender Haciendo* for youth) would help move labor into productive sectors. Furthermore, prioritizing the recovery of human capital lost amid the pandemic is essential.

Digital Adoption Index versus Schooling
(Latest available)



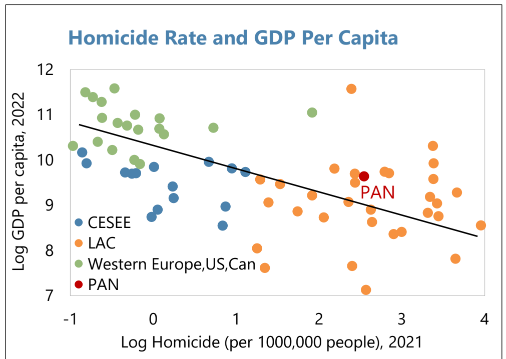
Sources: World Bank, Digital Adoption Index Database, Human Capital Project Database, and IMF staff calculations.

58. Governance can be improved in several areas. Panama scores poorly in terms of corruption perception, while low judicial independence and weak insolvency frameworks and property rights dampen the business climate. The authorities need to strengthen anti-corruption mechanisms such as the asset declaration regime (access and verification),[37] enhance contract enforcement (by addressing risks of judicial corruption), enhance judicial independence (e.g., judicial selection and discipline), enhance public communication and outreach (including through reliable data provision and timely information sharing) as well as mechanisms for public consultation, enhance protection of property rights (especially land rights), and improve the efficiency of the bureaucracy, including by enhancing the degree of digitalization of government services.

[37] Senior officials in Panama are required to file an asset declaration at the beginning and end of their term. See: https://www.unodc.org/documents/corruption/WG-Prevention/Art_8_Financial_disclosure_declaration_of_assets/Panama.pdf

Other Reforms

59. Improving domestic security would also help strengthening growth. Homicide rates in Panama are high compared to high-income countries and in the mid-range compared to other countries in the Latin America and Caribbean (LAC) region. Research shows that crime and insecurity entail not only social costs but also significant negative effects on productivity, capital accumulation, and economic growth.[38]



Source: World Bank.

60. Building resilience to climate change would help reduce economic volatility and boost growth over the medium and long term. Panama is vulnerable to climate change and related natural disasters—such as the rise of the sea level or exposure to prolonged droughts—that can have substantial social and economic costs.[39] Investments in resilient infrastructure, for example to enhance the efficiency of water resources management, would help build Panama's adaptive capacity in tourism, agriculture, transport, and logistics sectors.

61. Other reforms are also important for boosting inclusive growth. These include updating labor laws (overly stringent firing practices and restrictions on foreign workers coupled with a lack of skilled local labor), removing remaining barriers to the economic empowerment of women,[40] 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). Continuing to improve social protection, while being mindful of fiscal implications, could help strengthen social cohesion and address territorial disparities.[41]

Authorities' Views

62. The authorities agree with the need to boost human capital and productivity. They noted that the increase in education spending from about 5.8 to 7 percent of GDP aims at boosting academic outcomes. The authorities plan to prioritize teachers' training programs, improve digital skills to meet current labor market demands, invest in educational infrastructure, and continue addressing regional disparities in the quality of schools. They agree with the assessment that FDI

[38] See Annex 4 of the October 2023 *Regional Economic Outlook: Western Hemisphere*, "Crime and its Macroeconomic Consequences in Latin America and the Caribbean".

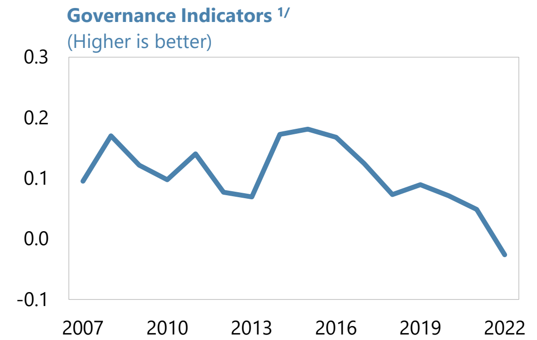
[39] According to the Ministry of Environment, Panama is expected to lose 2 percent of its territory due to sea level rise by 2050, which will likely disrupt businesses and force a relocation of thousands in the affected territories.

[40] In the World Bank's Women, Business and the Law (WBL) 2.0 framework, Panama scores better than the global and regional averages on legal frameworks but worse on supportive frameworks.

[41] Social assistance programs have helped alleviate poverty, especially during the pandemic, yet challenges persist in mitigating disparities, especially in rural and indigenous areas. See Annex VII for more details.

will continue to play an important role in boosting productivity and sustaining convergence going forward and remain optimistic about future inflows.

63. The authorities emphasized their commitment to enhancing governance and improving the country's reputation. They noted their efforts had led to Panama being removed from the Financial Action Task Force (FATF) grey list and the EU's list of high-risk third countries. They had intensified actions against tax evasion and smuggling. For instance, the National Customs Authority (ANA) had updated its regulatory and sanctioning framework, upgraded its IT systems, and adopted an integrated risk management approach to curb non-compliance effectively. To further reduce tax evasion, the authorities had made e-invoices compulsory for companies. To improve fiscal transparency, they had developed [Panama Transparente](), a website where the public could see a map of all public investment taking place, with details of the individual projects. The civil society can comment on the projects on this site. An organic budget law, which would further increase transparency, including by publication of all acts related to the budget, had not yet been approved by parliament.



Source: The Worldwide Governance Indicators, 2023 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.

E. Improving Statistics

64. The authorities have advanced key statistical projects that support surveillance, helped by Fund TA. The 2023 population census has been finished and stands to benefit the design and targeting of social programs and poverty measurement. The rebasing of GDP to base year 2018 is partially finished and rebased GDP data from the supply side are now being published. Work to produce the corresponding rebased monthly production indicator (IMAE) is well advanced. A project to update the consumer price index with the results of the 2017/2018 Household Income and Expenditure Survey is in progress.

65. Data has some shortcomings that somewhat hamper surveillance, particularly related to timeliness and external sector statistics (see Annex IX). Compared to 2022, the timeliness of key macroeconomic statistics worsened in 2023. Staff turnover, data collection problems and resources reallocation toward the census and the GDP rebasing projects caused broad delays in the release of macroeconomic statistics, including labor and external sector data, and impacted the timely publication of the IMAE. A recent spike in balance of payments errors and omissions (associated with the accumulation of CFZ and export processing zone imports mentioned in ¶3) hamper the analysis of recent trends and near-term outlook.

66. Steady progress in the priorities identified in the National Statistical Plan will further improve data transparency and quality. The plan stands to improve data compilation and dissemination, the identification of data gaps, and the coordination across agencies and data users.

Authorities' Views

67. The authorities broadly agreed with staff's identification of data adequacy and shortcomings. They noted that the timeliness of data had improved sharply now that the census was over, and they expected to make further improvements this year and next. Rebased GDP by expenditure components would be published in 2024 and an improved labor market survey in 2025. The continuous improvement of coordination among data agencies would further contribute to data improvements. Ongoing Fund assistance should help improve external sector statistics.

68. The authorities remain committed to subscribing to the SDDS in the near term. Achieving the authorities' objective to subscribe to the SDDS will require resolving recent delays and accelerating the publication of the IMAE. Panama currently publishes the IMAE with a timeliness of about 10 weeks, while the SDDS requires 6 weeks. The authorities noted that, during the ongoing rebasing of the IMAE, they would also explore how to improve its timeliness.

STAFF APPRAISAL

69. Panama has recovered strongly from the pandemic, but growth in 2024 is projected to decline and the balance of risks is titled to the downside. Key risks include the loss of investment grade status and a further rise in financing costs. Being a dollarized economy adds to the importance of maintaining fiscal sustainability and financial stability. The external position is assessed to be broadly in line with the level implied by fundamentals and desirable policies.

70. Panama has made significant progress in reducing its fiscal deficit. The fiscal deficit declined from 10.0 percent in 2020 to 3.0 percent of GDP in 2023, in line with the targets of the SFRL albeit also helped by one-off revenue sources.

71. Meeting the 2024 fiscal deficit target of 2.0 percent of GDP will require an unduly large compression of public investment. A fiscal deficit of 4 percent of GDP in 2024 would be adequate from a cyclical perspective, avoiding an overly large investment compression and allowing a more gradual adjustment to the permanent loss of fiscal revenues from Minera.

72. The SFRL goal of reducing the fiscal deficit over time to 1.5 percent of GDP remains appropriate. If the deficit stays around 4 percent of GDP in coming years, there would be no further decline in the debt ratio, leaving public finances vulnerable to renewed shocks. To ensure that public debt is on a firm downward trend, the public finances strategy for 2025 should contain a credible multi-year fiscal consolidation plan to reduce the deficit to the SFRL target of 1.5 percent of GDP by 2027. Without a credible plan, the risk of further sovereign downgrades is high, which would increase financing costs and exacerbate possible adverse debt dynamics.

73. With no lender of last resort and deposit insurance, it is imperative that the banking system remains well-capitalized and liquid. The Panamanian banking system appears broadly resilient against severe downturn scenarios, but risks have increased amidst higher interest rates and a slowing economy. 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. The recent FSAP outlined a reform agenda that will help underpin financial stability and foster further financial development. All Fintech companies that carry out financial activities as defined by the FATF should be subject to AML/CFT regulation and supervision.

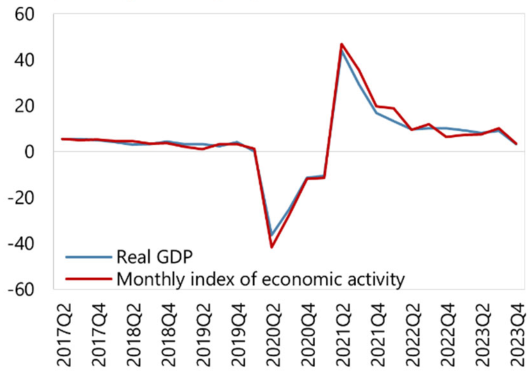
74. For income convergence to continue, labor productivity growth will need to accelerate. The demographic transition has largely run its course, and labor force participation in Panama already exceeds the average in the region and in high-income countries. Continuing to attract FDI, improving the quality of education and governance, and reducing the share of informal employment will be key to foster labor productivity and growth.

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

Figure 1. Real Sector Developments

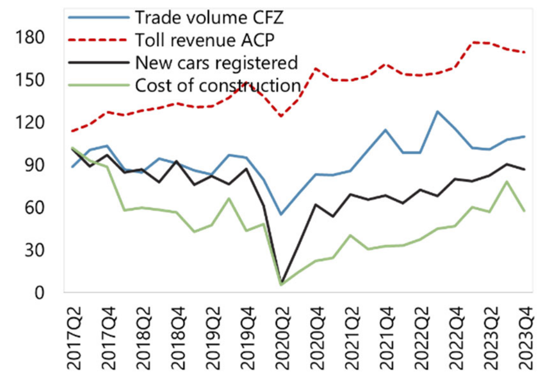
The pandemic was followed by a strong recovery in 2021 and 2022, and stronger-than-expected growth in 2023…

Economic Activity
(Percent; year-over-year)



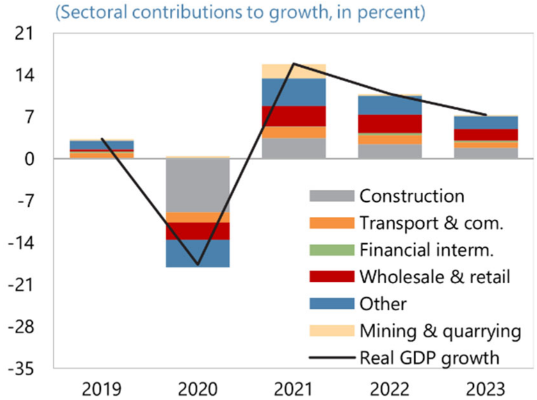
…amid rebounding activity across many sectors.

High-Frequency Indicators
(Index 2015Q1=100)



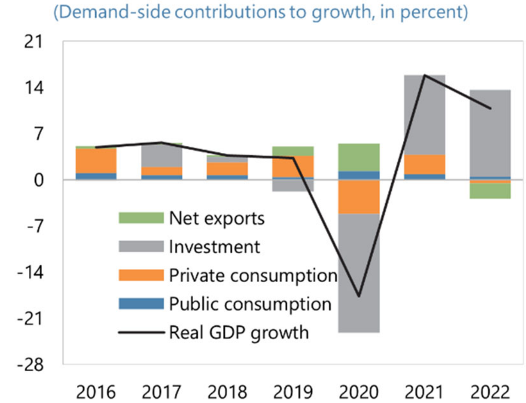
The recovery was mainly driven by commerce, construction, logistics, and mining.

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



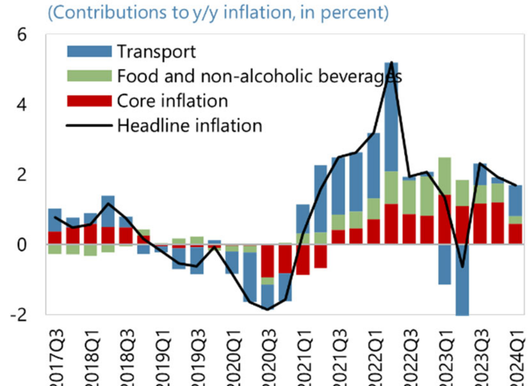
After a sharp decline during the pandemic, investment and private consumption growth supported a strong rebound.

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



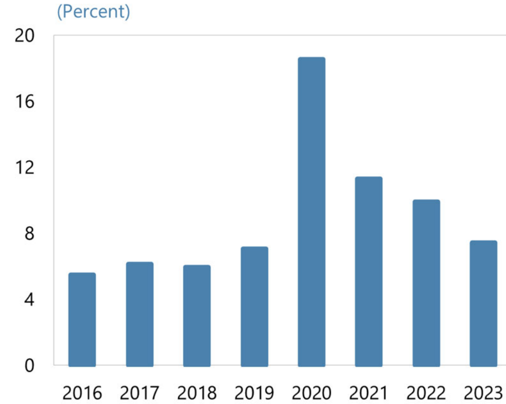
Inflation remained low in 2023 amid the extension of fuel subsidies.

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



Unemployment has declined from its peak of 18 percent in 2020 and is now approaching pre-pandemic levels.

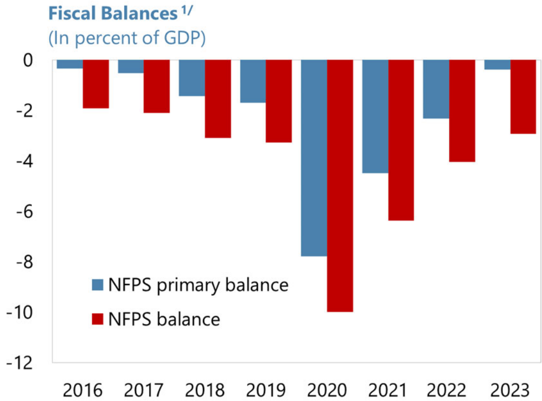
Unemployment Rate 1/
(Percent)



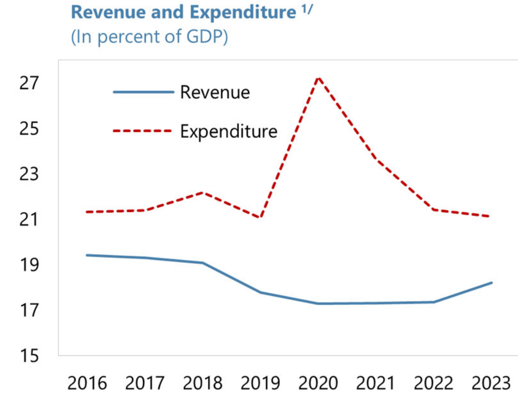
Sources: INEC and IMF staff calculations.
1/ 2022 data is from the April 2022 labor market survey.

Figure 2. Fiscal Developments

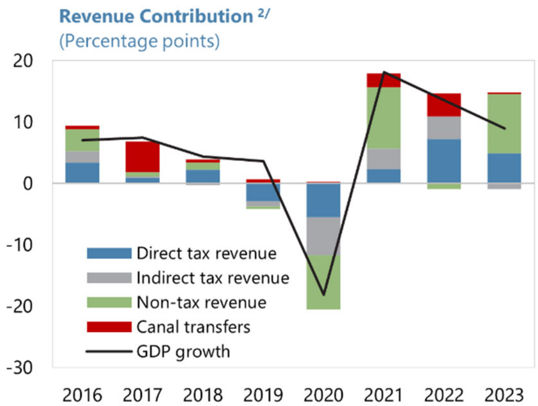
The fiscal deficit has declined from its pandemic peak in line with the SFRL target…



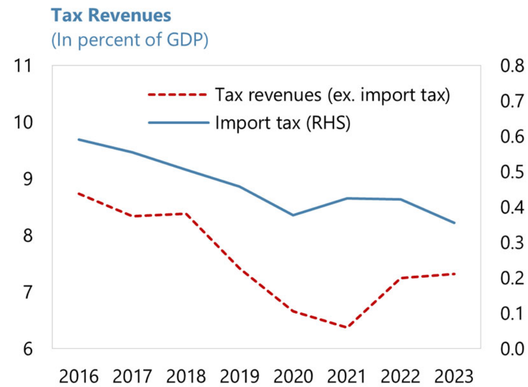
…reflecting a sharp drop in the expenditure to GDP ratio and a rebound in the revenue ratio



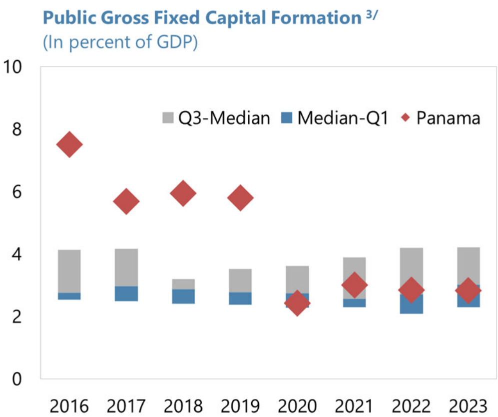
Total revenues have grown strongly in recent years…



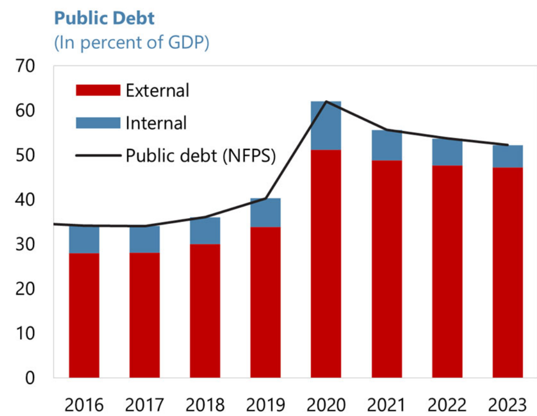
…but the tax revenue ratio remains well below the level of 2018.



Public investment in Panama used to surpass that in other countries in the region, but no longer.



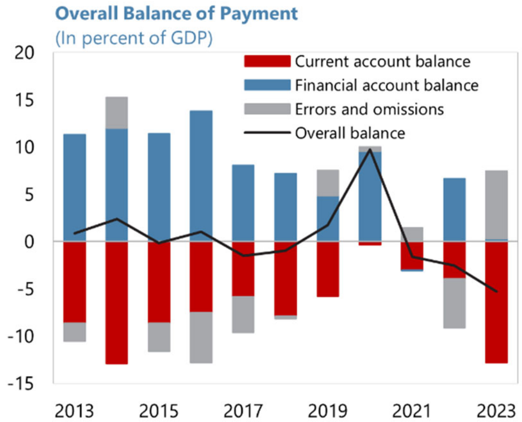
Public debt has declined from its peak in 2020 but remains elevated.



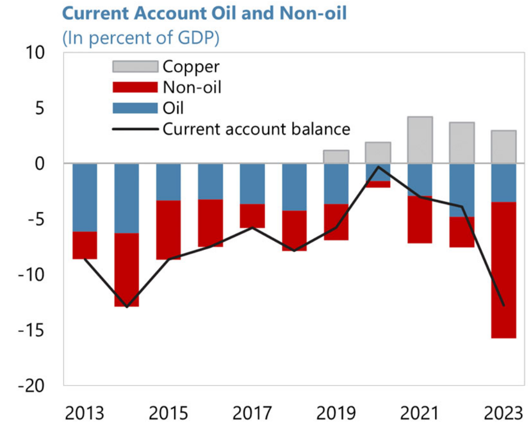
Sources: National Authorities, World Economic Outlook and IMF staff calculations.
1/ Non-Financial Public Sector.
2/ Data refer to the Central Government.
3/ Countries in the chart are CAPDR (Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica, Panama and Dominican Republic) and Brazil, Chile, Colombia,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

Figure 3. External Sector Developments

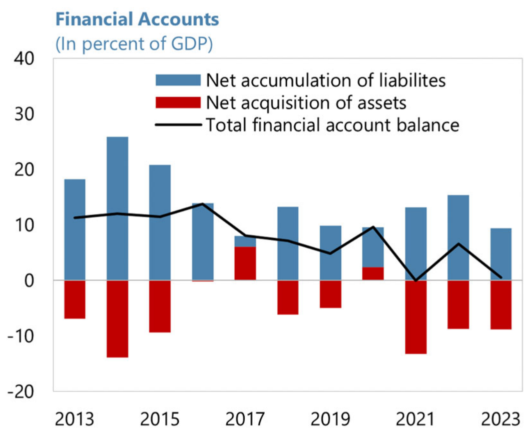
The headline current account deficit widened in 2023…



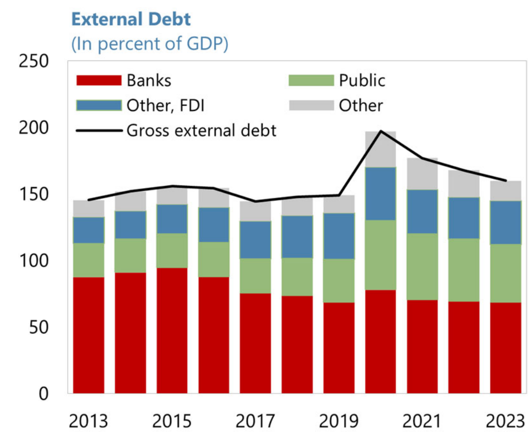
…the result of a sharp decline of the trade deficit of the CFZ and the export-processing zones



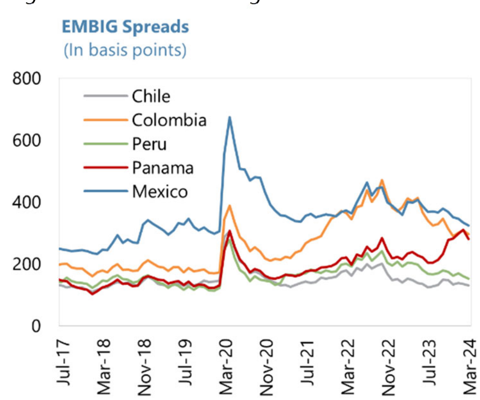
The financial account was in balance …



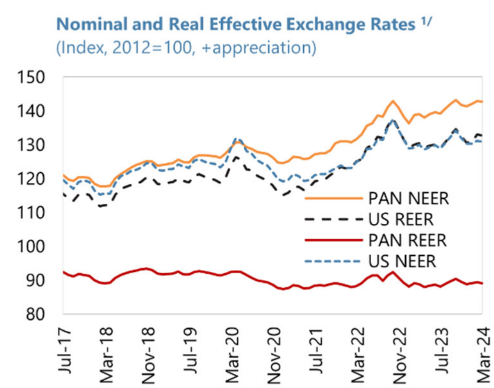
… while external debt declined due to the GDP denominator effect.



Sovereign bond spreads have increased relative to peers among downgrades and concerns that Panama might lose its investment grade status.



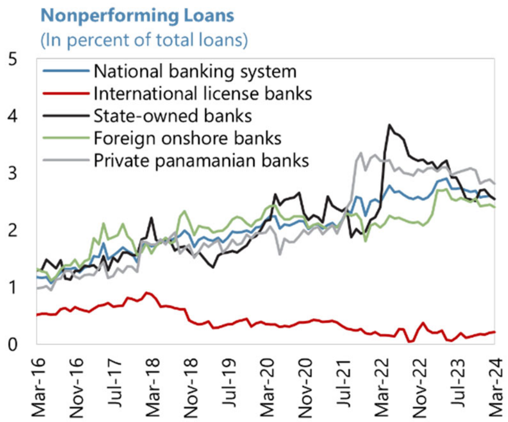
The REER is stable.



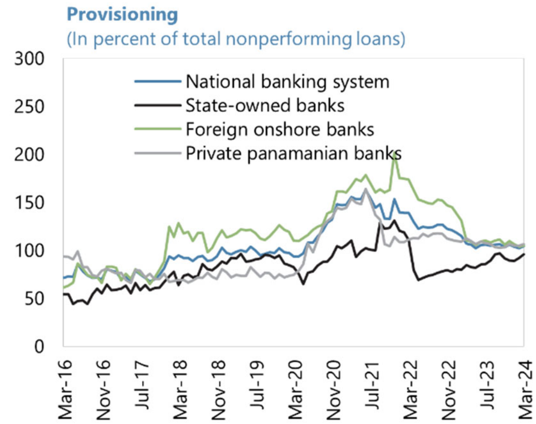
Sources: INEC and IMF staff calculations.
1/ Panama's NEER and REER exclude Venezuela.

Figure 4. Banking Sector Soundness

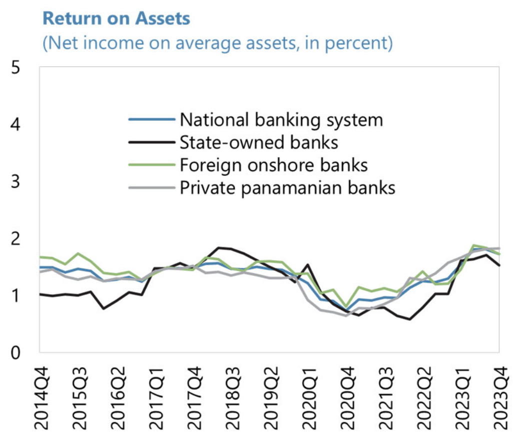
NPLs rose following the COVID-19 pandemic…



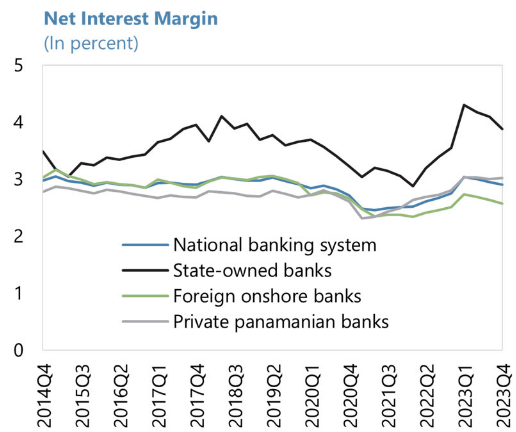
… but loan loss provisioning increased with the adoption of stricter provisioning requirements.



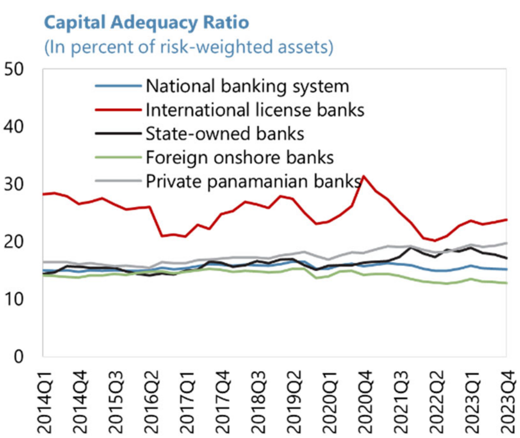
Profitability has recovered …



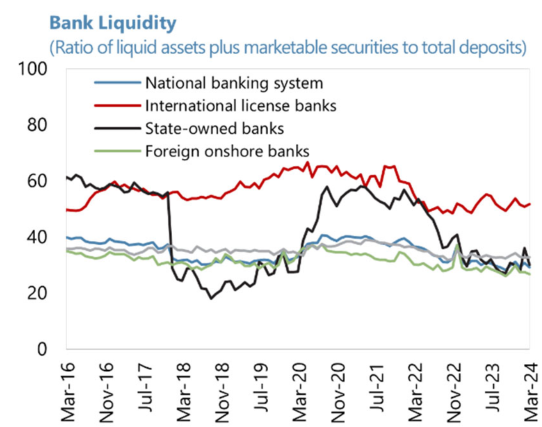
… helped by better net interest margins.



Banks' capital adequacy remains well above the regulatory minimum…



… while liquidity levels continue to be high.

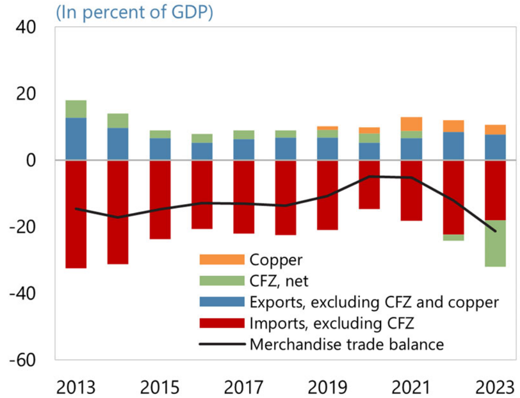


Sources: SBP and IMF staff calculations.

Figure 5. Balance of Payments

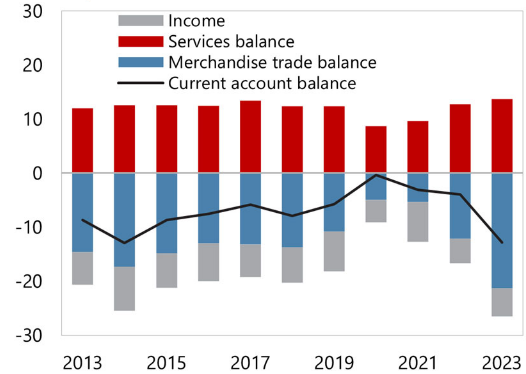
The trade deficit widened in 2023.

Merchandise Trade Balance
(In percent of GDP)



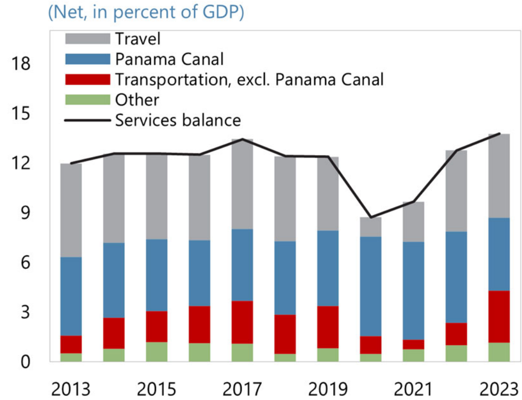
The trade deficit is partly offset by a surplus on services.

Current Account Balance
(In percent of GDP)



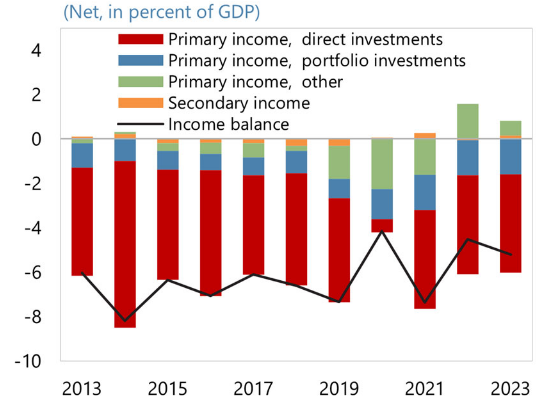
Service exports rely on the Panama Canal and tourism.

Services
(Net, in percent of GDP)



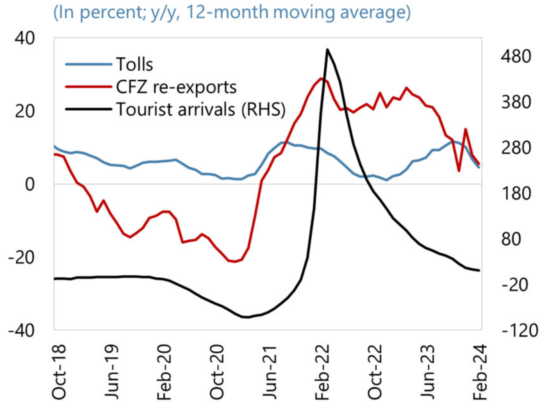
Income outflows are mainly from direct investments.

Income
(Net, in percent of GDP)



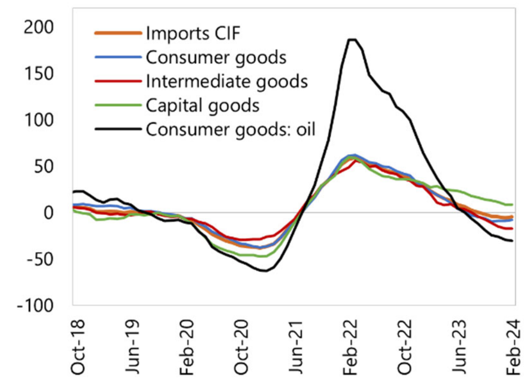
Tourism arrivals are leveling off after a large rebound.

High-Frequency Trade Data: Exports
(In percent; y/y, 12-month moving average)



Imports of consumer goods are now declining.

High-Frequency Trade Data: Imports
(In percent; y/y, 12-month moving average)

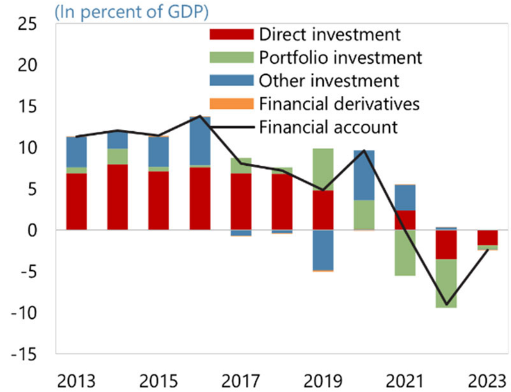


Source: Haver, and INEC.

Figure 6. Balance of Payments: Financial Account

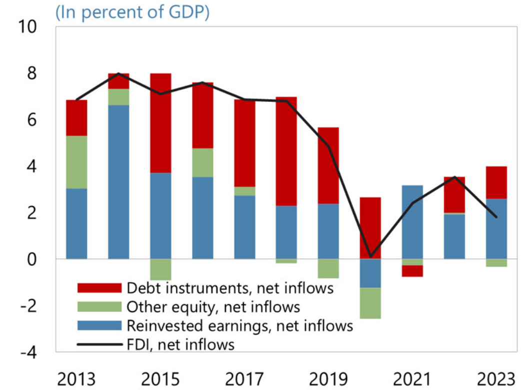
The financial account balance has decreased over time.

Financial Account Balance
(In percent of GDP)



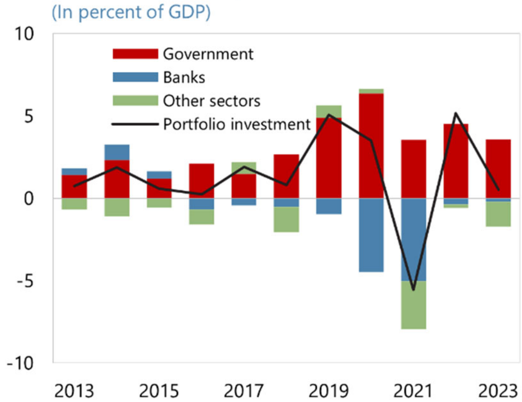
FDI has declined in 2023.

Foreign Direct Investment
(In percent of GDP)



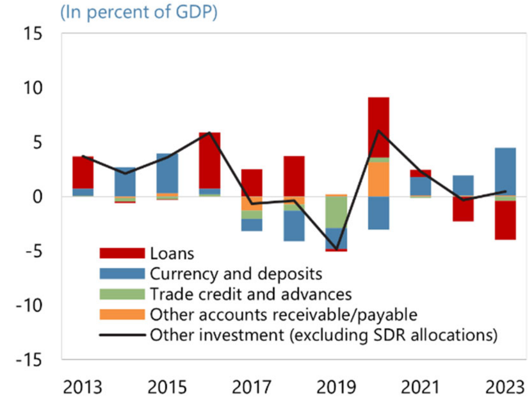
Portfolio investment has declined in 2023.

Portfolio Investment, net
(In percent of GDP)



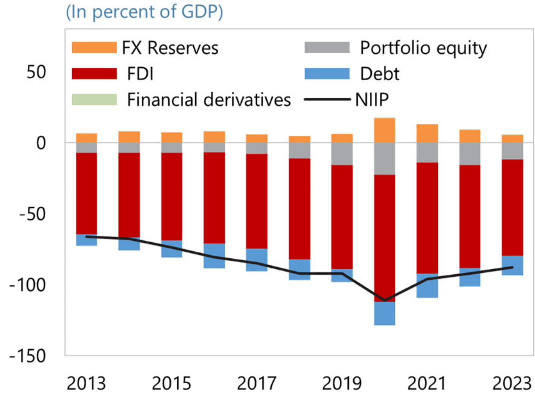
Other investment remained unchanged.

Other Investment, net
(In percent of GDP)



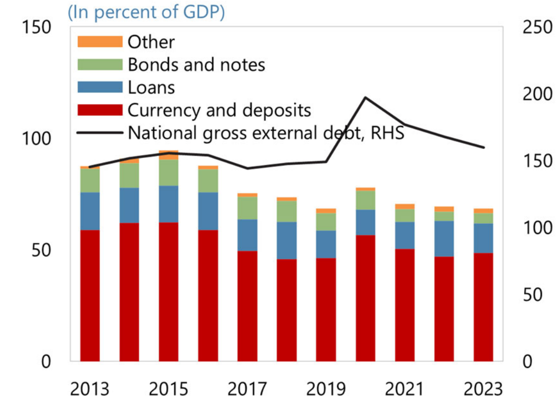
FDI remains the main component of the IIP

IIP Composition, by Instrument
(In percent of GDP)



Banks' external debt has been steadily declining.

Banks' External Debt
(In percent of GDP)



Sources: INEC, Haver Analytics, and IMF staff calculations.

Table 1. Panama: Selected Economic and Social Indicators, 2020–29

Population (millions, 2023)	4.4	Poverty line (percent, 2019)	21.5
Population growth rate (percent, 2023)	1.3	Adult literacy rate (percent, 2019)	95.7
Life expectancy at birth (years, 2022)	76.2	GDP per capita (US$, 2022)	17,411
Total unemployment rate (Aug, 2023)	7.4	IMF Quota (SDR, million)	376.8

					Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					(Percent change)					
Production and Prices										
Real GDP (2007 prices)	**-17.7**	**15.8**	**10.8**	**7.3**	**2.5**	**3.0**	**4.0**	**4.0**	**4.0**	**4.0**
Consumer price index (average)	-1.6	1.6	2.9	1.5	1.9	2.0	2.0	2.0	2.0	2.0
Consumer price index (end-of-year)	-1.6	2.6	2.1	1.9	2.4	2.0	2.0	2.0	2.0	2.0
Output gap (% of potential)	-17.9	-7.1	-1.0	0.0	-2.0	-1.0	0.0	0.0	0.0	0.0
Demand Components (at constant prices)										
Public consumption	**11.9**	**6.0**	**3.6**	**2.6**	**5.2**	**-2.5**	**-0.2**	**0.6**	**2.4**	**2.7**
Private consumption	-10.1	5.3	-1.2	1.3	2.5	3.0	4.0	4.0	4.0	4.0
Public investment 1/	-65.9	38.9	9.5	7.0	-13.7	-5.5	-9.7	0.4	7.1	7.2
Private investment	-44.7	30.1	25.5	11.0	2.5	3.0	4.0	4.0	4.0	4.0
Exports	-21.6	29.6	26.2	-1.5	22.9	-1.8	-7.7	0.2	3.1	2.8
Imports	-31.8	34.0	34.8	19.7	-23.4	3.3	3.0	0.3	4.1	3.7
Financial Sector										
Private sector credit	**-2.6**	**1.5**	**6.4**	**3.4**	**4.5**	**5.0**	**6.1**	**6.1**	**6.1**	**6.1**
Broad money	9.5	4.1	-1.9	2.1	4.8	5.0	6.1	6.1	6.1	6.1
Average deposit rate (Percent)	1.8	1.4	1.8	5.1						
Average lending rate (Percent)	7.7	7.6	7.7	9.8						
					(In percent of GDP)					
Saving-Investment Balance										
Gross domestic investment	**24.8**	**32.4**	**41.2**	**48.5**	**26.6**	**29.6**	**34.9**	**35.2**	**35.4**	**35.6**
Public sector	2.4	3.0	2.8	2.8	2.4	2.2	1.9	1.8	1.9	1.9
Private sector	22.4	29.4	38.4	45.6	24.2	27.4	33.0	33.4	33.5	33.7
Gross national saving	24.5	29.3	37.3	35.7	36.6	37.2	37.1	37.2	37.4	37.5
Public sector	-2.2	-0.1	1.9	2.6	0.7	1.7	2.6	3.0	3.2	3.3
Private sector	26.7	29.4	35.4	33.0	35.9	35.5	34.5	34.2	34.2	34.2
Public Finances 1/										
Revenue and grants	**20.3**	**20.2**	**19.8**	**21.1**	**20.6**	**20.6**	**20.8**	**20.8**	**20.9**	**20.9**
Expenditure	29.2	25.4	23.0	23.3	23.7	22.6	21.5	21.0	21.1	21.1
Current, including interest	22.0	19.5	17.4	17.7	19.0	18.3	17.8	17.4	17.4	17.3
Capital	7.2	5.9	5.6	5.6	4.7	4.3	3.7	3.6	3.7	3.8
Overall balance, including ACP	-8.9	-5.2	-3.2	-2.2	-3.2	-2.0	-0.7	-0.2	-0.2	-0.2
Overall balance, excluding ACP	-10.0	-6.4	-4.0	-3.0	-4.0	-3.0	-2.0	-1.5	-1.5	-1.5
Total Public Debt										
Debt of Non-Financial Public Sector 2/	**62.0**	**55.6**	**53.7**	**52.2**	**54.1**	**55.1**	**54.3**	**53.0**	**51.9**	**50.8**
External	51.1	48.7	47.7	47.2	47.7	47.0	46.0	44.6	43.2	42.0
Domestic	10.9	6.9	6.0	5.0	6.4	8.0	8.3	8.4	8.7	8.9
Debt of ACP	4.0	3.1	2.4	1.9	1.6	1.2	0.9	0.7	0.4	0.4
Other 3/	4.8	4.7	4.3	3.9	3.8	3.6	3.4	3.2	3.0	2.8
External Sector										
Current account	**-0.3**	**-1.2**	**-4.0**	**-12.6**	**10.1**	**7.6**	**2.2**	**2.0**	**2.0**	**1.9**
Net exports from Colon Free Zone	1.2	0.2	-1.8	-13.7	8.0	6.0	0.6	0.5	0.5	0.5
Net oil imports	1.6	2.9	4.8	3.5	3.3	3.0	2.8	2.7	2.6	2.6
Net foreign direct investment inflows	0.1	2.4	3.5	1.8	1.9	2.0	1.9	1.9	1.9	1.9
External Debt	197.1	177.0	167.8	159.9	159.5	158.2	156.3	153.8	150.9	146.0
Memorandum Items:										
GDP (in millions of US$)	57,087	67,407	76,523	83,382	87,347	91,731	97,309	103,225	109,501	116,159

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.
1/ Includes Panama Canal Authority (ACP).
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, 2020–29[1]
(In percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
					Non-Financial Public Sector					
Revenues	**17.3**	**17.3**	**17.4**	**18.2**	**17.8**	**17.8**	**17.9**	**18.0**	**18.0**	**18.0**
Current revenue	17.3	17.3	17.4	18.2	17.7	17.8	17.9	18.0	18.0	18.0
Tax revenue	7.0	6.8	7.7	7.7	7.9	8.1	8.2	8.2	8.2	8.2
Nontax revenue	4.5	4.8	4.3	5.0	4.3	4.3	4.3	4.4	4.4	4.4
o/w: Panama Canal fees and dividends	3.2	3.1	3.3	3.0	3.0	2.9	2.9	3.0	3.0	3.0
Social security agency	5.4	5.1	4.9	4.8	5.0	5.0	5.0	5.0	5.0	5.0
Public enterprises' operating balance	-0.2	0.0	0.0	0.5	0.1	0.1	0.1	0.1	0.1	0.1
Other [2/]	0.6	0.7	0.5	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Capital revenue	0.0	0.0	0.0	0.0	0.1	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
Expenditure	**27.3**	**23.7**	**21.4**	**21.1**	**21.7**	**20.8**	**19.9**	**19.4**	**19.5**	**19.5**
o/w COVID-19 related expenditure	2.8	2.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current primary expenditure	17.8	15.8	14.2	13.7	14.5	14.2	13.8	13.7	13.7	13.8
Central government [3/]	10.7	9.5	8.6	8.2	8.5	8.3	8.1	7.9	7.9	8.0
Rest of the general government	7.1	6.3	5.7	5.5	6.0	5.9	5.8	5.7	5.8	5.8
Social security agency	6.6	5.8	5.2	5.1	5.6	5.5	5.3	5.3	5.4	5.4
Decentralized agencies	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Interest	2.5	2.2	1.7	2.6	3.2	2.8	2.6	2.4	2.3	2.2
Capital	6.9	5.6	5.4	4.8	4.0	3.8	3.5	3.3	3.5	3.6
Accrued spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	**-10.0**	**-6.4**	**-4.0**	**-3.0**	**-4.0**	**-3.0**	**-2.0**	**-1.5**	**-1.5**	**-1.5**
Net Financing	**6.8**	**3.9**	**6.5**	**3.1**	**4.0**	**3.0**	**2.0**	**1.5**	**1.5**	**1.5**
External	9.7	4.5	5.3	3.6	2.7	1.6	1.7	1.3	1.1	1.3
Domestic	-2.9	-0.6	1.2	-0.5	1.3	1.4	0.3	0.2	0.4	0.2
					Panama Canal Authority (ACP)					
Revenue	**6.2**	**5.9**	**5.7**	**6.0**	**5.8**	**5.8**	**5.8**	**5.8**	**5.9**	**5.9**
Expenditure	**5.1**	**4.8**	**4.9**	**5.2**	**5.0**	**4.7**	**4.5**	**4.6**	**4.6**	**4.6**
Current primary expenditure	1.6	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.4
Transfers to the government	3.2	3.1	3.3	3.0	3.0	2.9	2.9	3.0	3.0	3.0
Interest payments	0.1	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Capital expenditure	0.2	0.3	0.2	0.7	0.7	0.5	0.3	0.3	0.3	0.2
Overall Balance	**1.1**	**1.2**	**0.8**	**0.8**	**0.8**	**1.1**	**1.3**	**1.3**	**1.3**	**1.3**
					Consolidated Non-Financial Public Sector					
Overall Balance (incl. ACP)	**-8.9**	**-5.2**	**-3.2**	**-2.2**	**-3.2**	**-2.0**	**-0.7**	**-0.2**	**-0.2**	**-0.2**
Memorandum Items:										
Primary balance (excl. ACP)	-7.8	-4.5	-2.3	-0.4	-0.8	-0.3	0.6	0.9	0.8	0.6
Structural primary balance (excl. ACP) [4/]	-4.1	-3.2	-2.1	-0.4	-0.5	-0.1	0.6	0.9	0.8	0.6
Primary balance (incl. ACP)	-6.6	-3.3	-1.4	0.5	0.1	0.9	1.9	2.2	2.1	1.9

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

4/ Primary balance adjusted for the output gap.

Table 3. Panama: Summary Operations of the Central Government, 2020–29[1]
(In percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Revenues and Grants	**11.8**	**11.8**	**12.1**	**12.8**	**12.6**	**12.5**	**12.6**	**12.7**	**12.7**	**12.7**
Current revenue	11.8	11.7	12.1	12.8	12.4	12.5	12.6	12.7	12.7	12.7
Taxes	7.0	6.8	7.7	7.7	7.9	8.1	8.2	8.2	8.2	8.2
Direct taxes	4.0	3.7	4.4	4.8	4.8	4.8	4.9	4.9	4.9	4.9
Income tax	3.6	3.3	4.0	4.4	4.4	4.4	4.5	4.5	4.5	4.5
Tax on wealth	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Indirect taxes	3.1	3.1	3.3	2.9	3.2	3.2	3.3	3.3	3.3	3.3
Import tax	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
ITBMS	1.7	1.7	1.9	1.6	1.8	1.8	1.9	1.9	1.9	1.9
Petroleum products	0.3	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Other tax on domestic transactions	0.6	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Nontax revenue	4.7	5.0	4.5	5.1	4.5	4.5	4.5	4.5	4.6	4.6
Dividends	2.6	2.7	2.7	2.7	2.7	2.6	2.6	2.6	2.6	2.7
Of which : Panama Canal Authority	2.2	2.2	2.5	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Panama Canal Authority	1.0	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Transfers from decentralized agencies	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other 1/	0.9	1.1	0.6	1.4	0.7	0.8	0.8	0.8	0.8	0.8
Capital revenue	0.0	0.0	0.0	0.0	0.2	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
Total Expenditure	**21.0**	**18.4**	**16.2**	**16.5**	**16.5**	**15.5**	**14.7**	**14.2**	**14.1**	**14.1**
o/w COVID-19 related expenditure	2.8	2.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current	14.4	13.4	11.3	12.2	12.6	11.9	11.4	11.1	10.9	10.8
Wages and salaries	6.2	5.6	5.1	4.9	5.0	4.8	4.6	4.5	4.5	4.6
Goods and services	1.5	1.3	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1
Current expenditure of CSS	0.5	1.0	0.5	1.1	0.4	0.4	0.4	0.4	0.4	0.4
Transfers to public and private entities	3.6	3.3	2.9	2.5	2.8	2.8	2.7	2.6	2.6	2.5
Interest	2.5	2.3	1.7	2.6	3.2	2.8	2.6	2.4	2.3	2.2
Domestic	0.5	0.4	0.4	0.3	0.4	0.3	0.2	0.3	0.3	0.2
External	2.0	1.8	1.3	2.3	2.8	2.5	2.4	2.1	2.0	1.9
Capital	6.6	5.0	4.9	4.3	3.9	3.6	3.3	3.1	3.2	3.4
Accrued spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings 2/	-2.6	-1.7	0.8	0.6	-0.2	0.6	1.2	1.6	1.8	2.0
Overall Balance	**-9.2**	**-6.7**	**-4.1**	**-3.7**	**-3.9**	**-3.0**	**-2.0**	**-1.5**	**-1.4**	**-1.4**
Financing (net)	9.1	4.2	6.6	3.9	3.9	3.0	2.0	1.5	1.4	1.4
External	9.7	4.5	5.3	3.6	2.7	1.6	1.7	1.3	1.1	1.3
Of which : Multilateral lenders	4.4	1.9	1.5	1.0	0.7	0.3	0.2	0.1	0.0	0.0
Of which : Private creditors	8.3	4.7	5.2	3.8	3.5	3.5	3.4	3.0	2.8	2.7
Of which : Other lenders	-3.0	-2.1	-1.5	-1.2	-1.5	-2.3	-1.9	-1.9	-1.8	-1.4
Domestic	-0.6	-0.3	1.3	0.3	1.2	1.4	0.3	0.3	0.4	0.1
Of which: Net credit from banks	-3.2	2.0	0.5	0.1	0.1	0.0	-0.3	0.1	0.1	0.1
Of which: Net credit from non-banks	-0.1	-2.1	-0.3	-0.3	1.6	1.9	1.0	0.6	0.8	0.7
Of which: Other lenders	2.6	-0.3	1.1	0.5	-0.6	-0.5	-0.4	-0.4	-0.6	-0.6
Memorandum Items:										
Primary balance	-6.7	-4.4	-2.4	-1.1	-0.7	-0.2	0.6	0.9	0.8	0.8
GDP (in millions of US$)	57,087	67,407	76,523	83,382	87,347	91,731	97,309	103,225	109,501	116,159

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

1/ Includes in 2021 a debt premium of US$241 million as per GFSM 1986, the reporting system followed by the authorities.

2/ Current revenues and grants less current expenditure.

Table 4. Panama: Public Debt, 2020–29
(In percent of GDP)

	2020	2021	2022	2023	Projections 2024	2025	2026	2027	2028	2029
					Central Government					
Gross Debt	68.3	61.2	58.8	57.1	58.8	59.5	58.5	57.0	55.6	54.4
of which: held by social security (CSS)	6.3	5.7	5.2	4.9	4.7	4.5	4.2	4.0	3.7	3.5
Domestic	15.6	11.3	9.7	8.6	9.8	11.2	11.3	11.2	11.4	11.4
of which: unrecorded arrears (prel).	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.)	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	52.7	49.9	49.1	48.5	49.1	48.3	47.2	45.8	44.2	42.9
Financial Assets	11.6	8.8	7.0	6.5	6.4	6.4	6.4	6.3	6.3	6.3
Deposits [1/]	7.7	4.5	3.5	3.1	2.8	2.6	2.4	2.2	1.9	1.7
Sovereign Wealth Fund [2/]	2.4	2.1	1.7	1.8	1.9	2.2	2.5	2.8	3.1	3.4
Loans	1.1	1.2	1.0	1.0	0.9	0.9	0.8	0.8	0.7	0.7
SDR holdings	0.3	1.0	0.8	0.8	0.7	0.7	0.6	0.6	0.6	0.5
Net Debt	56.7	52.4	51.8	50.5	52.5	53.1	52.1	50.7	49.3	48.0
					Non-Financial Public Sector					
Gross Debt	62.0	55.6	53.7	52.2	54.1	55.1	54.3	53.0	51.9	50.8
of which: unrecorded arrears (prel.)	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.)	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Assets	21.2	17.4	13.8	12.8	12.6	12.4	12.2	11.9	11.6	11.3
Central government	11.6	8.8	7.0	6.5	6.4	6.4	6.4	6.3	6.3	6.3
Decentralized institutions (incl. CSS) [1/]	9.6	8.6	6.7	6.3	6.2	6.0	5.8	5.5	5.2	5.0
Net Debt	40.8	38.1	39.9	39.4	41.6	42.6	42.1	41.2	40.3	39.5
Memorandum Items:										
Net Debt as defined under SFRL [3/]	65.9	59.1	57.1	55.3	56.9	57.3	56.0	54.2	52.5	51.0

Sources: Ministry of Finance and IMF staff calculations.

1/ Deposits at the National Bank (BNP).

2/ For 2020, includes a withdrawal of US$0.1 billion for deficit financing.

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

Table 5. Panama: Summary Accounts of the Banking System, 2020–29[1]

(In millions of US dollars unless otherwise stated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
	(in millions of US dollars at end of period)									
Net Foreign Assets	**10,729**	**10,854**	**6,290**	**7,074**	**7,425**	**7,793**	**8,168**	**8,559**	**8,965**	**9,381**
Short-term foreign assets, net	10,729	10,854	6,290	7,074	7,425	7,793	8,168	8,559	8,965	9,381
National Bank of Panama	8,485	7,580	4,626	4,474	4,688	4,924	5,225	5,544	5,882	6,241
Rest of banking system	2,244	3,274	1,664	2,600	2,737	2,869	2,943	3,016	3,083	3,141
Long-term foreign liabilities	0	0	0	0	0	0	0	0	0	0
Net Domestic Assets	**36,787**	**39,860**	**40,899**	**41,573**	**43,536**	**45,725**	**48,605**	**51,665**	**54,921**	**58,389**
Public sector (net credit)	-9,655	-7,906	-9,213	-10,377	-10,377	-10,377	-10,377	-10,377	-10,377	-10,377
Central government (net credit)	-3,381	-2,001	-1,739	-2,162	-2,162	-2,162	-2,162	-2,162	-2,162	-2,162
Rest of the public sector (net credit)	-6,273	-5,905	-7,474	-8,215	-8,215	-8,215	-8,215	-8,215	-8,215	-8,215
Private sector credit	53,465	54,281	57,758	59,750	62,465	65,601	69,589	73,820	78,309	83,070
Private capital and surplus	-10,890	-10,856	-11,182	-12,115	-12,691	-13,328	-14,138	-14,998	-15,910	-16,877
Other assets (net)	3,866	4,341	3,536	4,316	4,139	3,830	3,531	3,220	2,900	2,573
Liabilities to Private Sector	**46,667**	**48,569**	**47,669**	**48,648**	**50,961**	**53,519**	**56,773**	**60,224**	**63,886**	**67,770**
Total deposits	45,703	47,811	46,787	47,917	50,196	52,715	55,920	59,320	62,927	66,753
Demand deposits	9,100	9,526	9,239	9,023	9,452	9,927	10,530	11,170	11,850	12,570
Time deposits	24,264	24,416	23,679	25,982	27,217	28,583	30,321	32,164	34,120	36,194
Savings deposits	12,339	13,868	13,869	12,912	13,526	14,205	15,069	15,985	16,957	17,988
Bonds	964	759	882	731	765	804	853	904	959	1,018
Deposits as % of private sector credit	85.5	88.1	81.0	80.2	80.4	80.4	80.4	80.4	80.4	80.4
	(12-month change in relation to liabilities to the private sector at the end of the previous period)									
Net foreign assets	19.2	0.3	-9.4	1.6	0.7	0.7	0.7	0.7	0.7	0.7
Net domestic assets	-4.4	6.6	2.1	1.4	4.0	4.3	5.4	5.4	5.4	5.4
Public sector credit (net)	-0.5	3.7	-2.7	-2.4	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	-3.4	1.7	7.2	4.2	5.6	6.2	7.5	7.5	7.5	7.5
Private capital and surplus	-1.2	-0.1	0.7	2.0	1.2	1.2	1.5	1.5	1.5	1.5
Other assets (net)	-1.7	1.0	-1.7	1.6	-0.4	-0.6	-0.6	-0.5	-0.5	-0.5
Liabilities to the private sector	9.5	4.1	-1.9	2.1	4.8	5.0	6.1	6.1	6.1	6.1
	(12-month percent change)									
Memorandum Items:										
M2 [1/]	9.5	4.1	-1.9	2.1	4.8	5.0	6.1	6.1	6.1	6.1
Net domestic assets	-4.8	8.4	2.6	1.6	4.7	5.0	6.3	6.3	6.3	6.3
Public sector credit (gross)	39.8	3.5	-6.2	2.4	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	-2.6	1.5	6.4	3.4	4.5	5.0	6.1	6.1	6.1	6.1
Demand deposits as % of total deposits	19.9	19.9	19.7	18.8	18.8	18.8	18.8	18.8	18.8	18.8
	(In percent of GDP)									
Total deposits	80.1	70.9	61.1	57.5	57.5	57.5	57.5	57.5	57.5	57.5
Credit to private sector	93.7	80.5	75.5	71.7	71.5	71.5	71.5	71.5	71.5	71.5

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, 2015–2023
(In percent, end-of-period)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Core FSIs 1/									
Regulatory capital to risk-weighted assets	14.9	15.3	16.0	15.7	15.2	15.7	15.8	15.3	15.1
Tier 1 capital to risk-weighted assets	14.3	16.3	17.0	16.9	16.4	17.1	16.8	16.1	15.9
Nonperforming loans net of provisions to capital	8.4	8.8	10.5	8.6	-0.3	-5.2	-8.7	-5.5	-3.3
Capital to assets (leverage ratio)	10.2	11.4	12.5	12.5	12.7	11.8	12.2	11.8	12.1
Nonperforming loans to total gross loans	2.2	2.5	3.1	3.3	2.0	2.0	2.3	2.5	2.6
Provisions to nonperforming loans	35.9	41.2	38.3	53.7	102.4	148.0	173.7	138.6	123.2
Return on assets	1.5	1.3	1.6	1.6	1.5	0.7	1.0	1.4	1.9
Return on equity	14.0	11.8	13.4	13.1	11.5	6.4	9.1	12.8	16.4
Interest margin to gross income	62.9	62.9	60.4	61.5	61.3	62.0	56.9	59.1	59.0
Noninterest expenses to gross income	50.1	50.0	46.9	46.4	47.7	48.6	48.7	47.1	43.4
Liquid assets to total assets 2/	12.0	11.9	13.2	10.3	10.0	10.7	11.4	9.5	9.7
Liquid assets to short-term liabilities 2/	29.8	29.9	35.1	29.6	29.0	28.5	32.4	27.7	28.3
Additional FSIs									
Gross asset position in financial derivatives to capital	0.1	0.1	0.2	0.1	0.2	0.6	0.2	0.7	1.2
Gross liability position in financial derivatives to capital	0.8	1.3	0.9	0.7	0.4	0.4	0.4	0.6	0.5
Trading income to total income	0.9	1.6	0.7	0.3	1.9	2.8	2.7	-0.6	-0.4
Personnel expenses to noninterest expenses	46.7	46.2	46.8	46.4	45.8	46.2	44.2	42.7	44.6
Customer deposits to total (noninterbank) loans	85.3	83.1	82.5	80.8	81.5	89.4	111.5	102.9	103.2

Source: IMF Financial Soundness Indicators.

1/ Data are for general license banks only.

2/ 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

Table 7. Panama: Summary Balance of Payments, 2019–29
(In percent of GDP, unless otherwise stated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
					(In percent of GDP)						
Current Account	**-5.8**	**-0.3**	**-1.2**	**-4.0**	**-12.6**	**10.1**	**7.6**	**2.2**	**2.0**	**2.0**	**1.9**
Merchandise trade excluding Colón Free Zone and Export Processing Zones, net	-13.1	-7.6	-7.4	12.0	6.8	10.5	9.3	9.3	8.9	8.5	8.1
Exports, f.o.b.	7.9	7.1	10.8	7.6	5.0	2.4	1.8	1.7	1.6	1.5	1.5
Of which: Copper	1.1	1.9	4.2	3.7	3.0	0.4	0.0	0.0	0.0	0.0	0.0
Of which: Gold	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Imports, f.o.b.	21.0	14.7	18.2	22.4	18.1	19.1	18.7	18.4	18.3	18.1	18.1
Of which: Oil	7.2	3.1	5.6	8.7	5.5	5.3	4.9	4.5	4.3	4.2	4.0
Merchandise trade from Colón Free Zone and Export Processing Zones, net	2.3	1.2	0.2	-1.8	-13.7	8.0	6.0	0.6	0.5	0.5	0.5
Re-exports, f.o.b.	13.1	13.4	13.9	15.2	14.8	21.8	19.8	13.8	12.2	11.9	11.5
Imports, f.o.b.	10.8	12.3	13.7	17.1	28.7	13.8	13.8	13.2	11.6	11.4	11.0
Services, net	12.4	8.7	9.7	12.7	16.7	14.4	14.8	15.1	15.5	15.8	16.0
Travel, net	4.4	1.2	2.4	4.9	5.1	5.1	5.1	5.2	5.3	5.4	5.4
Transportation, net	7.1	7.1	6.5	6.9	7.6	8.0	8.3	8.4	8.7	8.8	8.9
Of which: Canal	4.6	6.0	5.9	5.5	4.4	4.0	4.0	3.9	3.9	3.8	3.7
Other services, net	0.8	0.5	0.7	1.0	4.1	1.2	1.3	1.4	1.5	1.6	1.7
Income, net	-7.3	-4.1	-7.4	-4.6	-4.0	-3.7	-3.8	-4.4	-4.6	-4.6	-4.6
Primary, net	-7.0	-4.2	-7.6	-4.6	-4.1	-3.8	-3.9	-4.4	-4.6	-4.6	-4.6
Of which: Direct investment	-4.3	-0.3	-4.3	-2.5	-3.6	-2.9	-2.6	-2.7	-2.8	-2.7	-2.6
Secondary, net	-0.3	0.1	0.3	0.0	0.2	0.1	0.1	0.1	0.0	0.0	0.0
Of which: Workers' remittances	-0.5	-0.2	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
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	**-3.1**	**0.1**	**-1.6**	**-9.0**	**-2.4**	**-3.6**	**-2.6**	**-3.2**	**-3.4**	**-3.0**	**1.6**
Foreign direct investment, net	-4.8	-0.1	-2.4	-3.5	-1.8	-1.9	-2.0	-1.9	-1.9	-1.9	-1.9
Of which: Reinvested earnings	-2.4	1.2	-3.2	-1.9	-2.6	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3
Portfolio investment, net	-5.1	-3.5	5.6	-5.9	-0.5	-0.5	0.6	0.4	-0.2	0.3	0.2
Financial derivatives, net	0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	4.9	-6.0	-3.1	0.3	-0.1	-1.2	-1.2	-1.6	-1.3	-1.4	3.3
Reserve assets, net	1.8	9.7	-1.6	-2.5	-0.1	0.2	0.3	0.3	0.3	0.3	0.3
Net Errors and Omissions	**2.6**	**0.4**	**1.5**	**-7.5**	**13.7**	**-11.5**	**-5.6**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items:											
Exports of goods and services (annual percent change)	0.3	-30.3	38.1	32.2	7.1	20.7	-0.4	-5.9	2.1	5.1	4.8
Imports of goods and services (annual percent change)	-6.4	-35.5	38.7	46.2	26.1	-22.9	4.0	3.6	1.1	4.9	4.8
Oil trade balance (percent of GDP)	-3.6	-1.6	-2.9	-4.8	-3.5	-3.3	-3.0	-2.8	-2.7	-2.6	-2.6

Sources: INEC, and IMF staff calculations.

Table 8. Panama: External Vulnerability Indicators, 2020–29
(In percent, unless otherwise specified)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Financial Indicators										
Broad money (12-month percent change)	9.5	4.1	-1.9	2.1	4.8	5.0	6.1	6.1	6.1	6.1
Private sector credit (12-month percent change)	-2.6	1.5	6.4	3.4	4.5	5.0	6.1	6.1	6.1	6.1
Deposit rate (6-month; in percent) 1/	1.9	1.6	1.7	5.0	5.0	3.9	3.9	3.9	3.9	3.9
External Indicators										
Merchandise exports (12-month percent change)	-20.8	43.9	24.9	1.9	32.8	-5.4	-15.9	-3.4	2.7	2.2
Merchandise imports (12-month percent change)	-35.1	40.8	48.7	29.5	-26.3	3.7	3.2	0.2	4.8	4.6
Current account balance (in percent of GDP)	-0.3	-1.2	-4.0	-12.6	10.1	7.6	2.2	2.0	2.0	1.9
Capital account balance (in percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (in percent of GDP)	0.1	-1.6	-9.1	-0.5	-3.3	-2.2	-2.7	-2.9	-2.5	1.9
Of which : direct investment	-0.1	-2.4	-3.5	-1.8	-1.9	-2.0	-1.9	-1.9	-1.9	-1.9
Non-Financial Public Sector external debt (in percent of GDP)	51.1	48.7	47.7	47.2	47.7	47.0	46.0	44.6	43.2	42.0
In percent of exports of goods and services 2/	147.4	120.1	100.9	101.6	89.3	92.8	102.4	103.2	100.7	99.1
External interest payments										
In percent of exports of goods and services 2/	11.8	6.9	5.9	14.2	11.3	10.3	10.4	10.1	9.8	9.6
External amortization payments										
In percent of exports of goods and services 2/	209.8	155.7	127.6	133.1	119.2	126.0	138.9	143.3	143.2	142.1
REER, percent change (average) 6/	-1.5	-2.7	2.0	-1.4	...	...	...	...	...	...
Gross international reserves at end of period										
In millions of U.S. dollars 3/	9,930	8,832	6,876	4,726	4,940	5,176	5,477	5,796	6,134	6,493
In months of imports of goods and services	4.9	3.0	1.8	1.6	1.6	1.7	1.7	1.8	1.8	1.9
In percent of broad money 4/	21.3	18.2	14.4	9.7	9.7	9.7	9.6	9.6	9.6	9.6
In percent of short-term external debt 5/	25.8	20.8	14.3	9.1	9.2	9.2	9.2	9.3	9.4	9.9
Memorandum Items:										
Nominal GDP (in millions of US$)	57,087	67,407	76,523	83,382	87,347	91,731	97,309	103,225	109,501	116,159
Exports of goods and services (in millions of US$) 2/	19,792	27,338	36,145	38,701	46,707	46,503	43,754	44,666	46,924	49,175
Imports of goods and services (in millions of US$) 2/	17,614	24,424	35,692	45,024	34,693	36,092	37,396	37,820	39,682	41,576

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 2023, except for some fiscal policy slippage despite continued strong economic growth. Recent initiatives support revenue mobilization and the goal of reversing the steady decline in the revenue-to-GDP ratio. Financial integrity was significantly strengthened, as reflected in Panama's removal from the FATF grey list in October 2023 and the EU list of high-risk third countries in March 2024, with work ongoing to assess sectoral risk of FinTech institutions and VASPs. The authorities are stepping up the implementation of the National Statistical Plan. Fuel subsidies are being phased out in 2024 in line with Fund advice.

1. Fiscal Policy. The SFRL continues to be the anchor, in line with IMF recommendations. The 2023 SFRL[1] deficit target of 3 percent of GDP was met, albeit with the help of one-off revenues. Recent initiatives, such as the launch of a new LTU in July 2023, and new, state-of-the-art, scanners at customs checkpoints support revenue mobilization and the goal of reversing the steady decline in the revenue-to-GDP ratio, in line with past advice. However, a recommended comprehensive, annual tax expenditure review to assess the costs and benefits of regressive exemptions and their rationalization is pending.

2. Financial Integrity and Tax Transparency. In October 2023, the FATF removed Panama from the grey list after all remaining issues were addressed, while encouraging the authorities to further strengthen the AML/CFT regime by i) enhancing the searchability of the UBO registry to allow searches based on the name of the legal person or natural person, as well as on the name of the beneficial owner(s), and ii) increasing the use of financial intelligence products (intelligence and strategic reports) by competent authorities. Moreover, sectoral risk assessments of FinTech institutions and virtual asset service providers are needed to identify and assess potential threats and risks arising from these sectors.

3. Financial Sector Soundness and Reforms. The authorities continue to undertake stress tests and develop their stress test methodology, 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.[2] The authorities have adopted a regulation on the CCB, which will be phased in during 2024-26, and are preparing the introduction of a capital surcharge for D-SIBs. The Financial Stability Report continues to evolve and is now published twice a year. Its latest edition (covering the first half of 2023) included contributions from other financial regulators that cover financial markets and non-bank financial institutions. BNP has implemented all recommendations from the Safeguards Assessment completed in September 2020.

[1] The SFRL was streamlined in October 2018 and further modified in response to the COVID-19 pandemic.

[2] The LCR is based on Basel III and requires banks to hold an amount of high-quality liquid assets that is enough to fund cash outflows for 30 days. The Legal Liquidity Index (LLI), which is specific to Panama, 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.

4. Data Adequacy. The authorities are pressing ahead with the implementation of the National Statistical Plan 2021-25, which is aligned with Fund advice provided in the ROSC. The recently completed rebasing of GDP helps better reflect the current economic structure and growth engines in the national accounts. The completion of the GDP rebasing exercise and population census would ease staff and logistical constraints to address some recent delays in the publication of macroeconomic data also in support of the authorities' objective to subscribe to the SDDS.

5. Structural Reforms. The authorities maintained targeted social transfer programs and supported the consumption needs of the vulnerable during the pandemic and high inflation period. Continued social unrest led to the extension of food and fuel subsidies (introduced in July 2022) to January 2024. In line with the Fund's recommendation to phase out COVID-related support, the government decided to eliminate the pandemic-era subsidy Vale Digital and the fuel subsidies in 2024. The increase in the minimum wage of 4.5 to 7 percent in 2024, to an average minimum salary of US$636.8, will continue to support the most vulnerable coping with inflation. Increased education spending aims at boosting academic outcomes and human capital. Infrastructure development has resumed with major projects currently underway, like the construction of the third Panama City metro line, or to start in the next couple of years. To improve resilience to climate change, the Ministry of Environment in 2023 presented a plan to improve the management of hydric resources in Panama, which inter alia aims at identifying national priorities, accelerating the implementation of mitigation measures, and supporting their internal and external financing processes.

Annex II. Prospects and Risk Assessment Matrix[1]

Risks	Likelihood	Time Horizon	Expected Impact		Policy Response
External Risks					
Intensification of regional conflict(s)	**High**	**ST**	**High**	Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	• Pursue adequate liquidity and fiscal buffers to safeguard macroeconomic and financial stability. • Ensure that social welfare and transfer programs are well targeted and reach the poor and those who are most in need, in a manner consistent with debt sustainability and the SFRL. • Any use of fiscal space should be accompanied by a credible medium-term fiscal framework (MTFF) and a credible plan to return to the deficit targets.
Abrupt global slowdown	**Medium**	**ST**	**High**	Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. • **China**: Sharper-than-expected contraction in the property sector weighs on private demand, further amplifies local government fiscal strains, and results in disinflationary pressures and adverse macro-financial feedback loops. • **Europe**: Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn.	• Pursue adequate liquidity and fiscal buffers to safeguard macroeconomic and financial stability. • Use such buffers to safeguard macroeconomic and financial stability if needed, albeit accompanied by a credible MTFF and a credible plan to return to the deficit targets. • Ensure that social transfers and subsidies are well targeted to the poor and needy, in a manner consistent with debt sustainability and the SFRL. • Enhance the safety net and crisis preparedness for the financial sector.

[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.

Risks	Likelihood	Time Horizon	Expected Impact		Policy Response
				• **U.S.**: Amid tight labor markets, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial, housing, and commercial real estate market correction.	
Monetary policy miscalibration	Medium	ST, MT	Medium	Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	• Continue to deepen domestic financial markets and rebalance public sector financing to domestic sources. • Enhance the safety net and crisis preparedness for the financial sector.
Systemic financial instability	Medium	ST, MT	High	High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	• Ensure that banks maintain adequate capital and liquidity buffers. • Continue to improve systemic risk monitoring and the macroprudential policy framework. • Improve crisis preparedness, including by reforming the crisis management and resolution framework.
Sovereign debt distress	Medium	ST, MT	High	Domino effects from high global interest rates, a growth slowdown in AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, and loss of market access.	• Pursue prudent fiscal policies to preserve debt sustainability and continue strengthening fiscal policy credibility. • Deepen domestic financial markets. • Maintain transparency, open communications, and active outreach toward international market participants. • Improve crisis preparedness, including by reforming the crisis management and resolution framework.

Risks	Likelihood	Time Horizon	Expected Impact		Policy Response
Commodity price volatility	**High**	**ST**	**High**	A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	• Allow the current account to adjust through lower non-oil imports. • Ensure that social transfers and subsidies to soften the impact of commodity price shocks are well targeted to the poor and needy in a manner consistent with debt sustainability and the SFRL.
Deepening geo-economic fragmentation	**High**	**ST, MT**	**High**	Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of the international monetary system, and lower growth.	• Continue efforts to diversify key export markets. • Advance structural reforms to improve productivity and strengthen competitiveness., including through sustained efforts to improve education and governance.
Cyberthreats	**Medium**	**ST, MT**	**Medium**	Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	• Improve legal and institutional frameworks for cybersecurity, 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 processes are in place to mitigate cyber-security risks.

Risks	Likelihood	Time Horizon	Expected Impact		Policy Response
Extreme climate events	Medium	ST, MT	Medium	Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	• Continue efforts to build resilience and limit disruptions caused by natural disasters, including the impact of droughts on the Panama Canal's operations, 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. • Ensure that social transfers and subsidies to deal with the impact of climate change are well targeted to the poor and needy, in a manner consistent with debt sustainability and the SFRL.
Disorderly energy transition	Medium	MT	Medium	Disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	• Pursue policies that facilitate the energy transition both domestically and globally. • Pursue prudent fiscal policies to preserve debt sustainability and continue strengthening fiscal policy credibility. Build liquidity and fiscal buffers when conditions allow. • Ensure that social transfers and subsidies to deal with the impact of a potential disorderly energy transition are well targeted to the poor and needy, in a manner consistent with debt sustainability and the SFRL.
Domestic Risks					
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. • Further develop the macroprudential policy framework and strengthen financial sector crisis preparedness.
Setbacks in Fiscal Consolidation Necessary to Return to the SFRL Limits	High	ST, MT	High	Should fiscal imbalances continue, the credibility of fiscal policy could deteriorate, damaging Panama's reputation, reducing market confidence, and leading to higher borrowing costs, impacting debt sustainability.	• Adopt a credible multi-year plan to meet the deficit targets, with explicit projections and measures for revenue and expenditure, that rebuilds fiscal buffers over time. • Reform tax and customs administration.

Risks	Likelihood	Time Horizon	Expected Impact		Policy Response
					• Strengthen the fiscal framework.
Social discontent	**High**	**ST, MT**	**High**	High inflation, real income loss, and spillovers from crises in other countries (including migration) worsen inequality and combine with discontent over Government policies and perceived corruption to trigger further social unrest. This gives rise to financing pressures and detrimental populist policies., which in turn exacerbate imbalances, slow growth, and trigger market repricing.	• Ensure that social welfare and transfer programs are well targeted and reach the poor and those who are most in need. • Develop clear communication and engagement strategies with affected communities, taking into full consideration their direct and indirect distributional effects in policy decisions. • Address governance and corruption vulnerabilities.
Loss of investment grade status	**High**	**ST, MT**	**High**	A loss of investment grade would further increase financing costs and refinancing risks and exacerbate debt dynamics. It may also reduce FDI and portfolio investment flows and trigger selloffs leading to declines in bond and equity prices.	• Adopt a credible multi-year plan to meet the deficit targets, with explicit projections and measures for revenue and expenditure, that rebuilds fiscal buffers over time, while ensuring debt sustainability. • Reform tax and customs administration. • Address governance and corruption vulnerabilities.
Droughts	**High**	**MT**	**Medium**	Severe droughts in Panama could result in delays and Canal restrictions with spillovers to the global shipping industry, lower hydro-energy generation and lower agricultural production.	• Continue efforts to build resilience against, and limit the potential disruptions caused by, droughts. • Proceed with the necessary investments to maintain the Canal's operations during future droughts.

Annex III. External Sector Assessment

Overall Assessment. *The external position of Panama in 2023 is assessed to be broadly in line with the level implied by fundamentals and desirable policies. The headline current account deficit was 12.8 percent of GDP in 2023 (up from a deficit of 3.9 percent of GDP in 2022). Most of the increase was caused by the unusual import surge in CFZ and Export Processing Zones (EPZ). Excluding the CFZ's and EPZ's unusual deficit, the current account surplus was 1.5 percent of GDP. Over the last decade, the underlying 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 a favorable global economic environment, particularly global interest rates and world trade. Policy efforts should continue to focus on Panama's resilience by safeguarding fiscal sustainability, reducing vulnerabilities, and building buffers.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The Net International Investment Position (NIIP) stood at -88 percent of GDP as of 2023Q4, up from -111 percent of GDP in 2020. Gross assets reached 120.8 percent of GDP in 2023Q4, 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 208.4 percent of GDP at the end of 2023 Q4 (268 percent of GDP in 2020), of which external debt is about 159 percent of GDP and non-debt FDI liabilities are about 87 percent of GDP. Banks account for the largest share of external debt (69.4 percent of GDP), followed by the government (45.1 percent of GDP), and FDI in the form of intracompany lending (31.1 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. The bulk of banks' debt is in the form of deposits and is 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, and tourism.

2023Q4 (% GDP)	NIIP: -88	Gross Assets: 120.8	Debt Assets: 119.8	Gross Liabilities: 208.4	Debt Liabilities: 184.3

Current Account

Background. Adjusting for the CFZ's and EPZ's unusual deficit, the current account has a surplus of 1.5 percent of GDP. Exports were supported by strong copper production, relatively resilient revenues from the Canal and the CFZ, and recovering tourism. The current account balance is projected to show a large surplus of 10 percent of GDP in 2024, as the inventory build-up in the CFZ and export-processing zones gets re-exported. This will only partly be offset by a reduction of copper exports following the closure of the mine.

Assessment. The EBA CA model estimates a current account norm of -1.6 percent of GDP. After accounting for the unusually large CFZ deficit in 2023, the CA balance is adjusted to 1.5 percent of GDP. This leads to a current account gap of 3.1 percent of GDP, including a policy gap of 1.9 percent of GDP, given that Panama's fiscal balance deviation from its desirable level was smaller than the rest of the world's deviation. Taking into account the very large errors and omissions (almost 10 percent of GDP in 2023), and the associated uncertainty about the true current account position, staff assesses Panama's external position to be broadly consistent with the level implied by fundamentals and desirable policies.

	CA model [1/] (in percent of GDP)
CA-Actual	**-12.8**
Cyclical contributions (from model) (-)	0.0
Additional temporary/statistical factors (-) [2/]	-14.2
Natural disasters and conflicts (-)	0.0
Adjusted CA	**1.5**
CA Norm (from model) [3/]	**-1.6**
Adjustments to the norm (-)	0.0
Adjusted CA Norm	**-1.6**
CA Gap	**3.1**
o/w Relative policy gap	1.9
Elasticity	-0.3
REER Gap (in percent)	**-10.2**

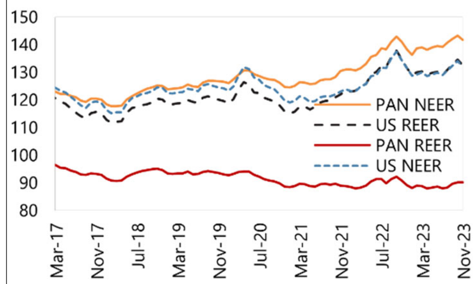
Source: IMF staff estimates.
1/ Based on the EBA-lite 3.0 methodology
2/ Adjustment for the (temporarily) unusually large trade deficit of the CFZ and Export Processing Zones in 2023
3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The real effective exchange rate (REER) remained broadly stable in 2023, depreciating by 1.4 percent on average relative to 2022, and depreciating by 1.6 percent relative to the 2019-22 average. The Nominal Effective Exchange Rate (NEER) appreciated by 2.4 percent on average relative to 2022. Low inflation in Panama relative to peers led to a REER depreciation.

Assessment. The EBA-lite CA model implies a REER undervaluation of 10.2 percent. Given the high uncertainty of the BOP figures with errors and omissions of 10 percent, and the fact that the REER has not changed much since 2017, staff assesses the 2023 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 declined from 3.8 percent of GDP in 2022 to 1.8 percent in 2023, as outward FDI increased, and reinvestment of earnings declined. At the same time, portfolio investment inflows decreased from 2022 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 a 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 sectors. 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. BNP's net foreign assets increased from 6.7 percent of GDP in 2021 to 7.6 percent of GDP in end February 2024, reflecting the payment of external obligations.

Assessment. Panama's reserve level is adequate. Reserves spiked during the pandemic and have since normalized. The central government deposits at commercial banks corresponded to 2.8 months of central government expenditures at end-2023, well above the best practice of 1 month of expenditure. Panama also has a Sovereign Wealth Fund that holds 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 58 percent of short-term deposits at end-June 2023 (nearly double the minimum statutory requirement of 30 percent), reinforcing the high level of liquidity buffers in the banking sector.

Figure AIII.1. External Debt Sustainability: Bound Tests [1/ 2/]

(External debt in percent of GDP)

Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent.

Table AIII.1. Panama: External Debt Sustainability Framework, 2017–29

(In percent of GDP, unless otherwise indicated)

	Actual									Projection						
	2017	2018	2019	2020	2021	2022	2023			2024	2025	2026	2027	2028	2029	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	144.3	147.7	149.0	197.1	177.0	167.8	159.9			**159.5**	**158.2**	**156.3**	**153.8**	**150.9**	**146.0**	**6.0**
2 Change in external debt	-9.9	3.3	1.3	48.1	-20.1	-9.2	-7.8			-0.5	-1.2	-1.9	-2.6	-2.9	-4.9	
3 Identified external debt-creating flows (4+8+9)	-11.7	-5.0	-4.2	33.2	-29.5	-16.4	-2.1			-15.7	-14.0	-10.0	-9.8	-9.6	-9.4	
4 Current account deficit, excluding interest payments	1.7	4.9	2.0	-3.7	0.2	1.1	6.2			-16.1	-12.8	-6.8	-6.4	-6.2	-6.0	
5 Deficit in balance of goods and services	-0.3	1.3	-1.6	-3.8	-4.3	-0.6	7.6			-13.8	-11.3	-6.5	-6.6	-6.6	-6.5	
6 Exports	42.1	42.1	40.7	34.7	40.6	47.2	46.4			53.5	50.7	45.0	43.3	42.9	42.3	
7 Imports	41.8	43.3	39.1	30.9	36.2	46.6	54.0			39.7	39.3	38.4	36.6	36.2	35.8	
8 Net non-debt creating capital inflows (negative)	-6.9	-6.8	-4.8	-0.1	-2.4	-3.5	-3.7			-1.9	-1.9	-1.9	-1.9	-1.8	-1.9	
9 Automatic debt dynamics 1/	-6.6	-3.0	-1.3	37.0	-27.4	-14.1	-4.7			2.2	0.7	-1.3	-1.5	-1.6	-1.5	
10 Contribution from nominal interest rate	4.1	3.0	3.8	4.1	2.8	2.8	6.6			6.0	5.2	4.7	4.4	4.2	4.3	
11 Contribution from real GDP growth	-8.0	-5.1	-4.7	32.1	-26.4	-16.8	-11.3			-3.8	-4.6	-6.0	-5.9	-5.8	-5.8	
12 Contribution from price and exchange rate changes 2/	-2.7	-1.0	-0.5	0.8	-3.7	...	...			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	1.8	8.3	5.5	14.9	9.4	7.2	-5.7			15.3	12.8	8.1	7.2	6.8	4.4	
External debt-to-exports ratio (in percent)	342.7	351.2	365.9	568.4	436.3	355.2	344.6			298.2	312.1	347.6	355.3	352.1	344.8	
Gross external financing need (in billions of US dollars) 4/	50.8	47.2	46.4	41.8	44.7	49.2	62.3			47.0	51.7	58.7	62.0	65.1	67.7	
in percent of GDP	78.8	70.1	66.5	73.2	66.3	64.3	74.8	10-Year	10-Year	53.8	56.4	60.3	60.0	59.4	61.8	
Scenario with key variables at their historical averages 5/										**165.7**	**172.4**	**174.2**	**175.0**	**175.2**	**173.1**	**-12.1**
Key Macroeconomic Assumptions Underlying Baseline								Historical Average	Standard Deviation						For debt stabilization	
Real GDP growth (in percent)	5.6	3.7	3.3	-17.7	15.8	10.8	7.3	4.4	8.6	2.5	3.0	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	1.8	0.7	0.3	-0.6	1.9	2.4	1.5	2.1	1.8	2.2	2.0	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.8	2.2	2.7	2.2	1.7	1.8	4.3	2.5	0.5	3.9	3.5	3.1	3.0	2.9	2.9	
Growth of exports (US dollar terms, in percent)	7.7	4.2	0.3	-30.3	38.1	32.2	7.1	3.2	19.7	20.7	-0.4	-5.9	2.1	5.1		
Growth of imports (US dollar terms, in percent)	5.8	8.2	-6.4	-35.5	38.7	46.1	26.1	3.5	23.8	-22.9	4.0	3.6	1.1	4.9		
Current account balance, excluding interest payments	-1.7	-4.9	-2.0	3.7	-0.2	-1.1	-6.2	-2.7	3.3	16.1	12.8	6.8	6.4	6.2		
Net non-debt creating capital inflows	6.9	6.8	4.8	0.1	2.4	3.5	3.7	5.4	2.6	1.9	1.9	1.9	1.9	1.8		

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. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Moderate	Panama faces a moderate risk of sovereign stress, marked by a considerable level of vulnerability in the near and long term.
Near term 1/	Low	Moderate	Near-term risks are considered as moderate despite a low mechanical signal (the logit-model does not account for recent developments). Low economic growth in 2024, the impact on public finances of the end of mining, rising interest payments, spending pressures (as per approved 2024 budget), and a high likelihood of sovereign downgrades contribute to the expectation of increased debt levels, posing ongoing stress risks.
Medium term	Low	Moderate	Medium-term risks are moderate subject to significant downsides. The fiscal deficit decreased from 10 percent of GDP in 2020 to 4 percent in 2022, and further to 3 percent in 2023, meeting the SFRL target. Potential repercussions from the copper mine arbitration and the risk of losing investment-grade status present significant medium-term challenges to public finances. Adherence to the SFRL fiscal rule (which may need adjustment to account for the impact of Minera) and sustained growth are expected to mitigate the debt-to-GDP ratio.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	...	...	
Long term	...	Moderate	Long-term risks are moderate. Financing and debt dynamics are susceptible to uncertainties associated with future sources of growth, in light of the closure of the copper mine, climate change-related impacts on the Panama Canal, a slowdown in fiscal consolidation, and the depletion of social security pension fund reserves by late 2025.
Sustainability assessment 2/	Not required for surveillance countries	Sustainable with high probability	Debt is projected to stabilize with GFNs at manageable levels, contingent on a credible multi-year plan to meet the amended fiscal rule. Based on this, debt is assessed as sustainable with high probability
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Panama's overall risk of sovereign stress is moderate and public debt considered sustainable subject to significant downside risks. Uncertainties around future sources of growth, potential repercussions from the copper mine arbitration and the risk of losing investment-grade status present significant medium-term challenges. A credible multi-year plan to meet the fiscal rule would place public debt on a declining path from its 2020 peak, underpinned by an improving primary balance and positive real growth-interest differential. Medium-term liquidity risks are moderate partly due to medium- and long-term maturity instruments (global bonds and multilateral debt). Panama's external financing needs and non-resident debt share will remain high due to its role as a regional US-dollar-based financial center. The risk of losing investment grade status and potential dislocations in global capital markets would put pressures on the rollover of external sovereign debts. In the long term, Panama needs to rebuild fiscal buffers through revenue mobilization and spending measures to support inclusive and sustainable growth amid potential de-globalization risks.

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. 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:						

CPS / NFPS / GG: expected / CG	#	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/
4. Accounting principles:	Basis of recording		Valuation of debt stock		
	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

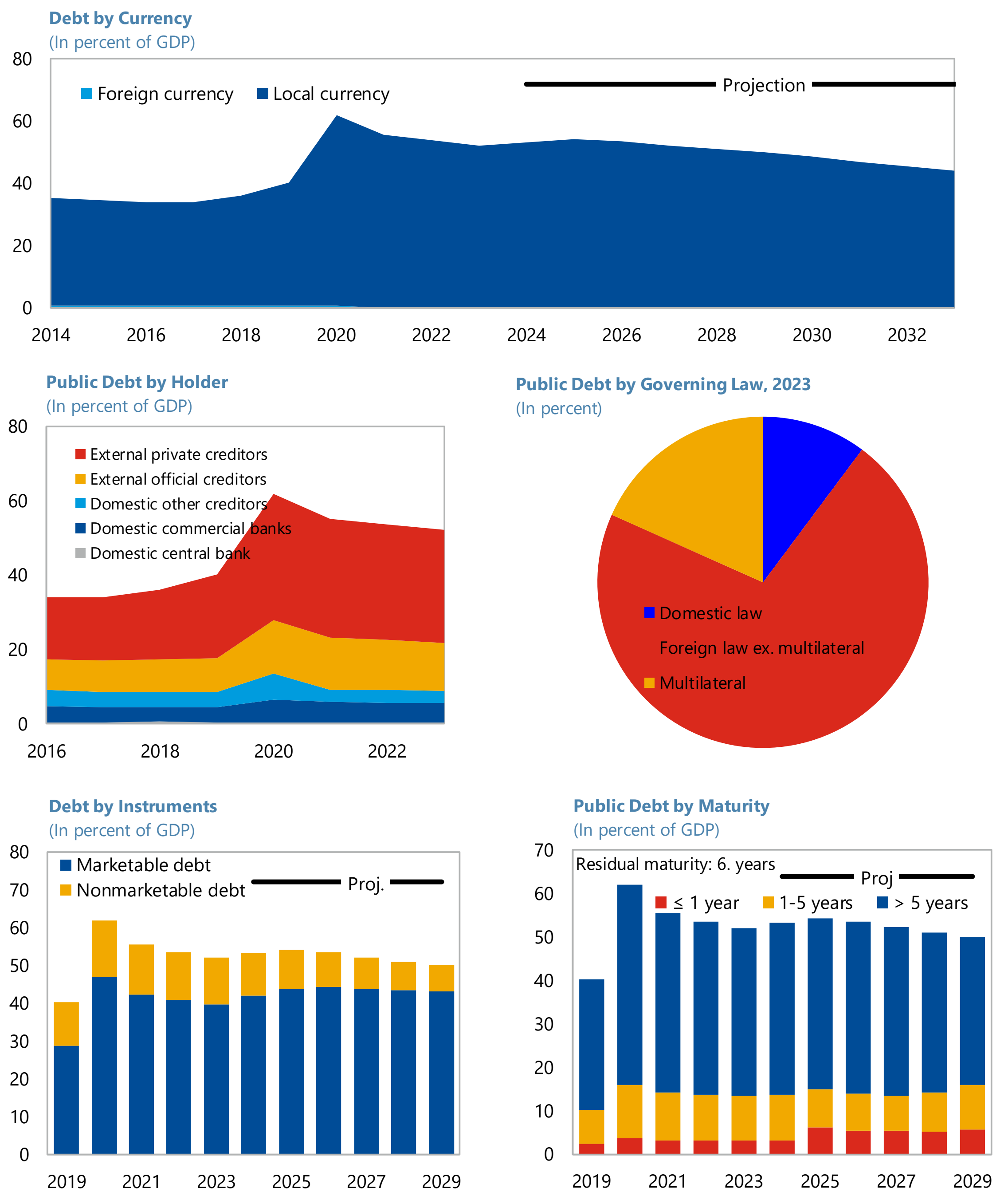
Reporting on Intra-government Debt Holdings

CPS / NFPS / GG: expected / CG	#	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. Public Debt Structure Indicators

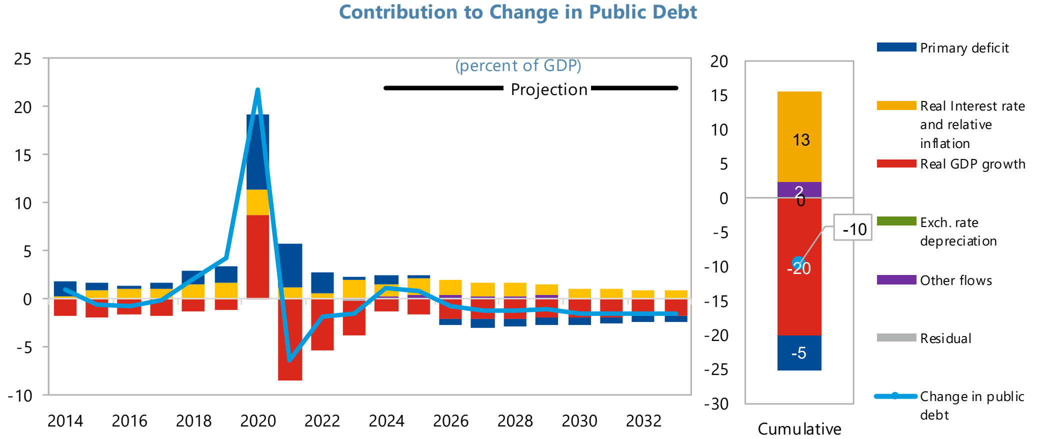


Note: The perimeter shown is nonfinancial public sector.
Commentary: Panama is a dollarized economy and has held only U.S. dollar-denominated debt after 2021. The larger share of public debt is held externally, and it is expected to have mostly long-term maturity in the forecast horizon.

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

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	52.2	53.3	54.2	53.5	52.2	51.1	50.0	48.5	47.0	45.5	44.0
Change in public debt	-1.5	1.1	0.9	-0.7	-1.3	-1.2	-1.0	-1.5	-1.5	-1.5	-1.5
Contribution of identified flows	-1.3	1.1	0.9	-0.7	-1.3	-1.2	-1.0	-1.5	-1.5	-1.5	-1.5
Primary deficit	0.4	0.8	0.2	-0.6	-0.9	-0.8	-0.7	-0.7	-0.7	-0.6	-0.6
Noninterest revenues	18.2	17.8	17.8	17.9	18.0	18.0	18.0	18.0	18.0	18.0	18.0
Noninterest expenditures	18.5	18.6	18.0	17.3	17.0	17.2	17.4	17.3	17.3	17.4	17.4
Automatic debt dynamics	-1.8	0.0	0.2	-0.5	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9
Real interest rate and relative inflation	1.8	1.3	1.8	1.6	1.4	1.3	1.2	1.1	1.0	0.9	0.9
Real interest rate	1.8	1.3	1.8	1.6	1.4	1.3	1.2	1.1	1.0	0.9	0.9
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	-3.7	-1.3	-1.6	-2.1	-2.1	-2.0	-2.0	-1.9	-1.9	-1.8	-1.7
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	0.2	0.3	0.4	0.4	0.3	0.4	0.4	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.2	0.3	0.4	0.4	0.3	0.4	0.4	0.0	0.0	0.0	0.0
Contribution of residual	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	6.6	6.2	6.0	7.9	6.7	6.6	6.5	6.9	6.8	6.6	7.3
of which: debt service	6.3	5.4	5.8	8.5	7.7	7.4	7.1	7.6	7.5	7.3	7.9
Local currency	6.3	5.4	5.8	8.5	7.7	7.4	7.1	7.6	7.5	7.3	7.9
Foreign currency	0.0	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)	7.3	2.5	3.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Inflation (GDP deflator; percent)	1.5	2.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	9.0	4.8	5.0	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1
Effective interest rate (percent)	5.2	4.8	5.4	5.1	4.8	4.6	4.5	4.4	4.2	4.1	4.0

Contribution to Change in Public Debt



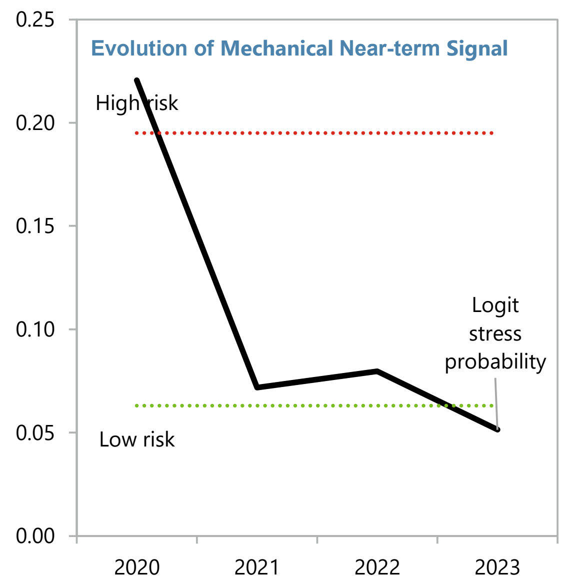
Commentary: Growth dynamics have predominantly shaped the debt trajectory since the pandemic. Fiscal discipline will gradually assume a larger role in reducing the debt burden. In the baseline scenario, the authorities comitted to a credible multi-year plan to meet the NFPS deficit target of 1.5% of GDP starting in 2027 (pushed back by two years) which will facilitate a progressive reduction in the debt-to-GDP ratio. Potentially higher financing costs and tighter global financial conditions could slow the adjustment.

Figure AIV.5. Near-Term Risk Analysis

Year of data	2020	2021	2022	2023
To predict stress in [t+1, t+2]	*2021-22*	*2022-23*	*2023-24*	*2024-25*
Logit stress probability (LSP)	0.221	0.072	0.080	0.051
Change in LSP	0.154	-0.149	0.008	-0.028
due to:				
Institutional quality	0.000	0.010	0.000	0.000
Stress history	0.000	0.000	0.000	0.000
Cyclical position	-0.014	0.132	-0.074	0.000
Debt burden & buffers	0.084	-0.159	0.029	0.004
Global conditions	0.080	-0.128	0.053	-0.032

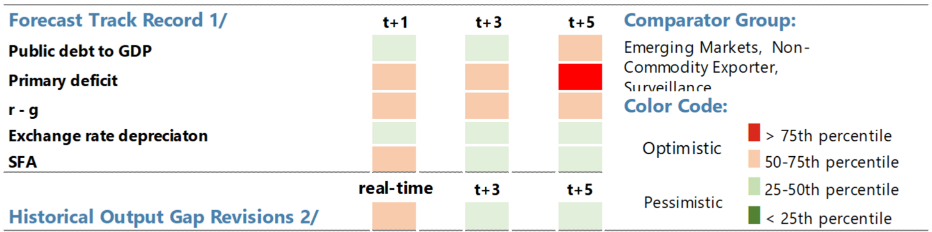
Prob. of missed crisis, 2024-2025 (if stress not predicted): 6.8 pct.

Prob. of false alarm, 2024-2025 (if stress predicted): 40.1 pct.

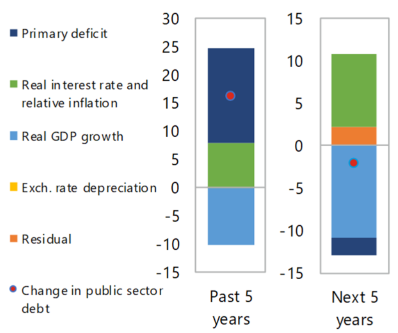


Commentary: Panama's risk of near-term stress is moderate. Improvements since 2020 largely reflect the normalization of global conditions and fiscal consolidation efforts supported by strong economic growth.

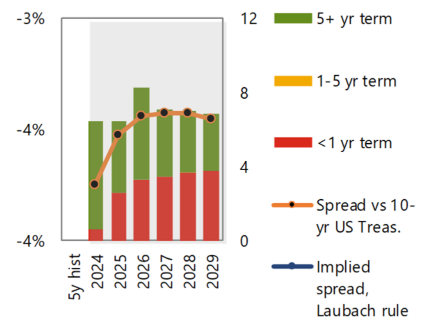
Figure AIV.6. Realism of Baseline Assumptions



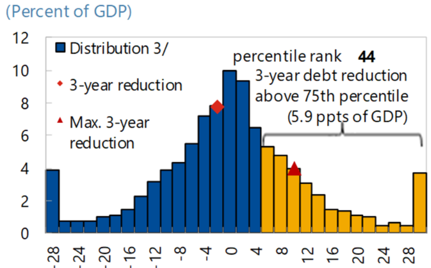
Public Debt Creating Flows
(Percent of GDP)



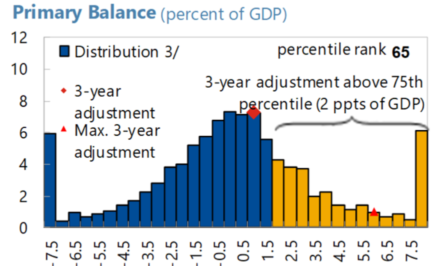
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



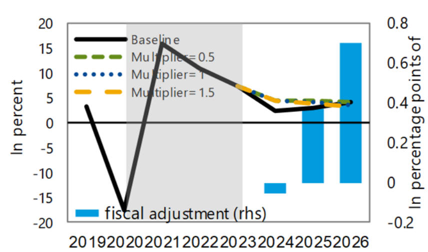
3-Year Debt Reduction
(Percent of GDP)



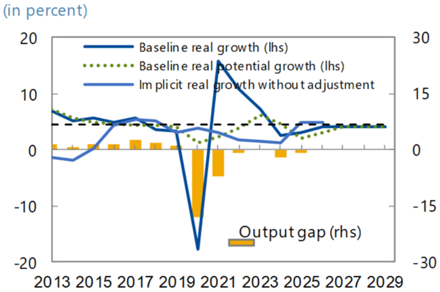
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS)



Real GDP Growth
(in percent)



Commentary: The projected debt path is within the norm. Forecast errors do not show systematic biases.

Source: IMF Staff.

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

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

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

Figure AIV.7. Medium-Term Risk Analysis

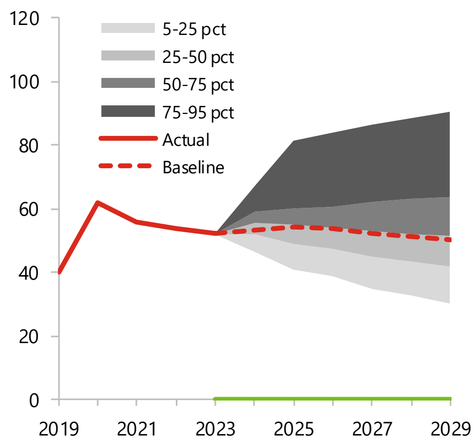
Debt Fanchart and GFN Financeability Indexes

(percent of GDP unless otherwise indicated)

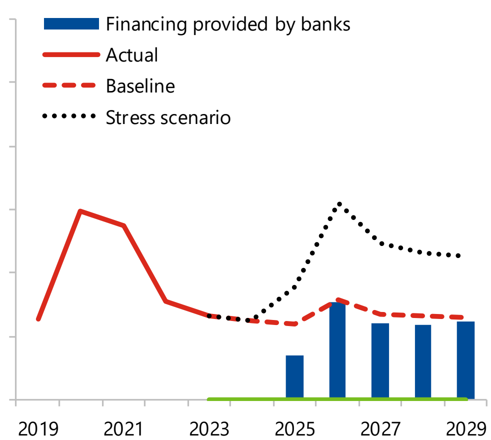
Module	Indicator	Value	Risk index	Risk signal	EM, Non-Com. Exp, Program (0 / 25 / 50 / 75 / 100)
Debt fanchart module	Fanchart width	60.2	0.9	...	
	Probability of debt not stabilizing (pct)	23.1	0.2	...	
	Terminal debt level x institutions index	28.2	0.6	...	
	Debt fanchart index	**...**	**1.7**	**Moderate**	
GFN finance-ability module	Average GFN in baseline	6.7	2.3	...	
	Bank claims on government (pct bank assets)	3.2	1.1	...	
	Chg. in claims on govt. in stress (pct bank assets)	11.7	3.9	...	
	GFN financeability index	**...**	**7.2**	**Low**	

Legend: Interquartile range; Panama

Final Fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

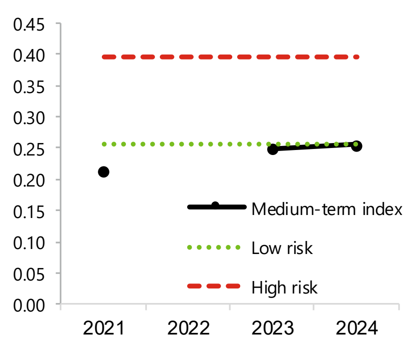


Triggered stress tests (stress tests not activated in gray)

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	...	0.3, Low

Prob. of missed crisis, 2024-2029 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2024-2029 (if stress predicted): 42.0 pct.

Commentary: The overall mechanical signal for the medium-term risk analysis is moderate. The Debt Fanchart Module is pointing to a moderate level of risk, with debt-to-GDP ratios rising above the 2020 peak in the 75-95 percentile range. The GFN Financeability Module suggests a low level of risk, although financing needs may increase significantly in a stress scenario.

Annex V. The Panama Financial Sector Assessment Program

The IMF-World Bank FSAP aims to assist countries in identifying and addressing systemic risks in their financial sectors, thereby enhancing their resilience to shocks and contagion.[1] The first FSAP for Panama took place in 2011-12. An updated assessment was conducted jointly with the World Bank during 2022-23 and was concluded by the IMF's Executive Board on December 1, 2023.[2] Its main findings are described in this Annex.

1. **The Panamanian banking system appears broadly resilient against severe downturn scenarios.** The system-wide solvency capital ratios rest well above regulatory minimums, but some individual banks fall short of them, when assessed against a severe yet plausible adverse macrofinancial scenario. Banks appear solid in terms of liquidity coverage, and only a few banks show weaknesses under a hypothetical stress scenario entailing severe liquidity outflows, for example, of deposits. By design, the system relies strongly on foreign correspondent bank support. The need for banks to sell Held-to-Maturity (HtM) bonds under liquidity stress to generate cash inflows is found to be small, and hence the feedback to solvency through realized losses is limited. This is due to available buffers from cash/reserves, foreign correspondent bank credit lines, and other liquid assets, including bonds held in the banks' trading portfolios.

2. **The FSAP recommends the introduction of a capital buffer framework for internationally active banks aligned with the Basel III capital standards.** These buffers should include, in particular, the Capital Conservation Buffer (CCB) and capital surcharges for D-SIBs. This is not expected to create additional pressure on the banking system as the systemic risk analysis points to two important conclusions in this context. First, stress tests show that phasing in a CCB is not expected to create notable pressure on banks under a baseline macroeconomic scenario, i.e., all banks' capital ratios would generally trend up despite the introduction of the additional buffer. Second, the assumed phase-in of D-SIB surcharges suggests that the Panamanian D-SIBs already have sufficient capital above current requirements and would not be adversely affected. Further, it should be noted that banks that ranked high regarding their impact in the interconnectedness analysis are already designated D-SIBs.

3. **The macroprudential framework could be further improved in several areas.** The SBP should make more use of its Financial Stability Report (FSR) to explain policy decisions and provide the underlying analysis. It could also use inputs from other CCF members to broaden the scope of the FSR to include the entire financial system. In addition, significant efforts and resources are needed to bring the macroprudential analysis and policy capabilities of the CCF member agencies to broadly similar levels.

4. **Reforms are needed to enhance the supervisory independence of the SBP, prioritize safety and soundness, complete the rollout of capital buffers, and strengthen oversight of**

[1] For background on the FSAP, see https://www.imf.org/en/Publications/fssa/.

[2] The Panamanian authorities opted not to publish the resulting Financial System Stability Assessment (FSSA) report. The FSSA of the 2011 FSAP was not published either.

liquidity and interest rate risk. The current Budget Law should be amended to restore the SBP's independence of action in respect of all budgetary issues, and future Budget Laws should maintain this autonomy. As mentioned above, the introduction of a capital buffer framework for internationally active banks aligned with that prescribed by Basel III capital standards should be a priority. The authorities should move to consolidated supervision of liquidity risk and formalize the regulations for interest rate risk in the banking book.

5. Safety nets can be developed further via an improved bank resolution framework, the introduction of a Deposit Insurance Scheme (DIS), and the establishment of an official lender of last resort. The proposed legislation on bank resolution should be reviewed, remaining gaps against international standards filled, and implementation challenges addressed. An industry-funded DIS should then be established, followed by the removal of the state guarantee for state-owned banks. The authorities should also explore alternative mechanisms to put in place an LOLR facility operated by a public authority, not a commercial bank, as at present, to reduce stigma effects.

6. Panama should continue to make progress in financial integrity. Over the past two decades, Panama has been publicly identified three times by the FATF for deficiencies in its AML/CFT regime. The most recent listing was due to lack of transparency of legal entities and limited efforts in pursuing foreign offenses, the flows from which touched Panama's jurisdiction. While it is encouraging that the FATF recently decided to remove Panama from its so-called grey list, the authorities need to continue ongoing efforts to increase the transparency of entities incorporated under Panamanian law, including by abolishing the issuance of new bearer shares, and monitor risks as the environment evolves.

7. Payment systems should be made safer and more efficient. A law on payment systems and services that constitutes the SBP as the regulator and overseer of the national payment system and the licensing authority for payment system operators and providers should be swiftly adopted. To mitigate the risks and conflicts of interests that the current operational setup for clearing and settlement poses, risk management frameworks need to be revised and Banco Nacional de Panamá should continue the process of separating its clearing and settlement operations from its commercial arm.

8. New challenges for the financial sector stem from looming climate-related risk. Panama is vulnerable to weather events, such as floods and droughts, that are expected to increase in intensity and frequency due to climate change. The authorities, especially given the banking sector's high exposure to the potentially vulnerable real estate and construction sectors, need to start monitoring and assessing such risks to ensure the financial sector's ability to withstand climate risk events.

9. Improvements in climate awareness, transparency, and regulation are needed to realize Panama's potential of becoming a regional hub for green finance. The size and relative sophistication of Panama's financial sector coupled with the country's rich ecosystem and established green credentials present opportunities to transform Panama into a regional center for sustainable finance. However, to realize this potential, several impediments related to climate and environmental awareness, transparency and regulations need to be addressed.

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
Systemic Risk Analysis				
1.	Develop various remaining components of a solvency bank stress test model suite to cover all relevant drivers. Once further developed, use the integrated stress test model suite to help inform the timing and calibration of macroprudential policy tools.	SBP	ST	The SBP has started to collect data from banks on the incomes of household borrowers (personal, automobile, and mortgage loans). This information is received semiannually, and two batches of data have already been received. They are being purged and analyzed.
2.	Develop a liquidity stress simulation model for banks.	SBP	ST	The SBP started using the template provided during the FSAP and has developed programming to feed this template with data received from the banks.
Financial Sector Oversight				
Macroprudential Oversight				
3.	Establish additional borrower-based macroprudential policy tools, such as caps on mortgage LTVs or on DTI or DSTI ratios to limit the buildup of vulnerabilities in the household segment.	SBP	ST	The SBP has started to collect data from banks on the incomes of household borrowers (personal, automobile, and mortgage loans). This information is received semiannually, and two batches of data have already been received. They are being purged and analyzed.

[1] SBP = Superintendency of Banks of Panama; CCF = Financial Coordination Council; MEF = Ministry of Economy and Finance; SSNF = Superintendency of Non-Financial Entities; RPP = Public Registry Office; DGI = Tax Authority; MiAMBIENTE = Ministry of the Environment; SMV = Superintendency of Securities Markets; SSRV = Superintendency of Insurance and Reinsurance.

[2] I —Immediate (within 1 year), ST—Short term (within 1-2 years), MT—Medium term (within 3-5 years).

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
4.	Ensure regular and timely discussions on macroprudential policy issues, including through quarterly meetings of the SBP and CCF macroprudential policy committees.	CCF, SBP	I	It is planned that meetings of the FCC's Macroprudential Policy Committee (MPPC) will be held periodically. Since the MPPC has been formed, the results of its meetings have been discussed subsequently in the CCF assembly meetings. The authorities have requested Fund capacity development to help develop the CCF members' macroprudential analysis.
5.	Develop the CCF member agencies' capabilities for macroprudential analysis and policies. Allocate a role for the MEF in the CCF.	CCF	ST	SBP technical staff have provided training to other members of the MPPC. In 2022, a first Financial Stability Day was held, which served as training for MPPC members. No formal role for the MEF has been allocated yet, but discussions are planned on how to involve MEF staff in the MPPC's technical work. The MEF has been invited as observer to some CCF meetings.
Banking Supervision				
6.	Amend the Banking Law to make explicit that the SBP's primary objective should be to promote safety and soundness of the banking system.	MEF	ST	This is being evaluated.
7.	Undertake supervision of liquidity risk on a consolidated basis and	SBP	ST	The SBP is evaluating the best course of action for liquidity risk supervision

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
	implement regulations for interest rate risk in the banking book (IRRBB).			on a consolidated basis. It has hired an external consultant to review the existing draft regulation for interest rate risk (IRRBB). It is expected that the draft will be submitted to the Board of Directors for consideration during 2024.
8.	Introduce a capital buffer framework for internationally active banks aligned with the Basel III capital standards. Introduce the capital conservation buffer and capital surcharges for systemically important banks.	SBP	MT	The regulation to introduce a capital conservation buffer framework was issued on October 3, 2023 (Rule 5-2023). The introduction of a capital surcharge for systemically important banks is planned for 2025.
Payment Systems				
9.	Facilitate the urgent adoption of a law on payment systems and services.	MEF, SBP	I	The SBP has prepared a draft law that was sent to the MEF for consideration. The MEF has formed a technical group with the SBP and the BNP to coordinate and standardize issues related to payment systems.
10.	Develop an oversight policy framework covering payment systems and payment services reflecting the new legal mandate.	SBP	ST	Implementation of this recommendation awaits the adoption of the law on payment systems (recommendation 9). Even though the SBP does not yet have prudential powers, from the ML/TF prevention point of view it

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
				supervises some business models linked to payment methods (for example, e-money issuers).
Crisis Management and Financial Safety Nets				
11.	Establish prudential requirements for all banks to develop recovery plans, with tailored requirements for international license banks.	SBP	I	The SBP is evaluating the best course of action. Based on work by a technical team, it has determined that timely progress can be made in two aspects: a) Initiating steps to hire a second Consultancy to review the text of the draft bill against the recommendations resulting from the FSAP. b) Establishing in a timely manner, within the SBP Organization Chart, an internal body dedicated to addressing issues related to banking "crises," as well as other specific related issues to be determined. The SBP is currently studying relevant examples from jurisdictions similar to Panama, where such units already exist (e.g. Colombia, Honduras & Costa Rica).
12.	Establish an explicit industry-funded deposit insurance scheme once sufficient progress has been made on resolution reforms; the DIS should extend protection to certain class(es) of depositor(s)	MEF, SBP	ST	This is being evaluated. Implementation will require a change in policy at the level of the State.

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
	at all general license banks.			
13.	Explore and implement mechanisms to establish a LOLR facility provided by a public authority and not a commercial bank.	MEF, SBP	ST	This is being evaluated. Implementation will require a change in policy at the level of the State.
Financial Integrity				
14.	Ensure corporations can no longer issue bearer shares and require custodial arrangements to include collection and verification of beneficial ownership information.	MEF, SSNF	I	This is being evaluated. The SSNF can verify the UBO information for all legal persons, regardless of whether they have issued bearer shares or not. In the UBO registry the information related to the UBO must be included regardless of whether the legal person has issued bearer shares.
15.	Reach agreement at the policy level and develop procedures to dissolve and unwind suspended companies that have passed the deadline for reactivation.	MEF, RPP, SSNF, DGI	ST	This is being evaluated by a working group.
16.	Collect information and assess the risk posed by foreign legal persons and arrangements incorporated and/or managed abroad by Panamanian law firms and adopt appropriate and proportionate controls.	SSNF	MT	The SSNF works on three pillars for the identification of such risks: - Sectoral risk: through the evaluation of risks within the sector under review - Reporting entity risk: questions and risk criteria in the self-evaluation questionnaire: i.e., if offices are located outside Panama and in which country; if the

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
				reporting entity belongs to an economic group and from which country, etc. - Risk from the legal person incorporated in Panama assessed through the UBO registry.
17.	Assess the money laundering (ML)/terrorist financing (TF)/proliferation financing (PF) risks emerging from virtual asset service providers (VASPs) and identify measures to prevent or mitigate these risks; regulate and subject VASPs to supervision or monitoring for AML/CFT purposes in line with the FATF Standards.	SBP	ST	Currently the SBP jointly with the MEF (CNBC), SMV, SSRP, UAF, and the US Embassy have formed a work and study team to review and establish strategies and policies to assess the VA and VASP risks. The corresponding regulatory framework should be established in the future. A working table has been prearranged to start in April of this year, to develop a regional assessment of the ML/TF risk associated with Virtual Assets and Virtual Asset Service Providers with the support of BCIE and GAFILAT. The SBP has been invited to participate in this important working table. In this working table, the preliminary results obtained will be submitted and the findings will be discussed with the responsible officials to reach consistent general conclusions. The guidelines to be adopted will be reference inputs for adopting regulatory

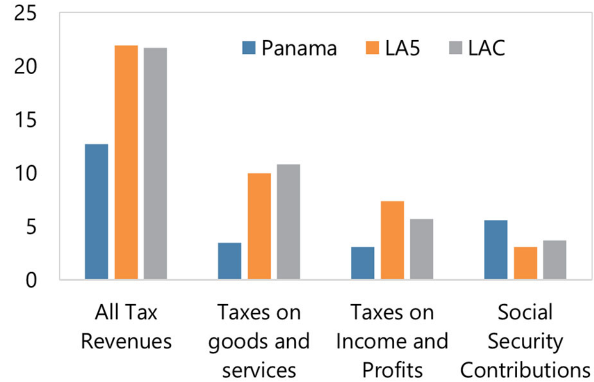
Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
				guidelines when appropriate.
Financial Sector Development				
Climate Risk Analysis, Regulation and Supervision, and Greening the Financial Sector				
18.	Improve coordination among superintendencies, government entities, and private sector stakeholders on climate-related and environmental risks; engage with external partners and join international platforms.	MiAMBIENTE, MEF, SBP, SMV, SSRP	I	
19.	Finalize the green taxonomy, making sure it is environmentally sound, well communicated, and covers the entire financial sector.	MiAMBIENTE, MEF, SMV, SBP, SSRP	I	On March 27, 2024, Panama launched its sustainable finance taxonomy. In the first half of this year, the member countries of the Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions' will issue a regional taxonomy.
Digital Financial Services and Financial Inclusion				
20.	Issue secondary regulations ensuring principles of regulatory neutrality and proportionality, and protection of customer funds, covering issuance of e-money, and rules for licensing of nonbank payment service providers.	SBP	ST	Implementation of this recommendation requires explicit legal powers for the SBP through legislation as proposed in Recommendation 9.
21.	Establish a comprehensive standalone financial	SBP	MT	Regarding banking entities, the regulation is explicit in indicating the

Recommendations		Agency[1]	I/ST/MT[2]	Implementation Status
	consumer protection regulatory framework with a specific focus on the new risks to consumers due to digital financial services and fintech.			parameters that banks must follow to mitigate the risks of different electronic channels (Rule 6-2011). However, in the case of other financial service users (non-banks), they are not currently within the SBP's jurisdiction, which is why it is important to approve the legal framework that regulates the payment system to ensure that these payment providers must comply with clear rules, contemplated in a legal framework.

Annex VI. Tax Revenues Mobilization

1. Panama's tax-to-GDP ratio is the lowest in the LAC region. In 2021, total fiscal revenues (including social security contributions) amounted to 12.7 percent of GDP, the lowest in LAC (OECD, 2021). The low tax revenues are primarily due to the combination of low tax rates and the widespread use of base-eroding policy measures, including tax incentives and exemptions across various taxes. Taxes on goods and services (3.5 percent of GDP) and income and profits (3.1 percent of GDP) are among the lowest in LAC. By contrast, social security contributions are above the LAC average.

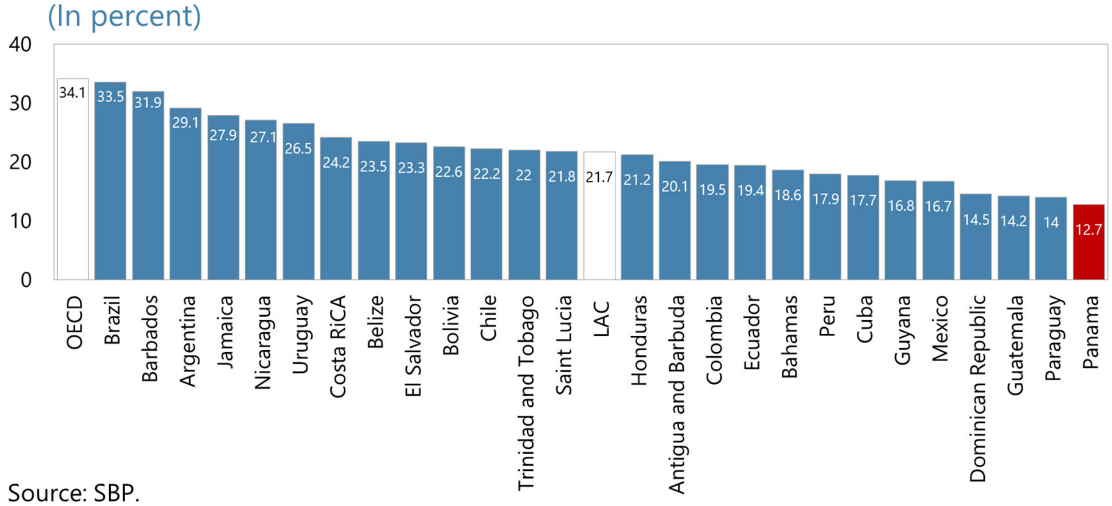
Tax Mobilization
(In percent of GDP)



Source: Organisation for Economic Co-operation and Development (OECD)

2. The tax revenue-to-GDP ratio has declined in the past decade, from 10.6 in 2012 to 7.7 in 2023. While this decrease was partially offset by higher ACP transfers, it increased the government's reliance on these transfers, which accounted for about 30 percent of central government revenues in recent years.

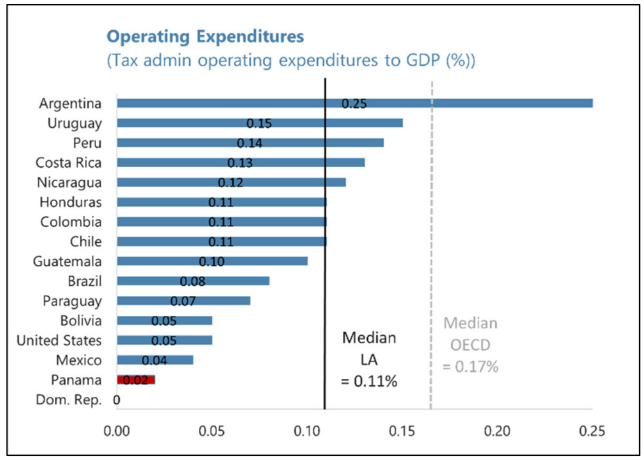
Fiscal-Revenues-to-GDP Ratios, 2021
(In percent)

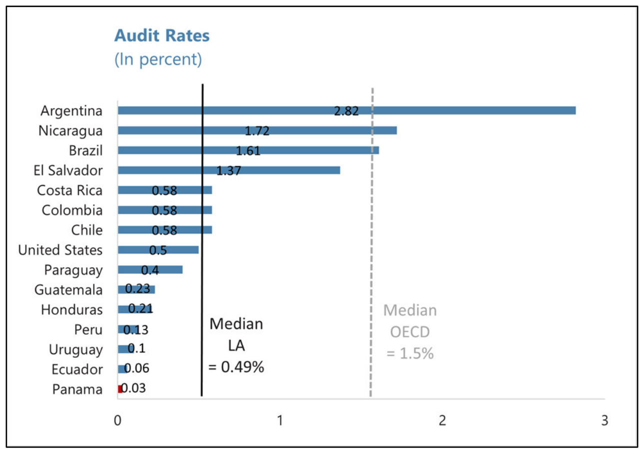


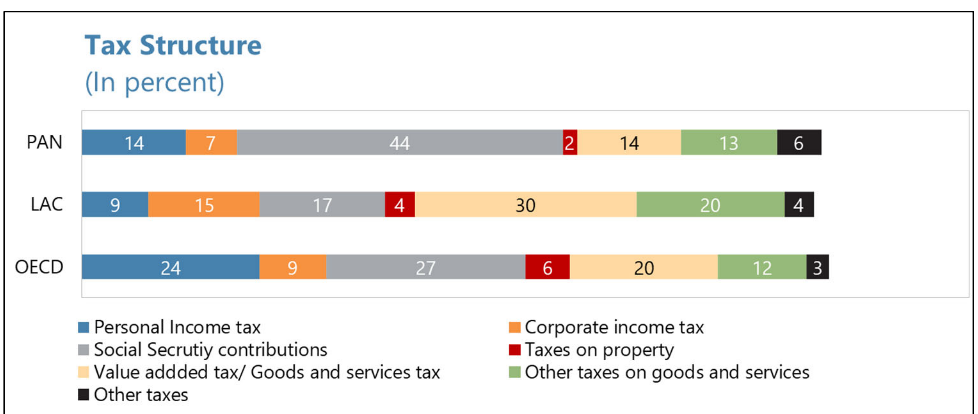
Source: SBP.

3. There is significant room for modernizing the Panamanian tax system. This can be achieved by enhancing its progressivity and transparency, reducing distortions, and aligning it with international best practices through revenue-neutral or revenue-enhancing reforms.

4. There is also a necessity to enhance control measures to mitigate non-compliance, smuggling, and informality. Enhancements in tax policy may lose their effectiveness if not adequately implemented. Likewise, a tax system with numerous exemptions across all taxes can be challenging to administer, even for highly efficient tax administrations in developed countries. Thus, apart from broadening the narrow tax base, guaranteeing the functionality of Panama's tax administration, and enhancing enforcement effectiveness is vital. Tax administration operating expenditures in Panama are about 0.02 percent of GDP, well below the averages in LAC (0.11 percent) and OECD (0.17 percent) countries. In addition, the audit rate in Panama, defined as the number of audited taxpayers divided by the number of active PIT taxpayers, is among the lowest in the region and well below the average of OECD countries (Bergolo et al, 2022). Therefore, changes in tax policies could be contemplated when compliance and enforcement are improved, as both can finance crucial current spending in social, educational, and infrastructure projects.







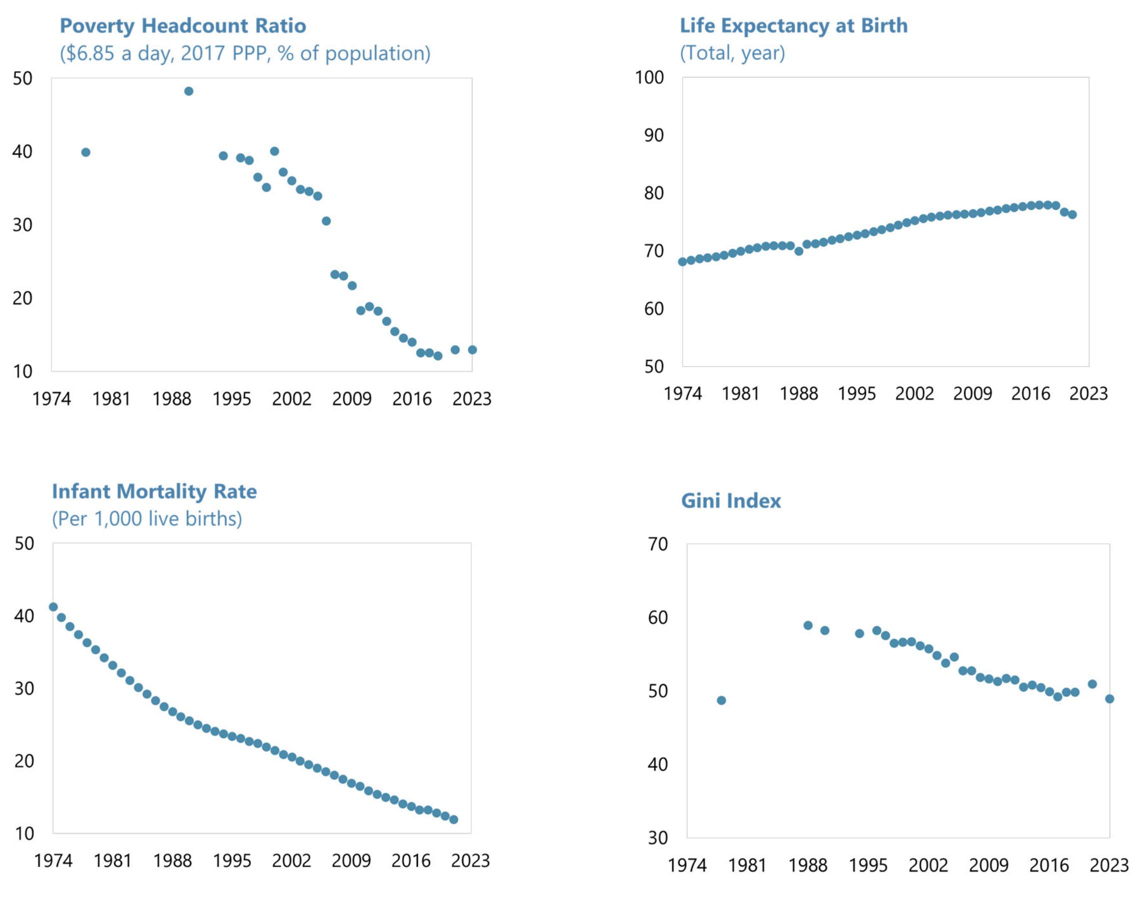
Source: OECD.

Annex VII. Social Inclusion

Panama's social indicators have shown improvement over decades, despite setbacks during the pandemic. Poverty declined significantly, but pandemic subsidies did not prevent a temporary rise in poverty and inequality. Panama still lags its peers in education, health, and equality. Social assistance programs have helped alleviate poverty, notably during the pandemic, yet challenges persist in mitigating disparities, especially in rural and indigenous areas.

1. Social indicators in Panama have improved markedly over the last few decades despite the deterioration during the pandemic. The poverty rate declined remarkably over the last decades, at a much faster pace than elsewhere in the region, while inequality, as measured by the Gini index, has also come down. Despite the considerable disbursement of subsidies during the pandemic, both poverty and inequality deteriorated during this period and have not yet returned to pre-pandemic levels. The share of people living in multidimensional poverty has also come down

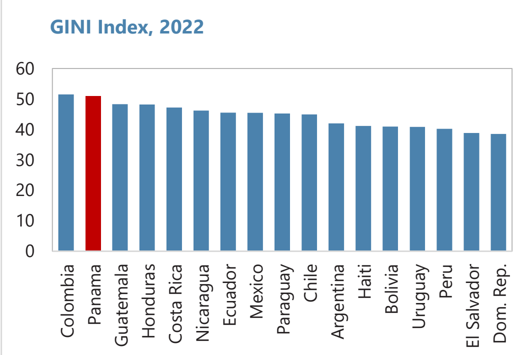
Social Indicators



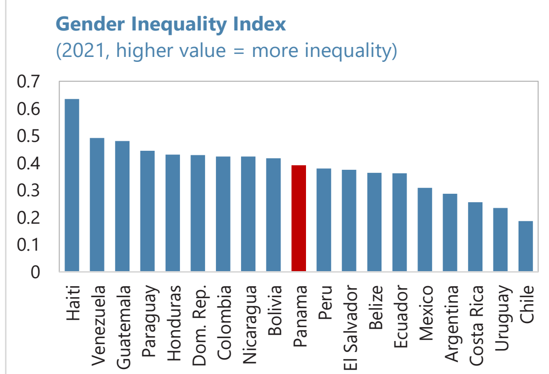
Sources: World Development Indicators.

from 19 percent in 2018 to 15 percent in 2022, according to the Ministry of Social Development.[1] Other indicators such as life expectancy and infant mortality also improved dramatically in Panama.

2. Panama's social indicators are still weak relative to peers. Panama lags the peers in its income group in many aspects of social indicators, such as education, health, gender equality, and social inclusion. Panama scores poorly in terms of both its human capital index and harmonized test scores, but also on gender inequality. Importantly, during the pandemic, women bore a disproportionate burden of household care duties, resulting in a widening of gender gaps that continues to endure. Female labor force participation remains below pre-pandemic levels.



Source: World Development Indicators (WDI).



Source: United Nations Gender Inequality Index.

3. Regional disparities remain significant in Panama, with poverty and lack of social services being the highest among indigenous groups. While the national poverty rate in Panama was 21.8 percent in 2021, the poverty rate in the indigenous regions (*comarcas)* – where 6.3 percent of the population lives[2] – ranged between 63.7 and 79.6 percent the same year.[3] Inequality in access to housing conditions is also striking – while most of the country has access to clean water, electricity, and basic sanitation, a large share of those who live in the comarcas do not. Literacy and school attendance levels in the comarcas also lag the national average.

[1] Multidimensional poverty measures the access and the quality of households to education, health, work, and environment.

[2] According to the 2023 census, over 97 percent of the population living in the *comarcas* are indigenous.

[3] These estimates differ methodologically from the World Bank's poverty headcount ratios.

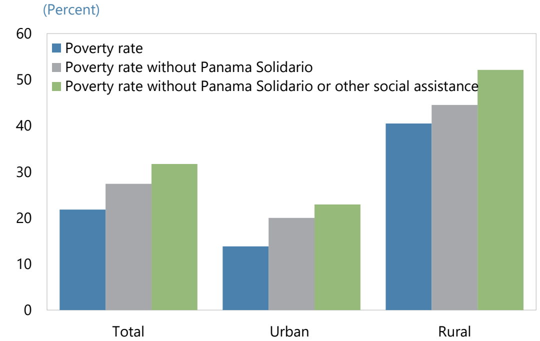
Regional Inequalities

Sources: Ministry of the Economy and Finance (MEF), and Census 2023, INEC.

A. Social Assistance and Subsidies

4. Social assistance programs have played an important role in reducing poverty. Panama has various social assistance programs that target the most vulnerable. Among them are: (i) *Red de Oportunidades*, a conditional cash transfer program introduced in 2006 to support families in extreme poverty; and (ii) *Panama Solidario*, an emergency assistance program launched during the COVID-19 pandemic, which delivered digital vouchers (*Vale Digital)*, subsidies, and food.[4] Even though *Panama Solidario* might have been insufficient to fully

Poverty and the Role of Social Assistance, 2021
(Percent)



Source: Ministry of Economy and Finance (MEF).

[4] The social assistance program *Vale Digital* was discontinued at end-2023.

compensate for pandemic-related income losses, without this emergency assistance, poverty would have been substantially higher, especially in rural areas and in the *comarcas*. According to authorities' estimates, poverty rates would have surged to 27 percent, surpassing the actual 21 percent. Other social assistance programs have also played an important role in mitigating poverty, especially in rural areas, but territorial disparities persist even when accounting for social programs.

5. The social program *Plan Colmena* has also helped to mitigate multidimensional poverty. The program was created to fight poverty and inequality through the empowerment of local governments and technical boards. Its goal is to improve healthcare, nutrition, potable water, sanitation, rural electrification, road infrastructure, education, and housing. The program has managed to mitigate multidimensional poverty in 279 of the 300 *corregimientos* (administrative districts) covered by the program.[5]

[5] In total, there are 693 *corregimientos* in Panama.

Annex VIII. Minera Panama

Following weeks of strikes and protests, Panama's Supreme Court ruled in November 2023 that the new contract with mining company Minera for the operation of the Cobre Panamá copper mine was unconstitutional. Subsequently, the government announced in December 2023 that it would close the mine, which directly and indirectly contributes some 5 percent of GDP.

1. **Cobre Panamá[1] is Central America's largest open-pit copper mine and the largest foreign investment in Panama.** Its original concession was granted in 1997,[2] and the mine began operating in 2019. The mine accounts for about 1.5 percent of global copper production.[3] Minera Panamá has invested around US$10 billion (12 percent of Panama's GDP) to develop the mine. The mine is located in the Donoso District of Colón Province, an area of biodiverse rainforest. The concession agreement includes provisions that are intended to minimize the environmental impact of the mine. A comprehensive environmental and social impact assessment was undertaken prior to the start of the mine's construction.

2. **In December 2017, the Supreme Court ruled that the concession was unconstitutional.** In 2021, after an appeals process, Panama's Supreme Court upheld the ruling that Law No. 9 was unconstitutional because not all proper procedures had been followed when it was approved in 1997.

3. **Following the 2021 verdict, the government started negotiations with Minera Panamá about a new contract.** The government was of the view that Minera Panamá had been paying less than its fair share due to a tax holiday. Under the original concession, the company paid a 2 percent royalty on a net smelter return basis but was exempt from most other taxes (except for social security contributions on employee wages) as long as it had an outstanding debt related to the project. During most of the negotiations, the mine continued operating but did not pay royalties. As of 2022, the government no longer accepted Minera Panama's royalty declarations, as it was awaiting the outcome of the new contract.

4. **In March 2023, the government reached an agreement that ended the tax holiday (retroactively from Dec 2021) and reinstated the general regime of corporate income taxes at a 25 percent rate, the general withholding regimes, and royalties of 12-16 percent of the operating margin.** The contract also required a yearly minimum payment of US$375 million, in

---

[1] Cobre Panamá is owned by Minera Panamá, S.A., the local subsidiary of the Canadian firm First Quantum Minerals. First Quantum owns 90 percent of Minera. The other 10 percent is owned by Korea Mine Rehabilitation and Mineral Resources Corp. (KOMIR).

[2] Congress 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.

[3] Production started in June 2019 and reached initial nominal capacity in 2021 of 85 million annual throughput (the quantity or amount of raw material processed within a given time). During 2023, the mine was expanded to increase capacity to 100 million annual throughput. The mine at full capacity would produce about 400,000 tons of copper, 150,000 oz of gold, and 4,000 tons of molybdenum annually.

addition to social security contributions, municipal taxes, acreage fees, and water charges. The contract also included environmental obligations.[4]

5. **When the National Assembly started debate on the new contract in August 2023, protests and strikes erupted.** Critics argued that the contract jeopardized national sovereignty, Panama's natural resources, local communities' rights, and the environment. In response, several amendments of controversial clauses were agreed with Minera.

6. **A revised contract was approved by the National Assembly on October 20.** This triggered new mass protests, including roadblocks of key transport arteries, and at least 10 lawsuits were filed at the Supreme Court. The demonstrators included civilians, indigenous groups, environmental activists, and the construction and teachers' unions.[5]

7. **On November 16, 2023, Minera Panama paid to the Government of Panama US$567 million in taxes for the period December 2021 - October 2023.**

8. **On November 28, 2023, the Supreme Court ruled that the new mining contract was unconstitutional, after which the government announced that it would close the mine.** The Supreme Court found that Law 406, which gave the contract force of law, violated 25 articles of the Constitution. It also ruled that "the Protection of the right to life, health and the environment of future generations takes precedence over any other right of an economic nature, including the right to investment." Following the ruling, the government announced that it would close the mine, which is currently neither operating nor exporting.

A. Contribution of the Mine to Panama's Economy

9. **In 2022Q4-2023Q3, before the closing of the mine, copper exports were about US$2.8 billion, or 3½ percent of GDP.** Copper exports are equal to 11.3 percent of exports of goods and services[6] and 75 percent of exports of commodity exports.

10. **About 60 percent of copper export proceeds are spent in Panama.** In 2023, Minera spent US$1.8 billion domestically, of which US$215 million in net salaries, US$120 million in social security contributions, US$570 million in taxes, and US$900 million in payments to Panamanian vendors. Payments to Panamanian vendors have increased in the last few years, as Minera has increased its sourcing of products and services in Panama.

---

[4] Total tropical forest in Panama is 11,650 square miles. So far, the copper mine has developed an area of 12 square miles (0.1 percent). It plans to eventually clear 22.8 square miles. Minera has completed reforestation of 15 square miles. Under the new contract it was obliged to reforest another 32 square miles. The mining company is also committed to conservation and care of an area totaling 811 sq. m. According to the ministry of the environment, the mine has passed 35 environmental assessments.

[5] The teachers' union joined the protests and strikes, leaving about 800 thousand students from public schools without classes for six weeks. Source can be found here.

[6] Exports of goods here only include domestic exports; they do not include re-exports from the Colon Free Zone.

Minera Panamá's Production, 2021 (In millions of US Dollars)				
	Mining Activity	Power Plant	Minera Panamá	In percent of National Total
Gross Value of Production	3,032	134	3,166	3.2
Intermediate Consumption	780	119	899	2.6
Local Intermediate Consumption	552	42	594	2.4
Gross Value Added	2,251	15	2,267	3.6
Compensation of Employees	219	14	232	1.4

Sources: Indesa's calculations with data from Minera Panamá and INEC.

11. **According to a study by Indesa, in 2021, Minera directly contributed 3.6 percent of Panama's GDP.** If indirect effects are also considered, the figure rises to 4.8 percent. Minera, directly and indirectly, also contributes 2 percent of employment.

Economic Impact of Minera Panama (Including Multiplier Effect)			
	National	Province of Colón	Province of Coclé
Production (millions of US$)	4,683	3,474	216
(percent of total)	4.8	16.9	6.1
GDP (millions of US$)	3,066	2,207	126
(percent of total)	4.8	17.0	6.7
Income (millions of US$)	447	243	27
(percent of total)	3.0	11.0	5.0
Employment, direct and indirect (thousands)	40,793	5,658	4,418
(percent of total)	2.3	5.0	3.5

Source: Indesa's calculations with data from Minera Panama and INEC.
Note: Values include multiplier effects of Minera Panama. The estimated production multipliers are 1.5 for the mining activity and 1.7 for the power plant.

12. **The closure of the mine will have a negative economic impact.** Growth projections for 2024 have been revised down from 5 percent to 2.5 percent (compared to 7.3 percent growth in 2023). The closure of the mine will impact other economic sectors, including manufacturing, construction, transportation, and logistics, as most of Minera's intermediate consumption comes from national suppliers. The mine closure will reduce tax revenue and royalties by at least US$375 million and social security contributions by US$120 million.

13. **The negative effects will be heterogenous across regions.** For example, the province of Colón will be more affected, as 17 percent of production and 5 percent of employment in the province are related to Minera's activity.

14. **The indirect effects of the mine closure may affect growth beyond 2024.** The direct impact of the closing of the mine on medium-term growth should be limited, as the mine's production was projected to remain constant in the next decade, thus not contributing to growth.

However, there may be indirect growth effects from closing the mine if investment sentiment and the business climate are affected, thus deterring FDI inflows to other sectors and possibly domestic investment as well. Though the outlook remains highly uncertain, growth projections for 2025 have also been revised down from 4 to 3 percent, while the medium-term growth projection remains at 4 percent.

B. Arbitration

15. Minera's Canadian parent company has notified the government that it has started international arbitration proceedings. First Quantum requested one arbitration proceeding under the Canada-Panama Free Trade Agreement and another before the International Court of Arbitration.

16. If these proceedings were to be decided in favor of First Quantum, the fiscal implications could be significant. First Quantum has reported that it will seek at least US$20 billion, reflecting an estimated fair market value of its initial investment.

17. Other companies are seeking damages as well. Franco-Nevada (counterpart in a precious metal streaming agreement[7] with Minera Panama) has notified the Ministry of Commerce and Industries of its intent to initiate arbitration pursuant to the Canada-Panama Free Trade Agreement. Franco-Nevada preliminarily estimates its damages to be at least US$5 billion.[8] KOMIR is seeking compensation through an investor-state dispute settlement mechanism for US$747 million.[9]

[7] Precious metals streaming is a term for when a company makes an agreement with a mining company to purchase all or part of their precious metals production at a predetermined discounted price to which both parties agree. In return, streaming companies provide upfront financing for mining companies looking for capital. See Precious metals streaming - Wikipedia

[8] See https://s201.q4cdn.com/345177888/files/doc_financials/2023/q4/9705_Franco-Nevada_2023_Annual_Report_Digital_Filing_Ph11.pdf

[9] https://www.kedglobal.com/business_politics/newsView/ked202401250017

Annex IX. Data Issues

Table AIX.1. Panama: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating [1/]							
C							
Questionnaire Results [2/]							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	B	B	C	B	B	B
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	B	B	C	B	C		
Granularity [3/]	C		B	C	B		
			B		B		
Consistency			B	D		B	
Frequency and Timeliness	C	B	C	C	B		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provided to the Fund has some shortcomings that somewhat hamper surveillance. Data timeliness, especially for real sector data, is a key shortcoming. The recent spike in errors and omissions in balance of payments statistics hamper analysis of recent trends and outlook. The monthly production index (IMAE) is often published with over 10 weeks delay. The published 2018 rebased GDP series have not yet been backcasted. The overall assessment reflects the importance for surveillance of the shortcomings related to the external sector and national accounts.

Changes since the last Article IV consultation. The timeliness of some macroeconomic data has deteriorated and constitutes the main data weakness. High-frequency information is only available with large lags (3 months delay). While Panama usefully rebased GDP to 2018, the rebasing hasn't been extended to the full decomposition useful for surveillance.

Corrective actions and capacity development priorities. Continued CD on GFS (to expand coverage), national accounts and prices would support surveillance. TA from the ILO would assist in producing more frequent and timely labor market data. There is no comprehensive presentation on how the nonfinancial public sector is consolidated. Improving the timeliness of real sector data should be a priority. The upcoming new CPI based on the 2017/2018 household survey will improve the series' usefulness for surveillance. Ongoing Fund assistance will help improve external sector statistics.

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff do not use data and/or estimates different from official statistics.

Other data gaps. The frequency of labor statistics deteriorated since the pandemic, from semiannual to annual, hampering surveillance. Information on non-bank financial institutions, non financial corporations and households is limited, including savings data per sector. Data on house prices are limited and there is no commercial property price index. Breakdown of debt instruments by residency of the holder would be desirable for surveillance.

Table AIX.2. Panama: Data Standards Initiatives

Panama participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since October 2018.

Table AIX.3. Panama: Table of Common Indicators Required for Surveillance

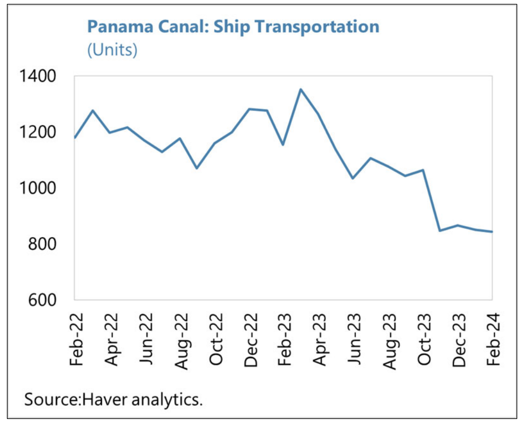
As of April 22, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Panama[8]	Expected Timeliness[6,7]	Panama[8]
Exchange Rates					...	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	March-24	April-24	M	M	M	M	1M-3M	1M
Reserve/Base Money	December-23	March-24	Q	Q	M	M	2M	50D
Broad Money	December-23	March-24	Q	Q	M	M	1Q	50D
Central Bank Balance Sheet	February-24	March-24	M	M	M	M	2M	50D
Consolidated Balance Sheet of the Banking System	December-23	March-24	Q	Q	M	M	1Q	50D
Interest Rates[2]	April-24	April-24	D	D	D	D	...	1D
Consumer Price Index	March-24	April-24	M	M	M	M	2M	15D
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	December-23	February-24	Q	Q	A	Q	3Q	45D
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	December-23	February-24	Q	Q	Q	Q	1Q	45D
Stocks of Central Government and Central Government-Guaranteed Debt[5]	March-24	April-24	M	M	Q	M	2Q	1M
External Current Account Balance	December-23	April-24	Q	Q	Q	Q	1Q	75D
Exports and Imports of Goods and Services	January-24	March-24	M	M	M	Q	12W	45D
GDP/GNP	December-23	March-24	Q	Q	Q	Q	1Q	75D
Gross External Debt	December-23	April-24	Q	Q	Q	Q	2Q	75D
International Investment Position	December-23	April-24	Q	Q	A	Q	3Q	75D

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex X. Global Spillovers of the Panama Canal Drought

1. **The Panama Canal is a strategic waterway that facilitates 40 percent of US containers and 5 percent of global trade.** Half of the tonnage shipped through the Canal from the Pacific to the Atlantic originates from Asia, and another quarter from the West Coast of South America. 62 percent of the tonnage shipped in this direction is headed to the East Coast of the United States, and another 18 percent to Europe.



Cargo Movement Through the Panama Canal by Origin and Destination -- Pacific to Atlantic -- Fiscal Year 2023

(In millions of Long Tons) 1/

From	East Coast of the United States	Europe	East Coast of South America	East Coast of Central America	Panama	West Indies	Africa	East Coast of Canada	Asia and the Middle East	Total
Asia	41.6	0.4	3.4	2.0	0.2	1.1	-	0.4	-	49.2
West Coast of South America	11.9	9.7	2.6	0.8	1.2	0.4	0.2	0.3	-	27.0
West Coast of Central America	4.5	1.3	0.2	0.8	0.9	0.2	0.6	0.2	0.0	8.8
West Coast of Canada	0.6	3.7	0.6	0.4	0.1	0.1	0.8	-	0.2	6.5
West Coast of the United States	0.5	2.3	0.3	0.1	0.1	0.1	0.0	0.1	-	3.5
Oceania	2.2	0.3	0.1	0.1	0.0	0.1	-	0.3	-	3.1
Panama	0.1	0.1	0.1	0.1	0.1	0.0	0.0	-	-	0.4
Grand Total	**61.5**	**17.7**	**7.3**	**4.4**	**2.7**	**2.1**	**1.5**	**1.2**	**0.2**	**98.5**

Source: Panama Canal Authority.
1/ Does not include 7 million cargo tons with origin or destination in the same coast.

Cargo Movement Through the Panama Canal by Origin and Destination -- Atlantic to Pacific -- Fiscal Year 2023

(In millions of Long Tons) 1/

From	Asia	West Coast of South America	West Coast of Central America	West Coast of the United States	Panama	Oceania	West Coast of Canada	Total
East Coast of the United States	80.5	26.1	13.8	3.7	3.4	1.5	0.3	129
Europe	0.5	7.2	2.0	3.2	0.2	0.1	0.0	13
East Coast of South America	4.5	4.7	3.2	0.3	0.1	0.0	0.1	13
West Indies	3.4	1.4	0.7	1.2	1.0	0.0	-	8
East Coast of Central America	1.8	0.3	0.3	0.3	0.0	0.0	-	3
Africa	0.1	0.6	0.4	1.1	0.0	-	-	2
East Coast of Canada Asia and the Middle	0.7	0.3	0.1	0.2	-	0.0	-	1
Around the World (Pacific)	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0
Panama	-	0.5	0.0	0.1	-	-	-	1
Grand Total	**91**	**41**	**20**	**10**	**5**	**2**	**0**	**170**

Source: Panama Canal Authority.
1/ Does not include 9 million cargo tons with origin or destination in the same coast.

2. **Three quarters of the tonnage going from the Atlantic to the Pacific originates from the East Coast of the United States**. 54 percent of the tonnage is destined to Asia and another 24 percent to the West Coast of South America.

3. **Interestingly, cargo movements from the Atlantic to the Pacific are about 70 percent higher than the other way around.** Shipments from the East Coast of the United States to Asia are almost twice as large as those from Asia to the US East Coast.

4. Energy and grains account for 70 percent of the tonnage shipped through the Canal. Energy and gains also account for 70 percentage of the transportation from the Atlantic to Pacific.

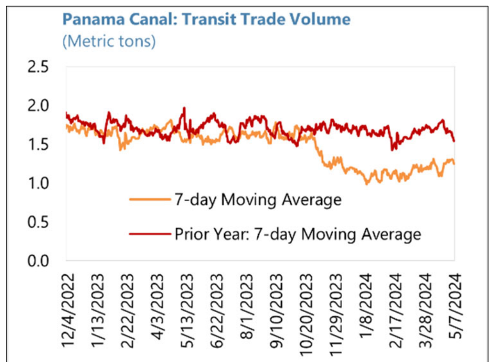
Principal Commodities Shipped Through the Panama Canal: Fiscal Years 2021-23
(In millions of Long Tons)

Atlantic to Pacific			Items	Pacific to Atlantic		
2021	2022	2023		2021	2022	2023
13	12	13	Chemicals and Petroleum Chemicals	4	4	3
40	36	32	Grains	4	2	4
83	89	83	Petroleum and Petroleum Products	6	6	5
25	21	19	Container Cargo	44	43	40
0.69	0.72	0.71	Energy and Grains (percent of total ships)	0.13	0.12	0.13

Source: Panama Canal Authority.

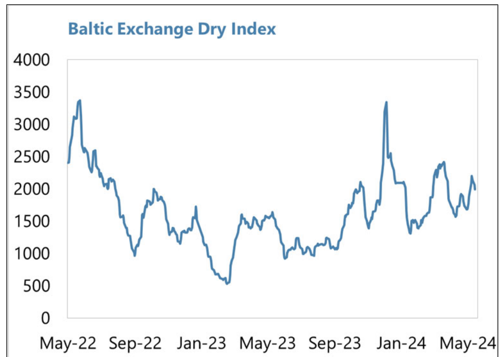
5. A historical drought has reduced the water level in Gatun Lake. According to the ACP, the average water level at Gatun Lake in November over the past five years was 86.7 feet. However, in November 2023, its depth had decreased to 79.8 feet.

6. In response, the ACP reduced the number of ship transits from the regular 36 to 38 per day to 24 in January. This reduction is expected to be unwound gradually from April, when the rainy season started. In March, the ACP announced that the number of transits would be increased to 27 per day, and in April it announced a further gradual increase to 32 per day. The ACP has also reduced ships' loads by up to 40 percent. Once water levels fall below a certain point, measures are needed to stop large vessels from running aground. Restrictions on the maximum draft of ships will be relaxed starting from mid-June.



Source: IMF Portwatch.

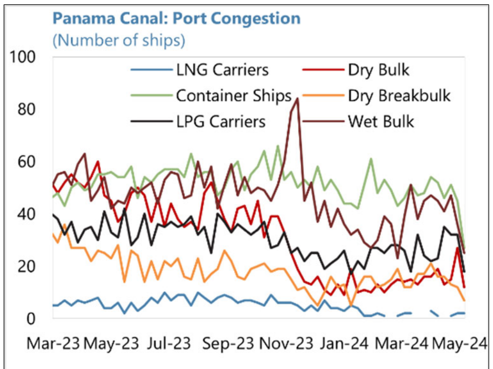
7. The drought puts upward pressure on food and energy prices. The reduction in Panama Canal traffic has caused a traffic jam of vessels and significant increases in shipping times and shipping costs.



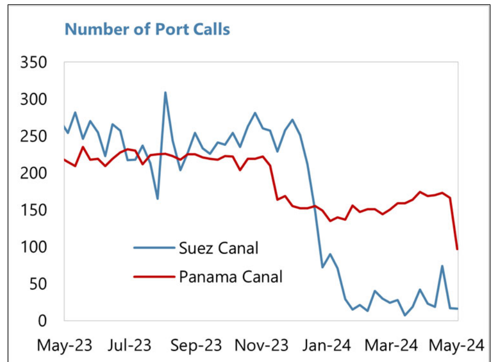
Source: CEIC database.

- The costs of a transit through the Panama Canal have increased significantly, as auction prices for transits have shot up to a record of US$4 million in November compared to the previous average price of around US$1 million. The benchmark Baltic Dry Index, considered a benchmark for bulk grain freight, spiked to a 1½ year peak during November and December and even after a subsequent decline remains elevated.

- Longer waiting times further add to increased costs.



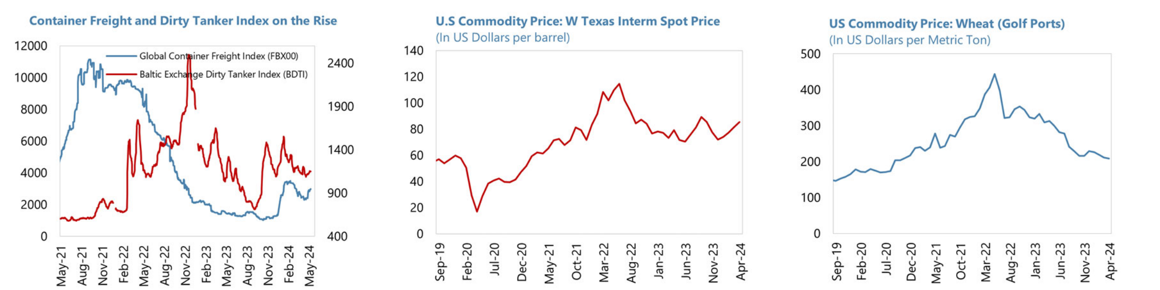
Source: CEIC database.



Source: CEIC database.

- Alternative routes involve longer shipping times—and costs. A trip from the US Gulf coast to Asia around the Cape of Good Hope takes 32 days—12 days more than through the Panama Canal.[1] Going through the Suez Canal takes 30 days, but this has become a bottleneck as well.

- The bottleneck in the Panama Canal risks driving up energy and food prices. The number of dry bulk and wet bulk[2] ships going through the Panama Canal has fallen sharply as ships are taking alternative, more expensive, routes. The simultaneous bottleneck in the Suez Canal further adds to the problem.



Sources: CEIC Database, Haver analytics, and IMF staff calculations.

[1] According to Hummels and Schaur (2013), an additional day in transit is equivalent to an increase of a value-based tariff of 0.6-2.1 percent.

[2] Wet bulk refers to liquid cargo that is transported in large volume. It includes oil, LPG and LNG. Dry bulk encompasses cargo that consists of dry goods, usually in large quantities and not packaged separately. Dry bulk cargo is often loose and loaded directly into the ship's cargo holds. Examples of dry bulk cargo include grains.

INTERNATIONAL MONETARY FUND

PANAMA

May 16, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of March 31, 2024)

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	557.90	148.06
Reserve Tranche Position	54.41	14.44
SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	558.16	100.00
Holdings	397.58	71.23
Outstanding Purchases and Loans:		**Percent of Quota**
Emergency Assistance 1/	235.50	62.50

1/ Emergency Assistance may include ENDA, EPCA, and RFI.

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):

	2024	2025	2026	2027	2028
Principal	141.30	94.20			
Charges/Interest	12.42	8.67	6.61	6.61	6.61
Total	153.72	102.87	6.61	6.61	6.61

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

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

Last Article IV Consultation

The 2022 Article IV consultation was concluded on February 22, 2023. Panama is on the standard 12-month consultation cycle.

Financial Sector Assessment Program (FSAP)

The 2023 FSAP was concluded on December 1, 2023. It found that the main risks of macrofinanical stress in Panama stem from potential external shocks, including a resurgence in global macroeconomic uncertainty from regional conflicts, further rising interest rates in the United States, and higher crude oil prices. The banking sector, which dominates Panama's financial system, appears to be well capitalized, liquid, and generally resilient against these risks according to a stress test that simulated a hypothetical, severe downturn scenario. Some pockets of weakness were revealed. Banks appear solid in terms of liquidity coverage, and the system relies strongly on foreign correspondent bank support.

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

Gerardo Peraza (based in Guatemala) is the Regional Resident Representative for Central America, Panama, and the Dominican Republic.

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

(As of April 18, 2024)

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

Inter-American Development Bank: https://www.iadb.org/en/who-we-are/country-offices/panama

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

Central American Bank for Economic Integration (CABEI): 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

PANAMA

May 24, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By Western Hemisphere Department

The information below has become available following the issuance of the Staff Report. It does not alter the thrust of the staff appraisal.

1. **Economic activity in the first quarter was weak.** The Main Economic Indicator (IMAE) was only 0.7 percent higher than in Q1 2023. The mine closure, lower Canal revenues, and weaker construction all contributed to the negative dynamics. While some of the factors (including the Canal revenues) are expected to reverse later this year, recent developments underscore the downside risks mentioned in the Staff Report.

2. **The non-financial public sector deficit for Q1 came in at 1.9 percent of full-year GDP, slightly higher than in 2023Q1 (1.8 percent of GDP).** Revenue grew by 10 percent year-on-year, boosted by baseline effects,[1] but this was offset by a 25 percent year-on-year increase in investment. The apparent absence of investment compression in Q1 further increases the likelihood that the SFRL 2024 deficit target of 2.0 percent of GDP will not be met.

3. **Preliminary staff analysis suggests that the large 2023 current account deficit may have been significantly overstated.** At the request of the authorities, the Statistics Department has begun reviewing the accounting behind the large trade deficit of the Colon Free Zone (CFZ) and export-processing zones; specifically, large CFZ imports of a large international company that drove much of this deficit. Preliminary evidence suggests that there was no change in ownership when the merchandise reached the CFZ. According to BMP6, without a change in ownership, these transactions should not have been counted as imports in the balance of payments.

4. **Based on the ongoing discussions with staff on the accounting for the CFZ transactions, Panama's statistics agency (INEC) has significantly revised down the 2023 and 2022 current account deficits.** The newly published revised statistics put the 2023 deficit at 4.5 percent of GDP (instead of 12.6 percent) and the 2022 deficit at 0.6 percent (instead of 4.0 percent). Similar large adjustments have been made to errors and omissions. The revisions reflect corrections for goods brought into the CFZ that did not change ownership. Staff's initial assessment is that the adjustments are warranted. Further revisions to the BoP data may be needed. Ongoing assistance will help provide a final view and quantification.

[1] Tax revenues in 2023Q1 were depressed by the shifting of US$255 million tax revenues received in the first two weeks of 2023 to 2022. Excluding this effect, revenue grew by 0.9 percent year-on-year.