IMF Country Report No. 13/88

PANAMA

2012 ARTICLE IV CONSULTATION

March 2013

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 2012 Article IV consultation with Panama, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 16, 2012, 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 January 10, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its January 25, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Panama.

The document listed below has been or will be separately released.

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

PANAMA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

January 10, 2013

KEY ISSUES

Context. Panama's economy continues to grow strongly, buoyed by the Panama Canal expansion and large public infrastructure projects. Annual real GDP growth averaged about 9 percent over the past five years, the highest in Latin America. Together with declining public debt ratios and a sound financial sector, this has led to an upgrade of Panama's sovereign debt rating. Over the medium term, Free-Trade Agreements (FTAs) with major trading partners should help sustain FDI flows. The creation of a Sovereign Wealth Fund to save additional revenue from the expanded Canal should further strengthen the economy's resilience to external shocks.

Risks. Short-term risks are mainly associated with unsettled external conditions, with longer-term risks linked principally to domestic structural challenges. A significant U.S. slowdown or renewed global financial turmoil would affect Panama, given its close integration with the U.S. economy and global trade, and reliance on external financing. Given a closed output gap, high inflation, and easy credit conditions, the further relaxation of the fiscal targets raises overheating risks, as the fiscal stance is now markedly pro-cyclical. Longer term issues include the need to advance reforms to transition to a more sustainable medium-term growth, and address fiscal challenges to spur further investments in infrastructure and social needs within lower deficit limits.

Policy Challenges. With Panama's output above potential and external risks looming large, discussions focused on the importance of achieving a tighter fiscal stance than the one currently envisaged by the authorities in order to avoid overheating risks and preserve room for maneuver in the near term. Ongoing efforts to upgrade financial sector supervision and strengthen the financial safety net should be accelerated, including by closing existing data gaps, enhancing non-bank supervision and establishing a liquidity facility.

.Approved By
Gian Maria Milesi-Ferretti and Martin Mühleisen

Discussions took place in Panama City during November 6–16, 2012. The staff team comprised Mmes. Deléchat (head), Ospina and Vtyurina, and Mr. Kamil (all WHD), Ms. Buzaushina (FIN) and Mr. Jafarov (MCM). Mr. Macia (OED) also participated in the meetings.

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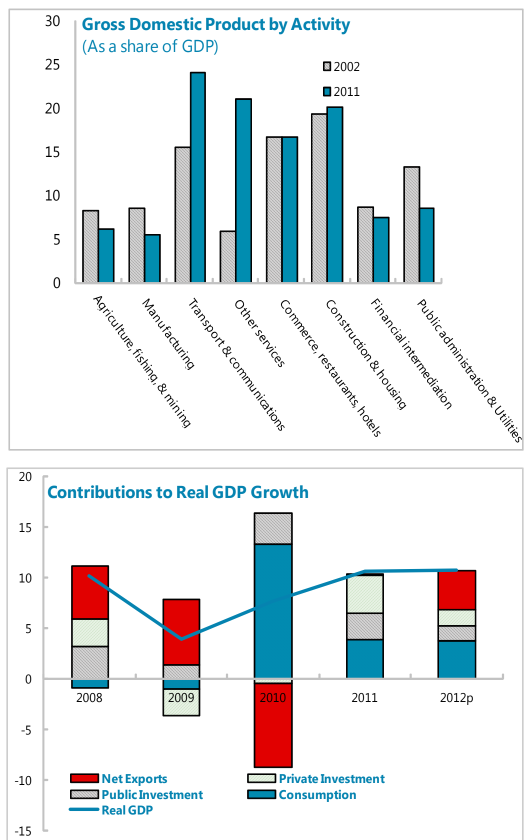
ANNEX

RECENT DEVELOPMENTS

1. **Panama's per capita GDP has more than doubled over the past decade, driven by a steady rise in public and private investment underpinned by a stable macroeconomic environment and prudent policies.** Unemployment is at historic lows, and poverty has declined owing to rapid economic growth and stronger social safety nets. Macroeconomic stability anchored by full dollarization has favored the expansion of domestic services and activities mostly centered around the Panama canal and the Colón Free Zone (or canal conglomerate[1]), as well as the development of Panama's financial center (Chart 1). Panama's resilience to the 2008-09 global financial crisis and the economy's quick turnaround in 2010 were explained by a prompt and appropriate policy response as well as strong fundamentals, including a solid banking sector, a diversified economy, and exports based on services. More recently, implementation of an ambitious public investment program and the Panama canal expansion aimed at positioning Panama as a world-class logistics hub have underpinned economic activity amid a weak external environment.

Chart 1. Panama: Growth Performance, Supply and Demand Factors



Sources: National Authorities and IMF staff calculations.

2. **Panama's economy continued to expand at a fast pace in 2012, as implementation of the large public infrastructure projects in the context of supportive fiscal and credit conditions boosted domestic demand**. Real GDP growth reached 10.6 percent in 2011, closing the output gap opened during the global crisis. The economy continued to expand at the same rate in the first three quarters of the year, driven by strong activity in commerce, construction, as well as transportation, storage and communications (Figure 1). Canal traffic and activity in the Colón Free Zone (CFZ) have been supported by strong demand from South America and emerging Asia. After a slight softening in the second quarter, economic activity picked up again in June, and growth is projected at 10.7 percent for the year.

3. **Both headline and core inflation started to decline in September, and fell markedly in November.** Headline inflation hovered around 6 percent until August due to rising world food prices, demand pressures (including the effect of the 17 percent minimum wage increase granted at

[1] The canal conglomerate refers to all activities related to the Panama canal, including ports, shipping, logistics, commerce including the CFZ, and financial and telecommunication services. As of 2008, the canal conglomerate represented about 22 percent of total GDP, based on a study prepared for the Panama Canal Authority (ACP).

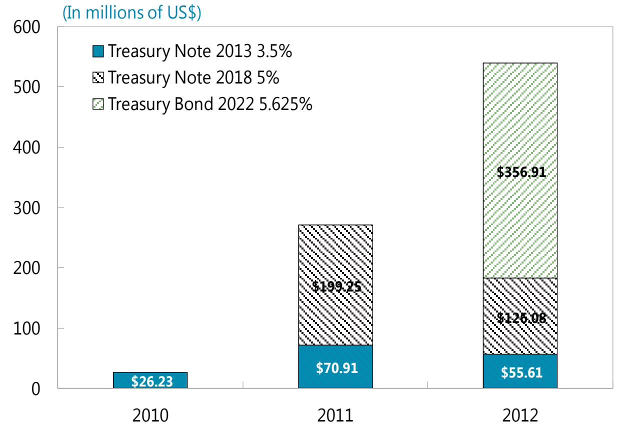
the beginning of the year), and higher-than-envisaged public sector spending. A decline in world food and fuel prices led headline inflation to drop to 4.5 percent through November. Core inflation declined from 5.9 percent in 2011 to 4.1 percent in November, due to a decrease in services' inflation. December headline inflation is projected at 5 percent (y/y).

4. Budget deficit ceilings have been revised upwards. The original 2012 budget deficit target of 2 percent of GDP was revised to 2.7 percent in March, mostly to accommodate higher energy subsidies.[2] The deficit ceiling was further raised to 2.9 percent for 2012 and 2.8 percent in 2013 (from 1.5 percent of GDP) upon the approval of the law on the Sovereign Wealth Fund in June 2012 (Savings Fund of Panama or FAP, Box 1). Following severe floods and mudslides in November, Parliament approved an amendment to the FAP law, which would allow withdrawals starting in 2012 instead of 2015 as envisaged in the original FAP law approved in June. A supplementary budget for the reconstruction would have to be presented to Parliament in early 2013, along with a request to raise the 2013 fiscal deficit ceiling by an equivalent amount (above the 2.8 percent ceiling).

5. Fiscal performance in the first nine months of 2012 was boosted by a strong increase in tax revenue. Tax revenue increased by 27 percent, mostly owing to strong corporate income tax collection. This improved performance reflects the full impact of the 2009-10 tax reforms, recent changes in the estimation of income tax, and enhanced tax administration including the creation of a Large Taxpayers' Unit (LTU). As spending expanded at a lower pace during the same period (capital spending grew by 13 percent, and current spending by 12 percent), the fiscal deficit remained contained at 2.4 percent of GDP (Figure 2).[3]

6. Public debt vulnerabilities are low. Gross public debt declined to 44.9 percent of GDP as of end-2011,[4] and staff's debt sustainability analysis indicates that it remains on a downward trajectory (Figures 2 and 7). Proactive liability management has helped smooth the amortization profile. Dependency on external issuance is being reduced through the market makers program, initiated in June 2011. Since then the share of domestic debt issuances has grown to 24.6 percent of total public debt, and secondary market transactions amount to over half of primary issuances (Chart

Chart 2. Secondary Market Trading
(In millions of US$)



Sources: National Authorities and IMF staff calculations.

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[2] While the ceiling under the Social and Fiscal Responsibility Law (SFRL) was 2 percent, the law allowed carrying over the unspent amount in the previous year to the next year, in this case, the equivalent of 0.7 percent of GDP. This is no longer allowed under the revised SFRL.

[3] Recent amendments to the Tax Code included replacing the monthly advance income tax (Amir) by the previous system of estimating income tax payments based on the previous year's income.

[4] The SFRL's debt limit (once public debt has reached 40 percent of GDP it must remain below that level) is defined as the ratio of total Non-Financial Public Sector's debt net of Fiduciary Development Trust Fund/FAP assets.

2). Following the upgrade by Moody's in October, Panama's sovereign debt rating is now on par with that of Brazil, Mexico and Peru. Sovereign spreads have been low and stable (Figure 3).

7. The external current account deficit is projected to improve somewhat in 2012. The current account deficit widened to 12.8 percent of GDP in 2011 due to high imports of capital goods and reinvested earnings, with Foreign Direct Investment (FDI) flows (9.2 percent of GDP) providing the bulk of the external financing. Notwithstanding an improvement in the goods and services balance in the first three quarters of 2012, the current account deficit is projected to remain elevated at 12 percent of GDP in 2012, largely due to a strong increase in the repatriation of profits and dividends abroad and the reinvestment of earnings by foreign companies. The deficit will continue to be largely financed by FDI flows, which grew by 56 percent (y/y) in cumulative nominal terms by end-September 2012. The Canal expansion project is about 45 percent completed, and is now expected to be finished by early 2015 (about 6 months behind schedule).

8. Credit conditions have remained supportive of domestic demand. The banking system, including local affiliates of foreign banks, has been shielded so far from unsettled external conditions thanks to the system's diversified ownership structure, high reliance on deposit funding, low exposure to European banks, as well as rapid economic growth. Underpinned by strong capital and liquidity ratios, bank credit has continued to expand at a healthy pace (14.3 percent as of September 2012 y/y), though credit to the CFZ, commercial and residential real estate, and tourism grew more rapidly. Liquidity ratios have declined but remain comfortable, at 21 percent in September 2012. Non-performing loans are low and provisions are increasing (Table 5). Interest rates on deposits have declined to historic lows but lending rates have been broadly stable owing to strong credit demand (Figure 3).

9. The difficult political environment may jeopardize the continuity of the reforms going forward. Although President Martinelli's party retains a majority in Congress, some recent reform initiatives, mostly relating to the privatization of state assets, had to be withdrawn due to strong popular opposition. The proposal to allow the sale of remaining state shares in partially privatized enterprises was blocked by the National Assembly and a draft law regulating public-private partnerships had to be withdrawn. A law that would have allowed the sale of public land in the CFZ was repealed following violent demonstrations. The next presidential elections are scheduled for May 2014.

10. The overall track record of implementation of Fund advice is positive, though the recent fiscal stance has been more expansionary than envisaged in the 2011 Article IV consultation. There is a fluid dialogue with the authorities, who have sought staff's advice and technical expertise on major policy initiatives and structural reform efforts, such as the establishment of the FAP and a liquidity facility. In the context of their ambitious program of modernization of the state, the authorities are also fairly intensive users of Fund's technical assistance, in the areas of public financial management, revenue administration, financial sector supervision, and statistics. Nonetheless, some recent decisions, particularly in the fiscal area, are at odds with staff's recommendations, and there has been slow progress with some technical assistance projects (Text Box 1).

Text Box 1: Panama: Response to Fund Advice

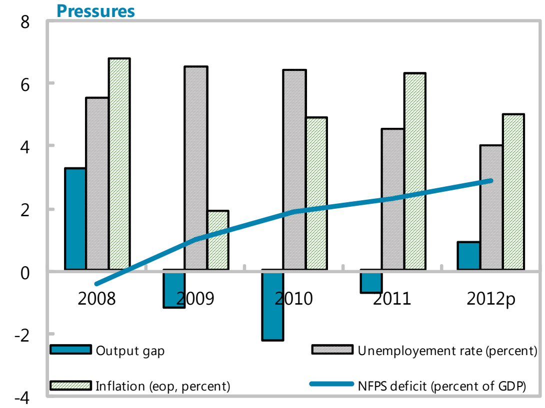
- A sustained fiscal consolidation effort since 2004-05 led to notable declines in public debt. After being appropriately countercyclical in 2009, fiscal policy remained moderately expansionary thereafter, in contrast with staff's recommendation of a modest consolidation starting in 2010. Fiscal deficit ceilings under the SFRL through 2017 have been revised upwards.
- The design of the FAP follows best international practices, though staff recommended aiming at fiscal balance in the medium-term to avoid borrowing at higher costs than the returns on FAP assets and achieve faster public debt reduction.
- The authorities welcomed the 2011 FSAP and are making good progress in strengthening regulatory and supervisory frameworks for bank and nonbank oversight. The authorities plan to strengthen the financial safety net through the establishment of a liquidity facility, supported by Fund technical assistance. The AML/CFT legal framework is also being upgraded.
- On tax administration, the Large Tax Payer Unit is operational, and a law creating an independent revenue agency will be presented to Parliament in January 2013.
- In the area of public financial management, some inroads have been made in strengthening fiscal accounting, though progress in adopting international public sector accounting standards and GFSM 2001 classification has been slow. In spite of delays, the authorities remain committed to establishing a Single Treasury Account. A recent decree requires the publication of projections of expenditures under deferred payment schemes (including turnkey projects) in budget documents, as recommended by staff.

OUTLOOK AND RISKS

A. Medium-Term Outlook

11. Staff's baseline scenario is favorable, with broadly balanced risks. Real GDP growth is expected to decline to 9 percent in 2013, and to gradually converge to its potential rate of 6-6½ percent over the medium term as capital spending unwinds. Although the large infrastructure projects have peaked, loose imported monetary conditions and higher-than-envisaged public spending, together with some recovery in external demand, would continue to support both public and private consumption over the next year and would contribute to maintaining inflation at about 5 percent in 2012-13, well above U.S. inflation. Further increases in international food and fuel prices pose an upside risk to the inflation outlook (Charts 3 and 4). Overheating pressures should ease

Chart 3. Panama: Factors Contributing to Demand Pressures

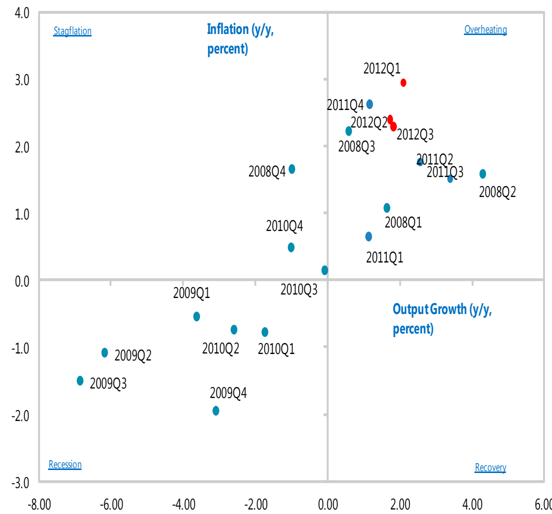


Sources: National Authorities and IMF staff calculations.

over the coming years as investment spending gradually declines, particularly in the context of depressed external conditions with high downside risks.

12. There are no immediate risks to financial stability, though the quality of credit should be closely monitored. Stress tests conducted as part of last year's FSAP indicate that the system is well prepared to withstand a wide range of shocks, including a repeat of the Lehman experience. Contagion from offshore to onshore banks would be limited. However, some small banks may be vulnerable to liquidity risks. Data gaps prevent a deeper analysis of systemic risks, but rapid credit growth in some sectors should be monitored. In addition, increasing household and corporate leverage in an environment of very low interest rates could become sources of risk in a potential downswing. There are no clear signs of a bubble in the real estate sector, but anecdotal evidence suggests that there could be some oversupply in the tourism and high-end real estate segments (both mortgages and commercial real estate). Nonetheless, banks' exposures to these segments are limited, owing to very conservative lending practices (e.g. low loan-to-value ratios, life insurance requirements, conservative property assessments, and automatic payroll deductions for mortgages).

Chart 4. Panama: Output and Core Inflation (Deviation from medium-term averages1/)



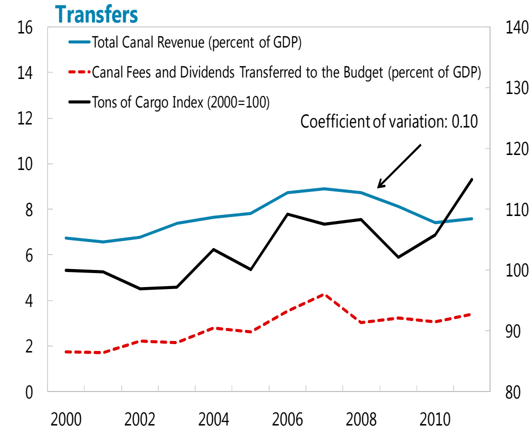
Source: National Authorities, WEO, International Financial Statistics, and IMF staff calculations.
1/ Simple averages for March 2005-September 2012.

13. Although the higher fiscal deficits do not compromise debt sustainability, they imply reduced room for maneuver should negative shocks hit the economy. The cyclically-adjusted primary balance could deteriorate by up to 0.9 percentage points of GDP in 2012. The authorities indicated that they intended to maintain the 2012 fiscal deficit below the revised SFRL ceilings, though this would still imply a positive fiscal impulse. The 2013 fiscal deficit ceiling would be raised by the amount needed for reconstruction after the floods, and spending pressures could intensify further ahead of the 2014 presidential election.

14. The projected current account path is consistent with medium-term external sustainability. The external current account deficit is projected to gradually converge from 12 percent of GDP in 2012 to its underlying level of about 7.5 percent of GDP by 2017 as the public investment cycle unwinds. FDI inflows are expected to be boosted by FTAs with major trading partners and would continue to finance the bulk of those deficits (Text Box 2). Although high at about 120 percent of GDP in 2011, total external debt (excluding external liabilities of offshore entities) would remain sustainable and resilient to most standard shocks (Annex I and Figure 8). Non-resident bank deposits account for almost two-thirds of total private external debt, but most are time and savings deposits; short-term debt accounts for only about 20 percent of total external debt. An exchange rate assessment exercise conducted using the CGER methodologies shows that, in spite of a modest recent appreciation, Panama's real effective exchange rate remains broadly in line with fundamentals. However, further real appreciation would undermine competitiveness.

15. Starting in 2015 the new macro-fiscal framework including the Sovereign Wealth Fund (FAP) should further enhance the economy's resilience to shocks. Canal transfers, which comprise a large portion of non-tax revenue, would be fixed as a share of GDP, with the FAP absorbing any residual volatility in total canal revenue. Historically, these revenues have been fairly stable as the Canal Authority has been adjusting fees when traffic declined (Chart 5). Transferring a large portion of the additional Canal revenues to the FAP once the Canal expansion is completed will help prevent excessive spending, inflationary pressures and a loss of competitiveness. In addition, the authorities will be able to use the FAP's assets to run countercyclical fiscal policy in the event of recessions or natural disasters.

Chart 5. Panama Canal Traffic, Revenue and Transfers



Sources: National Authorities and IMF staff estimates.

Text Box 2. Panama: Recent and Forthcoming Free Trade Agreements

Panama has been actively seeking preferential trade agreements with major trading partners:

- **The FTA with the US came into effect in October 2012**. The agreement was signed in 2007 and ratified by the U.S. Congress in 2011. Over 87 percent of US exports of consumer and industrial products became duty-free with remaining tariffs phasing out over ten years. Nearly 56 percent of U.S. agricultural exports became duty-free with remaining tariffs to be phased over fifteen years. The agreement also eliminates a 50 percent port duty for U.S. ships, which should encourage ship repair and the development of shipyards.

- **An Economic Partnership Association Agreement with the European Union, jointly negotiated with the Central American countries, was ratified by the European Parliament in December and could enter into force in the first half of 2013**. The EU is the second most important destination of Panama's exports and the agreement is expected to increase growth for the Central American region for up to 1.4 percent of GDP in the medium term. In particular, the agreement aims at creating a Free-Trade Area in goods and services between the two regions. The EU will eliminate tariffs immediately on most agricultural goods and virtually all duties on manufactures, and the rest within seven years.

- **An FTA with Canada was ratified by Canada's parliament in December and could enter into force in the first quarter of 2013.**. Coverage of the Canada FTA is similar to that with the U.S. and includes market access for goods, cross-border trade in services, telecommunications, investment, financial services and government procurement.

Panama also has FTAs in place with Chile, Peru, Taiwan and Singapore and a variety of commercial agreements with other countries (i.e. Dominican Republic, Colombia, Israel and Mexico). Other commercial agreements are in negotiation with South Korea, the European Free-Trade Association and Trinidad and Tobago.

B. Spillover Risks

16. Panama's extensive trade and financial linkages make it vulnerable to external shocks, but strong fundamentals would mitigate their impact. Panama is closely linked to both the U.S. business cycle as well as to world trade, through the Panama canal.[5] Panama is an important regional banking hub, and domestic macro-financial linkages are significant due to the large size of the banking sector (Box 2 and Figure 5).[6] Strong fundamentals and low vulnerabilities, including a reliance on stable services' exports and small and shallow capital markets would however mitigate the impact of external shocks. Panama's economy proved remarkably resilient during the 2008-09 global crisis and rebounded very quickly afterwards, owing to a rapid policy response, low government funding needs, ample capital and liquidity buffers in the financial system and the relatively rapid reversal of the freeze in foreign credit lines.

17. Staff's analysis indicates that external real and financial shocks could have a significant impact on output and credit growth. External shocks also appear to have a larger and longer-lasting impact on Panama's output through their effect on real domestic credit (Box 2 and Figure 5). Among the global downside risks mentioned in recent IMF's multilateral surveillance reports, scenarios directly affecting Panama's main trading partners and global financial markets would be the most relevant for Panama.

- In the short term, under the low-probability scenario of a "full" *U.S. fiscal cliff* that could lead to a contraction of U.S. output between 4.8 and 1.8 percent relative to the baseline,[7] Panama's growth would be between 2 and 6 percentage points below staff's baseline projection (9 percent in 2013) reflecting the impact transmitted mainly through trade channels. Lower U.S. demand would also impact Canal traffic, which is already slowing from its record year in 2011, and related activities, including ports and the CFZ.

- A *sudden stop in capital flows to the Latin America region*, or an *idiosyncratic slowdown in key South American trading partners*, such as Colombia and/or Venezuela, the main destinations of CFZ exports and important sources of foreign bank deposits, would also affect domestic activity and credit.

- The *ongoing crisis in Europe* is expected to have a limited direct effect as exposure to the region through financial channels and trade linkages is low, and even second round effects of the European crisis on global financial conditions and trade would only have a relatively mild impact on Panama.

[5] Panama canal traffic represents about 4 percent of world trade.

[6] See Chapter 1 of the Selected Issues Paper "Spillovers to Panama: Impact of Trade and International Financial Shocks".

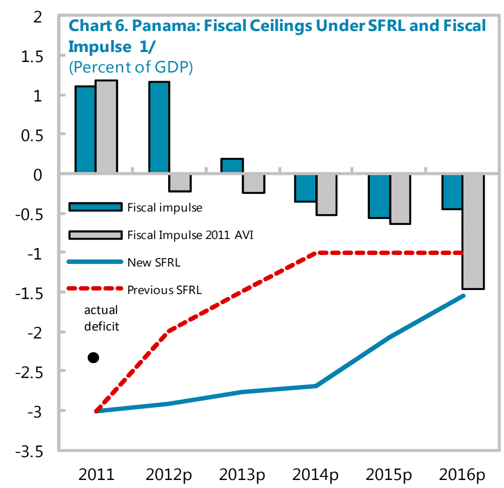
[7] Fund staff estimates of the impact of the U.S. fiscal cliff on U.S. output range from a contraction of 1.8 to 4.8 percent of GDP, assuming a fiscal retrenchment of 4 percent lasting through the whole of 2013. However, this remains a low-probability event, with temporary turmoil followed by an agreement in the first quarter more likely.

- In the medium term, a *hard landing in China* would affect growth for trading partners, including South American commodity exporters, and thus Canal activity, as South-East trade represents an increasing share of total traffic (about 16 percent of the total in 2011), ports and activity in the CFZ, with knock-on effects on credit and domestic non-Canal activity.

POLICY DISCUSSIONS

A. Near-Term Fiscal Policy Challenges

18. Staff argued that the further relaxation of the fiscal targets raises overheating risks and undermines the credibility of the fiscal anchor. Loose imported monetary conditions and the unusually uncertain global environment called for preserving fiscal space. Staff also expressed concern that the frequent revisions to fiscal targets created uncertainty and weakened the benefits of the fiscal rule (Chart 6). In addition, the recent revision to the FAP law allows withdrawals of FAP assets before any accumulation of new resources from the Canal and would translate into a higher deficit than envisaged in the current 2013 budget. Staff urged the authorities to accommodate reconstruction costs within the existing budget envelope and to use available IFI resources.[8] The authorities indicated that previous changes to the deficit ceilings were in strict application of the SFRL rules, and emphasized that they aimed at containing the 2012 overall fiscal deficit between 2.5 and 2.7 percent of GDP, below the revised ceiling.



Sources: National Authorities and IMF staff calculations.
1/ An escape clause under previous SFRL invoked in 2010 allowed the expansion of deficits for the three subsequent years, with any unspent previous year balance to be carried over to 2011.

19. In staff's view, a more neutral fiscal stance would lead to faster debt reduction and help contain inflation. Staff recommended keeping overall deficits at or close to the previous SFRL targets of 2-2½ percent of GDP in 2012-13, consistent with small primary surpluses. This could be achieved by a combination of lower subsidies and further improvements in tax administration. Phasing public investment projects over a longer period of time could also be considered.

- *Total energy subsidies increased to about 1 percent of GDP in 2011 following increases in imported fuel prices*. The authorities indicated that the electricity subsidy was being gradually reduced while the electricity tariffs had been increased, with tangible gains from the reforms starting in 2013. Staff noted that better targeting of broad-based subsidies would also be necessary, and that efforts to promote the development of alternative energy sources to reduce dependency on imported fuel should be accelerated.

[8] The World Bank Board approved an emergency credit line for Panama in case of natural disasters in the amount of US$66 million in 2011.

- *The authorities' plan to establish an independent tax revenue agency, and the recent operationalization of the LTU are expected to further improve tax collection.* The LTU covers 72 companies responsible for 25 percent of income tax collections. The authorities also noted that land valuation is being accelerated and that property tax collections should improve starting in 2013.

- *The authorities noted that the government's strategic plan aimed at filling critical infrastructure gaps over a five-year period, taking advantage of the current favorable financing conditions and that implementation shouldn't be delayed* (Box 3). They pointed out that overheating pressures would be mitigated by the fact that infrastructure investment was expanding productive capacity, and was aimed at attracting complementary private investment, particularly in the logistics sector. They added that most of the public investment program was sustainably financed out of current savings. Staff agreed that, during the implementation phase, investment was expanding potential output (the output gap is projected to peak at only 1.4 percent of GDP in 2013), and that debt levels remained sustainable. However, staff also noted that debt dynamics were increasingly driven by the growth performance.

20. In discussing contingent liabilities associated with public sector enterprises and turnkey projects, staff noted that they could pose fiscal risks. Public enterprises recently excluded from the SFRL's definition of the non-financial public sector have ambitious investments plans to be financed by debt.[9] Liabilities arising from turnkey projects amount to about 6 percent of 2011 GDP over 2014–16, with 20 percent of each annual investment budget reserved for these projects.[10] Staff strongly encouraged the authorities to accelerate the adoption of International Public Accounting Standards (IPSAS) and the 2001 GFSM classification of public accounts to ensure a more transparent and comprehensive coverage of all public sector actual and contingent liabilities. This would also help estimate the real size of the public sector's participation in the economy. The authorities noted that the debt unit was monitoring all public sector liabilities, and that after some delays they were prepared to start the bidding process for a new financial information system that would support the move to IPSAS.

B. Addressing Spillover Risks

21. The authorities broadly agreed with staff's assessment of the outlook and risks, and were appreciative of the spillover analysis. They concurred that a weaker external environment could help further reduce domestic demand pressures. Given strong domestic fundamentals, they agreed that the main risks to the outlook would stem from the materialization of a large external shock. In that situation, they indicated that the large share of capital spending (38 percent of total

[9] Total assets of the three public enterprises (highways, electricity distribution and Tocumen airport) excluded from the SFRL's definition amounted to about 4.8 percent of GDP in 2011. These entities broadly meet the criteria of being profitable commercially-run enterprises.

[10] At present these projects are recorded at the time of a payment, which can happen a year or two after the start of the work. The current way of recording cannot ensure adequate and timely reporting of amounts invested in infrastructure and debts incurred with the corresponding contractor.

expenditures) provided flexibility to the budget. While they agreed that fallout from a shock to U.S. output such as the realization of the fiscal cliff could have a significant impact, they also pointed out that linkages with Latin America and Asia had increased in recent years through their share of CFZ and Panama canal activity. Over the medium term, the authorities noted that the expanded canal would see a higher diversification of goods and shipping routes, which would reduce vulnerability to conditions in individual trading partners. At the same time, the FAP would allow for the implementation of countercyclical fiscal policies.

22. The authorities are accelerating plans to set up a fund to buffer against liquidity shortages in order to strengthen the financial safety net.[11] Although the financial system is sound and has been resilient to past shocks, the authorities and most private sector counterparts and analysts agreed that Panama would be vulnerable to liquidity risk. In the absence of a Lender of Last Resort (LOLR), most banks maintain ample liquidity in their balance sheets, but this wouldn't suffice to protect the sector in case of a large systemic liquidity shock. Following a high-level seminar in September that engaged all stakeholders, the authorities requested continued Fund support to finalize the design of a liquidity facility by June 2013. Following Fund technical assistance recommendations, the facility would provide LOLR support in case of temporary liquidity shortages. Given limited resources, the authorities saw merit in starting with a fund aimed at preventing smaller, idiosyncratic liquidity shocks, while exploring other funding options in order to gradually build up the capacity to address larger, systemic liquidity needs. They indicated the National Bank of Panama had agreed to provide initial resources in order for the liquidity fund to become operational.

C. Bolstering Financial System Supervision

23. The authorities are making headway in implementing the recommendations from the 2011 FSAP. The legal framework for insurance and capital markets was recently upgraded, and a draft law on cooperatives is to be presented to Parliament in early 2013. Banking oversight will benefit from new regulations on operational and interest rate risks, and the regulation for monitoring credit risk is being overhauled. The design of capital requirements and reporting standards for holding companies will strengthen consolidated supervision. The monitoring of macro-prudential and systemic risks is being enhanced: the Superintendency of Banks (SBP) has identified systemically important banks and initiated a quarterly Financial Stability Report (Text Table 1).

24. Staff and the authorities concurred that the current favorable macroeconomic conditions provide an opportunity to accelerate financial sector reforms. Among the key priorities, efforts to build capacity to monitor systemic risks and upgrade the supervision of non-bank financial institutions should be continued.

[11] See Box 4 (Panama–2011 Article IV Consultation Staff Report (IMC Country Report No. 12/83).

- *No institution in Panama has an explicit mandate to maintain financial stability or formulate macro-prudential policy*. The recently-created Financial Coordination Committee (CCF)[12] has already contributed to improving coordination among the supervisory agencies. Staff recommended that the CCF should be given a clear mandate to monitor systemic risks, sufficient resources to implement that mandate, and power to implement macro-prudential measures as needed. In addition, the mission highlighted that data gaps and capacity constraints hinder adequate monitoring of systemic risks. The authorities concurred that the analysis of systemic risk should be strengthened, but considered the current institutional arrangement adequate. Following discussions with staff on institutional and operational elements of a macroprudential framework, the authorities expressed interest for technical assistance in this area.[13]

- *Although they represent only 22 percent of total financial system's assets, current weaknesses in the supervision of non-bank financial institutions pose significant reputational risks for the whole system*.[14] In particular, prudential requirements need to be tightened in some segments (e.g. cooperatives). The mission welcomed recent and forthcoming upgrades to the regulatory framework, and urged the authorities to further enhance the capacity to supervise non-bank financial institutions.

- *The legal frameworks for AML/CFT and tax transparency are being upgraded*. The authorities noted that a new AML/CFT law is being prepared and could be presented to parliament in early 2013. The authorities noted that the law would incorporate recommendations from the October 2012 AML/CFT mission, including the requirements of the new Financial Action Task Force recommendations. Staff also encouraged the authorities to publish the AML/CFT assessment. Panama's failure to complete Phase I of the OECD Global Forum's peer review process could have negative repercussions. Approval of a law immobilizing bearer shares, expected to be presented to Parliament in January 2013, would be needed for Panama to comply with the international standards for transparency and exchange of information for tax purposes.

[12] The CCF was created in 2011 to improve coordination among financial sector supervisors and harmonize regulation, It's members include the Superintendents of (i) Banks (SBP), (ii) Insurance and Reinsurance (SSRP), (iii) Capital Markets (SMV); as well as of the head of the Panamanian Autonomous Institute of Cooperatives (IPACOOP), the Director of Financial Companies of the Ministry of Industry and Trade (MICI), and the Director of the Public Sector Workers Pension Funds (CICAP).

[13] Chapter 2 of the Selected Issues paper ("Macroprudential Policy in Panama? Lessons from Cross-Country Experience") discusses how macroprudential policy could supplement microprudential policy in Panama.

[14] A large cooperative and a stock exchange broker, none systemically important, had to be intervened recently.

Text Table 1. Implementation of 2011 FSAP Recommendations

Recommendation	Status/Expected Completion Date
Banking Oversight	
Finalize and implement regulations on operational and interest rate risks.	Implemented/ongoing. - The Board of Directors issued a regulation on operational risks on December 20th, 2011. The SBP staff was trained. - A draft regulation on interest rate risks is to be submitted to the SBP Board in early-2013, and issued in the second half of 2013.
Develop capital adequacy and regulatory reporting standards for holding companies.	Ongoing. A draft regulation is being prepared with technical assistance from CAPTAC-DR, to be adopted by June 2013.
Develop concentration limits and risk management requirements for interbank deposits.	No plans to develop such requirements. The authorities noted that the law allows them to introduce such limits and requirements for individual banks as needed.
Enhance offsite supervision to develop a view on macroprudential and systemic risk trends.	Ongoing. The SBP has identified systemically important banks and initiated a quarterly Financial Stability Report.
Regulate and effectively supervise cooperatives that provide credit and savings products.	Legislation pending. A draft law on cooperatives, which would upgrade regulation and strengthen supervision in that sector, will be submitted to Parliament in 2013.
Insurance Sector Oversight	
Approve draft Insurance Law with strengthened prudential requirements.	Implemented. The law was adopted in 2012.
Strengthen disclosure of performance indicators and brokers' commissions.	Ongoing.
Securities Market Oversight	
Strengthen the budgetary position, and the supervisory and enforcement capabilities of the supervisor (National Securities Commission).	Law 67 (dated 1 September 2011) upgraded the Commission to a Superintendency (SMV), strengthening its supervisory and enforcement capacity as well as its budgetary position. The SMV noted that it would seek to further strengthen its enforcement capacity.
Payments and Securities Systems Oversight	
Create a comprehensive payments system law guaranteeing payment finality.	No initiatives so far.
Adopt an RTGS or Hybrid Payments System	Medium-term recommendation. No initiatives so far.
Financial Safety Nets	
Conclude studies and introduce a banks' liquidity facility.	Ongoing. The authorities would set up a steering group with private sector representation by December 2012, and plan to introduce a liquidity facility by June 2013.
Establish a deposit insurance scheme.	There are no plans to establish a deposit insurance scheme. The authorities note that it would be costly and create moral hazard.
Capital Market Development	
Build a single yield curve across domestic and global bonds by dual listing and extending market making to global bonds.	Ongoing. The authorities have been making efforts to extend market making to global bonds.
Review and restructure or close public development banks and guarantee funds.	Medium-term recommendation. No initiatives so far.

D. Ensuring a Smooth Transition to the Medium-Term Growth Path

25. An important medium-term challenge is to ensure a smooth transition to a more sustainable and inclusive growth as the large public infrastructure projects unwind. Staff pointed out that, based on the experiences of other middle-income countries and a vast empirical literature, the quality of the investments and accompanying macroeconomic policies were key determinants of the impact of public investment on growth. The mission noted that, in Panama, (i) further improvements in project selection, planning, and monitoring in the context of the ongoing structural fiscal reform efforts would help ensure that public investment is of good quality; and that (ii) productivity would need to be enhanced through ongoing competitiveness and training and education reforms, in order to ease current skills mismatches and raise productivity as well as living standards. The authorities agreed with staff on the structural reform priorities as essential to address potential supply bottlenecks and ensure broad-based growth. Nonetheless, they were confident that there wouldn't be a sudden drop in economic activity following the completion of the Canal expansion and the large public investment program**.** They pointed out that substantial private investment projects, including a US$6.5 billion investment in copper mining due to start in 2013, and new public investments, such as the building of a second line of the Panama City metro, would help support growth.

Addressing Structural Fiscal Issues

26. Ensuring that the large public infrastructure projects are of high quality and productivity-enhancing will require further upgrades to public financial management. In particular, staff noted that budget planning, accounting, and monitoring should be strengthened further. Moving toward medium-term budgeting would support implementation of fiscal policy objectives. In spite of delays, the authorities confirmed that they remained committed to the establishment of a Single Treasury Account, which would help strengthen cash management and improve the predictability of budget execution. Staff welcomed ongoing efforts to strengthen investment planning and monitoring capacity through training and modernization of information systems, and noted that improvements in project selection, stronger procurement procedures and internal audits would help ensure that public investment is of high quality and cost-efficient.

27. Recent tax reforms made the system more progressive on the income taxation side, but they fell short of raising collections to the levels achieved by peer countries (Box 4).[15] Staff welcomed recent improvements in the tax performance but noted that stronger revenue collection over the medium term would be necessary to preserve social and capital expenditure within lower deficit limits. Higher revenue collection would also be necessary to offset forthcoming revenue losses associated with the entry into force of FTAs with major trading partners.[16] Staff highlighted that the efforts to strengthen tax and customs administration should focus on continuing to improve tax education, strengthening controls and improving the communication between the two

[15] See Chapter 3 of the Selected Issues Paper: "Panama: Taking Stock of a Decade of Tax Reforms".

[16] Tariff revenue amounted to about 1.3 percent of GDP in 2011.

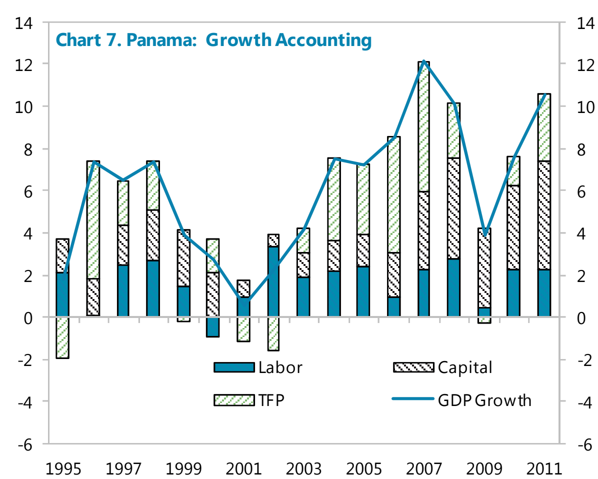
revenue collecting agencies to reduce evasion. Staff and the authorities also agreed that there was room to further reduce exemptions and tax expenditures.

Enhancing Competitiveness

28. Improving competitiveness is an essential element of the government's strategy. The authorities emphasized that reforms implemented during 2012 helped improve Panama's score and ranking in various competitiveness surveys, and it is now ranked the second most competitive economy in Latin America after Chile by the World Economic Forum. Measures included further facilitating business startups and reducing the time required for various administrative procedures. Bottlenecks in the logistics chain are being tackled, through the ongoing modernization of customs procedures to facilitate integration with the region, the development of ports, roads and airports infrastructure, and upgrades to the law on Free Trade Zones, in order to take full advantage of the FTAs and boost synergies with the canal conglomerate. Staff noted that remaining weak points such as the justice system should be tackled, and agreed with the authorities that ongoing education and health reforms would help improve access to basic services (see below).

Labor Market and Social Policies for Sustainable and Inclusive Growth

29. The scarcity of educated and trained workers may constrain growth in the medium term. Staff noted that the recent contribution of capital accumulation to growth has neared 60 percent, with relatively small shares of labor and particularly total factor productivity (Chart 7). Rising labor demand in the context of rapid economic growth has driven unemployment down and led to wage increases, but there is growing evidence of skills mismatches. Almost half of all employers indicate that they are looking for skilled workers, particularly in construction and services (Figure 6). At the same time, youth unemployment is high at 9.5 percent compared to 4.5 percent for total unemployment, while 37 percent of the labor force is informally employed. The authorities emphasized that government initiatives to increase school attendance through the universal scholarship program ("Beca Universal"), modernize curricula to align them with skills demand, enhance access to technology in the classroom, and increase the provision of vocational training in partnership with the private sector should help alleviate skills mismatches and ensure better opportunities for all Panamanians.



Sources: WEO, IMF staff estimates and calculations.

30. Although Panama's growth performance has been impressive, social indicators have improved slowly. The rapid development of the areas surrounding the canal and Panama City has not been accompanied by similar progress in rural and indigenous areas where most of the poor live. Over two-thirds of the current public investment program resources are allocated to projects in and around the capital city. Nonetheless, the authorities noted that, based on regular income surveys, poverty and extreme poverty had declined since 2010 from 29.8 and 12.2 percent, respectively, to 25.8 and 10.4 percent as of March 2012. Staff concurred that the expanded coverage of safety nets, in particular the flagship conditional cash transfer ("red de oportunidades"), and transfers for the elderly ("100 a los 70"), were bearing fruit, but noted that their efficiency could be improved through better targeting and ex-post monitoring.

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31. Panama's economy continues to expand at a fast pace, driven by high public investment and robust private demand. At the same time, downside risks to the already weak global outlook have become more prominent. In this context, the main near-term policy challenges remain to avoid overheating and strengthen fiscal and financial buffers. Structural policies should focus on ensuring a smooth transition to sustainable medium-term growth rates as the large infrastructure projects are completed.

32. The outlook is favorable, with broadly balanced risks. Easy credit and fiscal conditions should continue to support public and private consumption in 2013. Inflation has started to decline but demand pressures in the context of a tight labor market should keep it above that of the U.S. in the coming years. Overheating risks are expected to continue to ease as public investment projects and the Canal expansion unwind, in the context of weak external demand. The banking system is healthy, though strong credit growth should be closely monitored, together with rising household and corporate leverage. The large current account deficits are largely investment-driven and financed by robust FDI inflows. The real effective exchange rate remains in line with fundamentals, though further real appreciation could erode competitiveness. Public and private external debt is high as a share of GDP but remains sustainable over the medium term.

33. A tighter fiscal stance than currently envisaged would be essential to preserve fiscal space and avoid overheating. The recent revision in fiscal targets implies a positive fiscal impulse in 2012. Given a closed output gap and loose imported monetary conditions, fiscal deficits should be kept firmly below the revised ceilings as envisaged by the authorities. Reconstruction costs following the November floods should be accommodated within the existing budget envelope so as to avoid further stimulating the economy and deplenishing FAP capital. Frequent revisions to the legal deficit ceilings undermine the credibility of the fiscal anchor.

34. Further fiscal restraint could be achieved through enhanced tax administration and better expenditure management. The establishment of a large taxpayer unit, and plans to create an autonomous revenue agency represent notable advances. Further strengthening controls at the tax and customs agencies and developing a taxpayer culture through improved customer service should improve tax collection in the medium term. On the expenditure side, better planning, accounting and monitoring of capital investment and further reducing broad-based subsidies are necessary not only to contain deficits but also to ensure the quality of spending and limit fiscal risks.

35. Enhanced fiscal and financial buffers would help cope with adverse spillovers. Strong fundamentals would mitigate the impact of external shocks, but shocks to the U.S. or other major trading partners could have a sizeable impact on Panama's output. Panama would also be vulnerable to a global liquidity shock. In the medium term, the FAP would allow implementation of countercyclical policies, but in the short run stronger fiscal buffers would be needed. Progress with plans to strengthen the financial safety net through the creation of a liquidity facility is welcome.

36. There has been good progress in implementing FSAP recommendations, though efforts to upgrade financial sector supervision could be accelerated. The Council of Supervisors has the potential to become a powerful watchdog of financial system stability including, if needed, by implementing macro-prudential policies, but its mandate and technical capacity will have to be adapted. On the banking side, the SBP's efforts to monitor macro-prudential and systemic risks are timely, but need to be supported by the closing of existing data gaps, including on private sector leverage and housing prices at market value. Existing weaknesses in nonbank supervision could pose potential reputational risks to the financial system and upgrades to the legal framework for non-bank supervision should be accompanied by enhanced capacity of the respective supervisory agencies.

37. Continued improvements in competitiveness and recent education reforms should help sustain growth over the medium term. Recent improvements in the business environment are welcome. Addressing remaining bottlenecks in the logistics chain will ensure that Panama can reap the full benefits of the FTAs and of the Canal expansion. The government's initiatives to improve the quality of public education and the availability of vocational training in partnership with the private sector should help develop the mix of skills required by a modern, service-based economy and raise living standards of all Panamanians.

38. Staff recommends that the next Article IV Consultation takes place on the standard 12-month cycle.

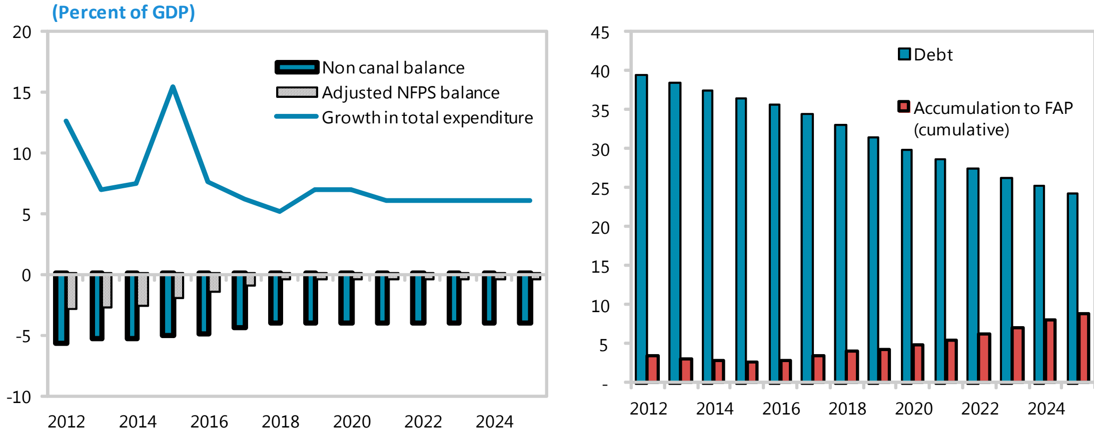
Box 1. Panama: Main Parameters of the Savings Fund and the Revised SFRL

In June 2012 the National Assembly approved Law 38 creating a Sovereign Wealth Fund ("Fondo de Ahorro de Panama", or FAP) in Panama, to become operational in December 2012. The objectives of the Fund are to (i) introduce a stabilization mechanism for emergency situations and for economic slowdowns; and (ii) create a long-term sovereign savings instrument. Startup capital of US$1.2 billion (about 3.5 percent of GDP) was transferred from the now liquidated Fiduciary Fund for Development. Starting in 2015, yearly contributions of the Panama Canal Authority to the budget in excess of 3.5 percent of GDP are to be transferred to the FAP.

Funds can only be transferred to the National Treasury under the conditions defined in the amended Social and Fiscal Responsibility Law (SFRL): (a) state of emergency declared by the Cabinet when the cost associated with an emergency is equal to or exceeds 0.5 percent of GDP; and (b) economic slowdown. There would be no withdrawals if (i) FAP assets are less than 2 percent of the previous fiscal year's GDP; and (ii) the annual contribution of the ACP falls short of 3.5 percent of GDP. Other important provisions include (1) an option to repay up to 0.5 percent of GDP in sovereign debt when FAP assets exceed 5 percent of GDP of the previous year, (2) a requirement that all FAP's interest revenue be transferred to the budget on a yearly basis, and (3) an option to make limited purchases of domestic debt on external or domestic secondary markets), in order to help develop the local capital market.

The revised SFRL's fiscal limit is no longer set on the NFPS Balance but on a newly defined fiscal indicator, the NFPS Adjusted Balance, defined as the NFPS Balance minus the deposits into the FAP. Until 2017, the revised law defines a transition period with higher deficits than previously envisaged, starting from 2.9 percent of GDP in 2012 to gradually decline to the new deficit target of 0.5 percent by 2018. From 2018 onwards, the budget will implicitly target a non-canal deficit of 4 percent of GDP (Figure 1).[1] Based on this fiscal framework and the authorities' baseline long-term macroeconomic scenario, the FAP will accumulate about 9 percent of GDP in resources by 2025 with the debt-to-GDP ratio declining to about 25 percent. This modified fiscal framework also implies that there will be a large jump in total expenditures in 2015 due to higher deficits and increased transfers from the canal.

Figure 1. Panama: Selected Indicators under the Baseline Scenario 1/
(Percent of GDP)



Source: Ministry of Economy and Finance, and IMF staff calculations.
1/ Excludes ACP. Assumes full rollover of debt.

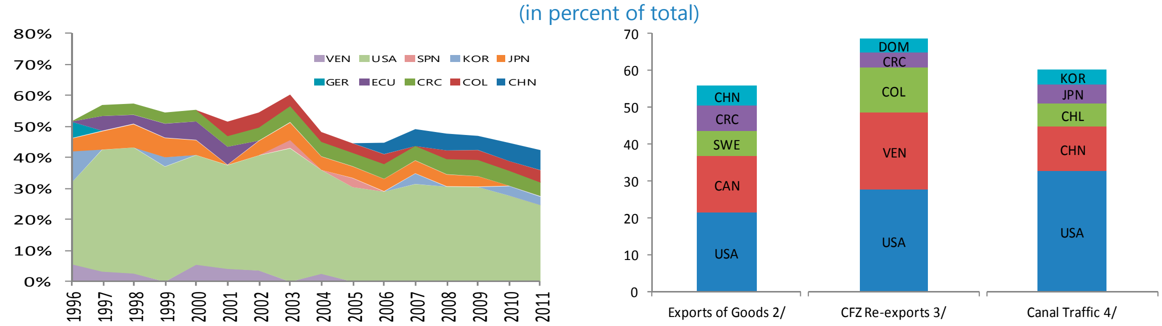
Box 2. Spillovers to Panama and Domestic Macro-Financial Linkages

A high degree of trade openness and reliance on external financing makes Panama vulnerable to adverse developments in the global economy. A structural VAR analysis suggests that global demand and international financial shocks have a relatively large and lasting impact on real activity in Panama as well as on real private sector credit. Furthermore, Panama's real credit appears to amplify the response of Panama's output to external shocks at longer time horizons.

While the U.S. remains Panama's most important trade partner, the importance of China and Latin America has been growing (Box Figure 1). The U.S. accounts for about 20 percent of merchandise exports and for about a third of total canal traffic (measured in tons) and of re-exports of the CFZ. In the last two years China has become Panama's second most important partner for merchandise trade. Colombia, Costa Rica, and Venezuela together account for 40 percent total CFZ re-exports in 2012, or more than the U.S.

Box Figure 1. Panama's Top 5 Trading Partners 1/

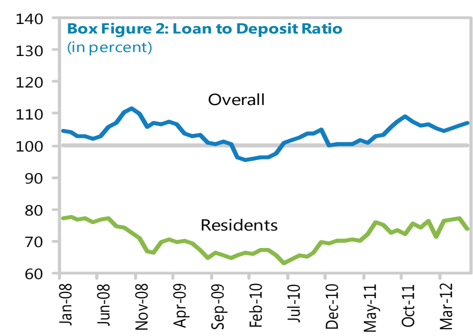
(in percent of total)



Sources: National Authorities, Direction of Trade Statistics, and IMF staff calculations.

1/ Left panel: In percent of total trade. 2/ As of 2011. 3/ As of 2012, January to October. 4/ As of FY 2012, in percent of total tons of cargo.

Panama is an important regional financial center. Panama has a sizeable banking sector, with total assets amounting to about 215 percent of GDP and domestic credit to the private sector amounting to about 90 percent of GDP. Since mid-2010 (with an exception in May 2011), the overall loan to deposit ratio has exceeded 100 percent, though lending to residents is more than covered by domestic deposits (Box Figure 2). As of September 2012, foreign interbank deposits accounted for around 15 percent of total domestic deposits. Revocable international contingent credit lines amounted to about US$4 billion (about 7 percent of total deposits in the banking center), with around half of these lines originating in North America. These lines are relatively concentrated and a few banks could be vulnerable to a sudden withdrawal, which could create confidence problems and a freeze in inter-bank lending and credit, as in late 2008. Foreign assets of Panama's banking center are mostly concentrated in Latin America, reflecting a strong presence of other Central and South American banks in Panama.



Box Figure 2: Loan to Deposit Ratio
(in percent)

Sources: National Authorities, IFS, and IMF staff calculations.

The impact of external spillovers to Panama's output and domestic credit is quantified using impulse responses from an SVAR model. The VAR model includes Panama's real GDP, Panama's real domestic private credit, Panama's trade balance to GDP ratio, global demand and the VIX index as a proxy for global financial conditions. Global demand is proxied by a trade-weighted average of the real GDP of Panama's main trading partners, the U.S. real GDP and the ratio of world trade to world GDP.

Box 2. *Continued*

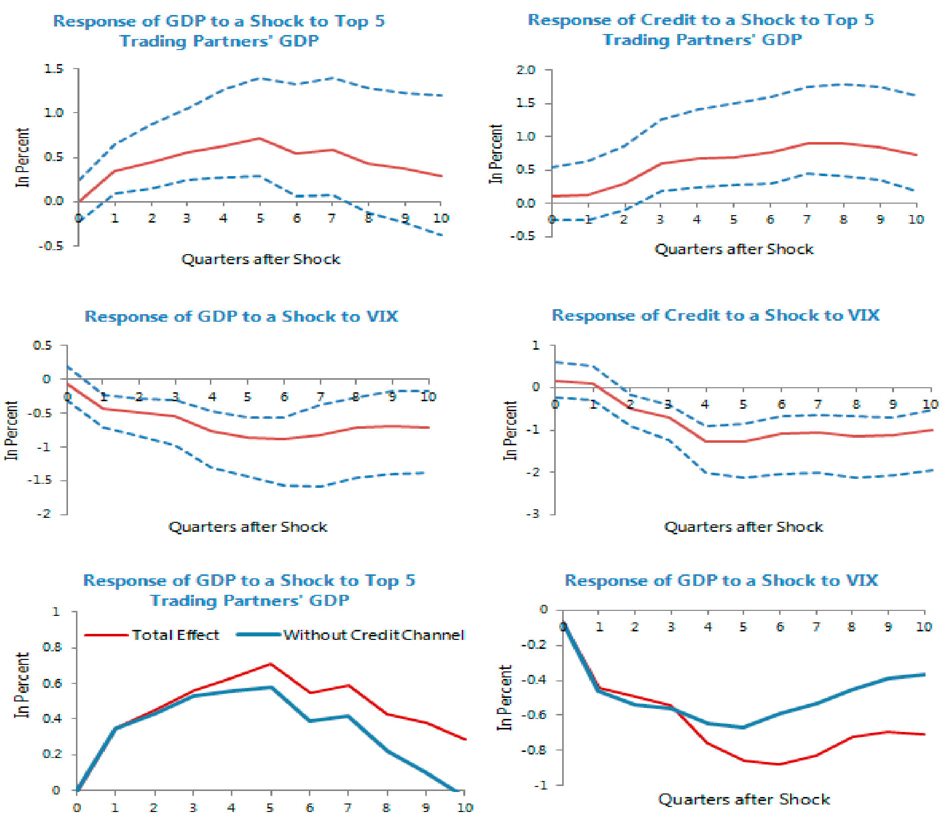
Structural shocks to external variables are identified by a Cholesky decomposition, assuming that external variables are contemporaneously exogenous to Panama's economy and that external demand reacts with a lag to innovations in the VIX.

Global demand and international financial shocks have a relatively large and lasting impact on Panama's real activity as well as on real private sector credit (Box Figure 3):

- a positive one standard deviation shock to trading partners' real GDP would lead to an increase in Panama's real GDP level by above 0.4 percent after the first quarter and by almost 0.7 percent after a year. There is a delayed impact on real credit, with an increase of almost 1 percent after two years.
- a positive one standard deviation shock to the VIX index would reduce Panama's real output by 0.4 percent after the first quarter and would have a long-lasting effect. Panama's real output would decline by almost 1 percent after a year. Real private credit would not be affected on impact, but would decline by 1.3 percent after a year.
- a positive one standard deviation shock to the U.S. real GDP leads to a larger increase in Panama's output after one quarter, while a shock to world trade would have an immediate impact on Panama's output,

Panama's real credit appears to amplify the output response to external shocks at longer time horizons, suggesting that the real credit response is demand-driven in Panama.

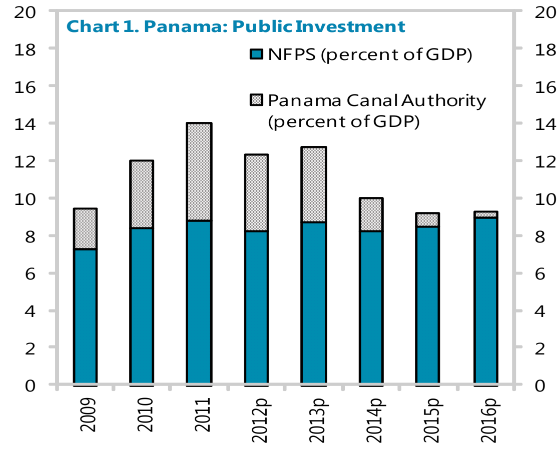
Box Figure 3. Panama: Dynamic Responses of Real GDP and Real Private Credit to Shocks 1/



Source: IMF staff estimates.
1/ Responses to a one standard deviation shock to top 5 trading partner's real GDP (+2.9 percent) and to a one standard deviation shock to VIX (+5.4 points).
Dotted lines correspond to 90 percent confidence intervals.

Box 3. Panama: Public Investment and Growth

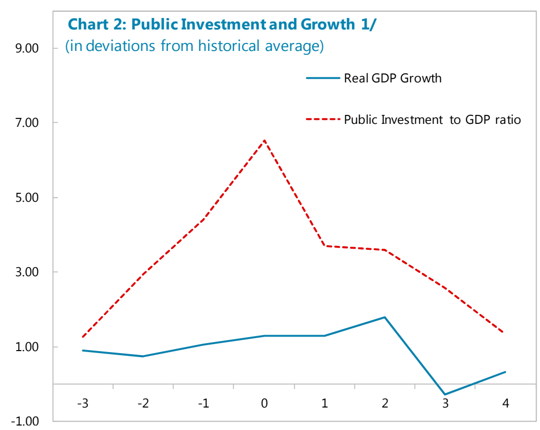
Large public infrastructure projects are expected to continue to drive growth over the coming years. Panama's public investment is projected to increase from an average of 5.7 percent of GDP in 2003-09 to 12.2 percent of GDP per annum over 2010-14. In addition to the Panama canal expansion project (US$5.25 billion or 20 percent of 2010 GDP), the Public Investment Program (PIP) totals US$15 billion or over 50 percent of 2010 GDP (Chart 1). The Panama canal's capacity will roughly double when the project is completed in 2015, which will lead to significant economies of scale and a diversification in canal transit. The PIP focuses on logistics, tourism, agriculture and financial services which were selected as sectors where economic growth returns and employment generation would be the highest.



Source: National authorities, and IMF staff calculations.

There is evidence of complementarities between this public investment and private investment. The Canal expansion has fostered the development of private ports, the building of roads has improved connectivity between logistics centers, and the expansion of airports in the provinces has fostered private investment in tourism as well as higher value-added agricultural exports. Public investments were also aimed at developing new industries around the logistics hub, such as light manufacturing and value-added warehousing. Investments in education and hospitals should help improve social conditions over the medium-term.

Panama's investment surge is comparable in size to that experienced by a group of 12 middle income countries (Chart 2). Panama's public investment to GDP ratio in the peak year was 9.8 percentage points above the pre-surge period average, somewhat higher than the group's average (6.2). Real GDP growth rose above historical averages over a two-year period following the peak of the public investment, suggesting a lag in the returns to investment. After the surge, output growth has tended to revert back to pre-surge averages, or in some cases to decline (e.g. Seychelles).



Source: World Economic Outlook; and IMF staff calculations.
1/ Averages for a sample of 12 middle-income countries having experienced a surge in public investment (Algeria, Belize, Bhutan, Dominica, Ecuador, Ghana, Honduras, Namibia, Panama, Serbia, Seychelles, and Vietnam.) T=0 represents the year in which the public investment to GDP peaked. Historical averages calculated up to three years before the start of the investment surge in each country.

Peer country experiences, as well as a vast empirical literature suggest that the quality of the investments and accompanying macroeconomic policies are key determinants of the impact of public investment on growth.2/ In particular, (i) the investments need to be sustainably financed to avoid a buildup of public debt (e.g. Seychelles); (ii) favorable trade policies and business environments would encourage complementary private investments; (iii) the returns on public investment are higher, the lower the initial public capital stock; (iv) the investments need to be of high quality, as measured by effective project selection, implementation and monitoring, and well planned.

[2] See for example Gupta et al. (2011), Dabla-Norris et al. (2011).

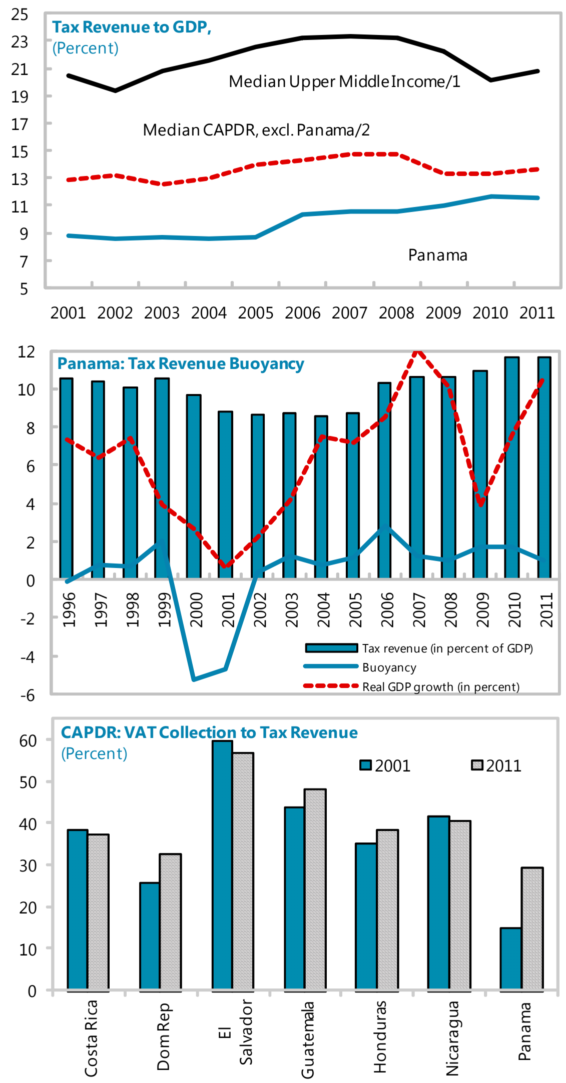
Box 4. Panama: Outcome of Tax Reforms

Panama has carried out three tax reforms over the past decade (2002, 2005 and 2009-10). Overall, the reforms made the system more progressive as they allowed for a combination of tax rate reductions (e.g., on the income side) and increases (e.g., VAT), and broadened the tax base.

The tax reforms implemented in 2009-10 yielded important revenue gains and improved the composition of revenue. The reform package aimed at strengthening collection through the closing of loopholes and improved compliance (with the mandatory installation of fiscal cash registers in businesses). The VAT rate was increased and personal income tax rates were lowered. Tax revenue increased by about 1.8 percentage points of 2010 GDP (compared to a projected 2.5 percentage points of GDP, as some measures came into force with a delay). VAT collection improved, and the share of sales tax in total revenue increased.

In spite of these advances, various indicators of tax performance show that Panama still lags behind the region and its income peer group (Figure 1). Panama scored 48 percent in tax effort, compared with a median of 78 percent for middle income countries, tax effort being the difference between actual tax revenue to estimated tax collection capacity, based on a country's economic, social, institutional and demographic characteristics. Similar results in income peer group countries can be attributed to either a legal framework that allows for a large level of exemptions (Guatemala) or fairly low tax rates (Singapore and China SR, Hong Kong). In Panama's case, besides the low tax rates (VAT, personal income), exemptions, in particular from custom duties, corporate income tax, real estate tax, and VAT, have deprived the budget of significant amounts of revenue, although they have been reduced during the course of the decade (from almost 15 percent to 4 percent of tax revenue). VAT rates and VAT revenue-to-GDP ratios in Panama remain well below those of the region as well as the median for middle-income countries.

Figure 1. Panama's Tax Reforms in Perspective

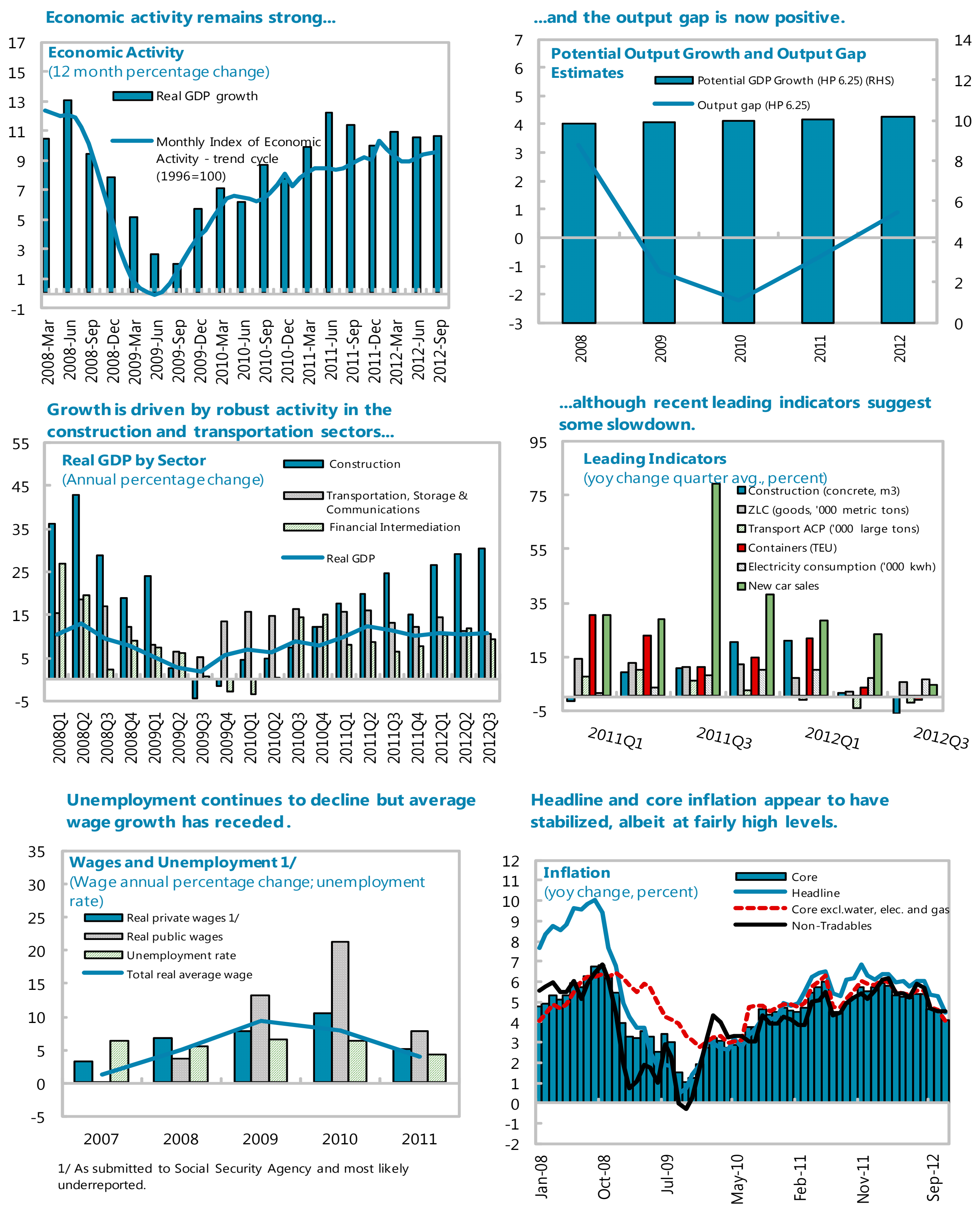


Sources: National Authorities; and IMF staff estimates.

1/ Albania, Argentina, Belarus, Botswana, Brazil, Bulgaria, Colombia, Jamaica, Lithuania, Malaysia, Namibia, Peru, Romania, Russia, South Africa, Turkey, Uruguay.; 2/ CAPDR: Costa Rica, the Dominican Republic, El Salvador, Honduras, Guatemala, Nicaragua, and Panama.

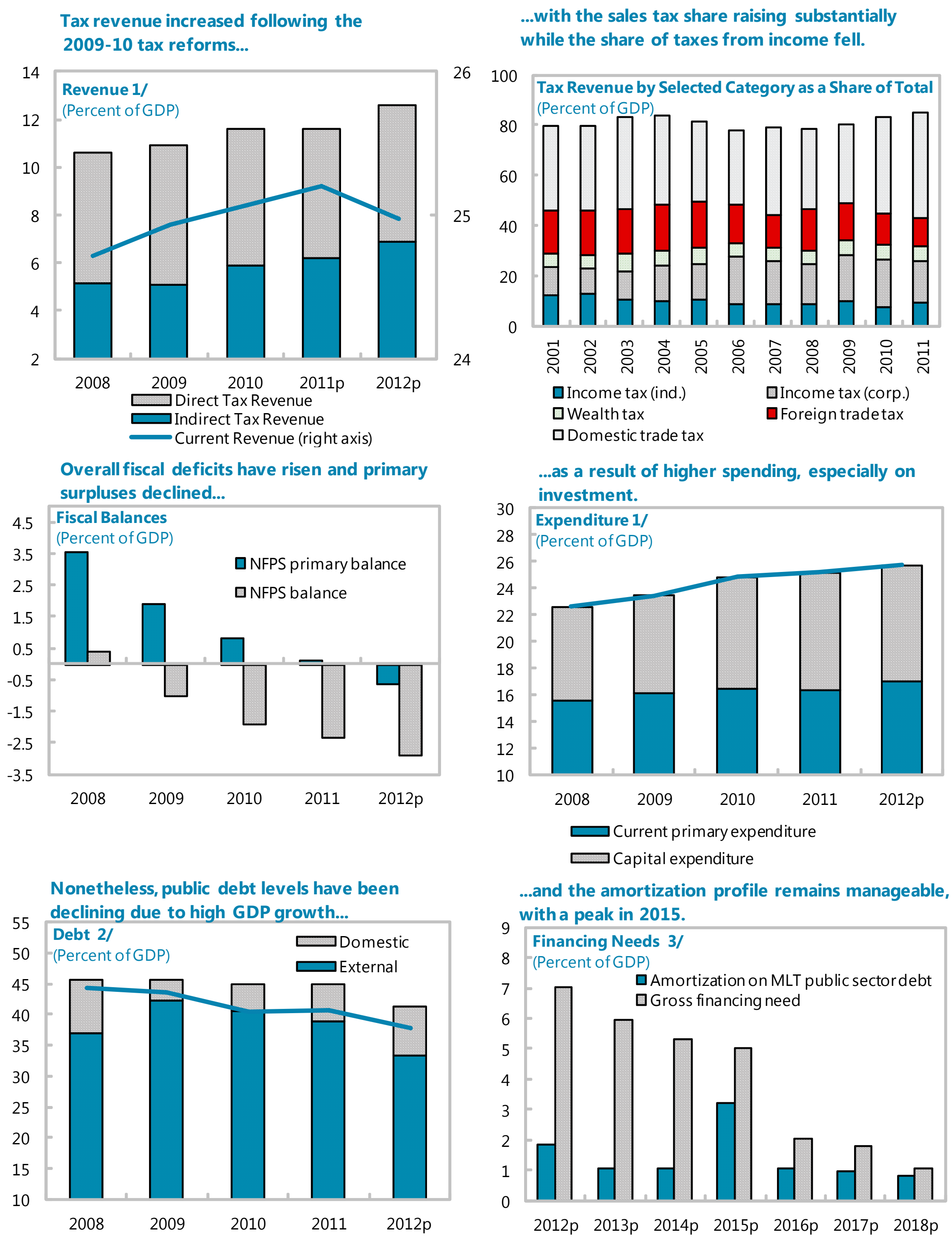
Going forward, tax administration reforms can help increase tax revenue in the context of a diminished appetite for further comprehensive tax reforms. The establishment of a large taxpayer unit and of an independent revenue agency should help strengthen controls and develop a taxpaying culture, in part through better client service.

Figure 1. Panama: Real Sector Developments, 2008-12



Sources: National Authorities and IMF staff calculations.

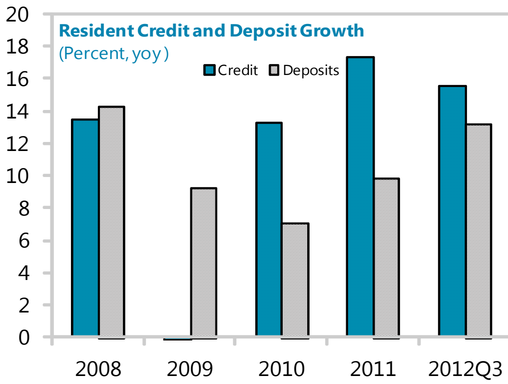
Figure 2. Panama: Fiscal Developments, 2008-18



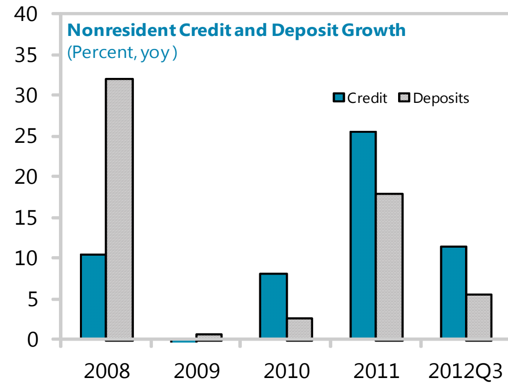
Sources: National Authorities and IMF staff calculations.
1/ Data refer to the Central Government.
2/ Includes Panama Canal Authority debt starting 2010.
3/ NFPS deficit and amortization only.

Figure 3. Panama: Financial Sector Developments, 2008-12

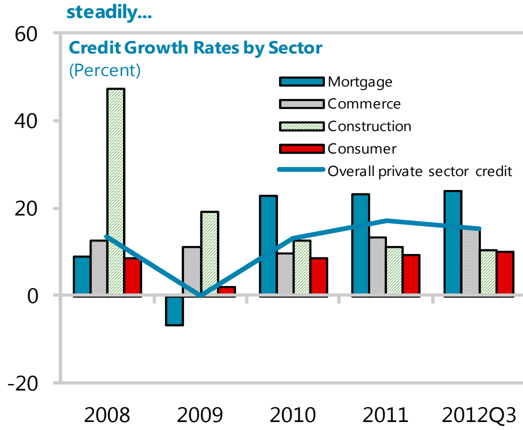
Both resident credit and deposit growth remained strong.



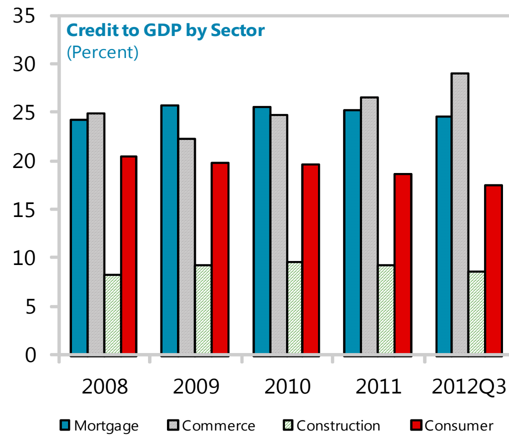
Nonresident credit and deposit growth recovered in 2011 but has been more modest since.



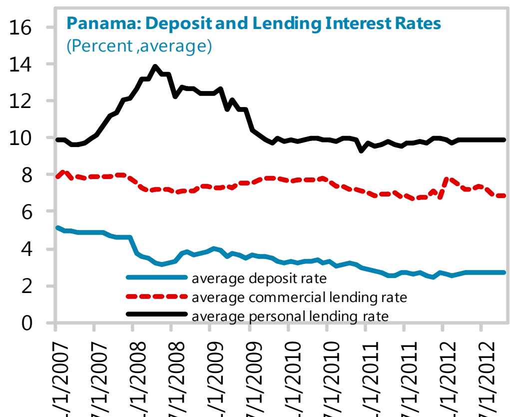
Credit to all sectors has been growing steadily...



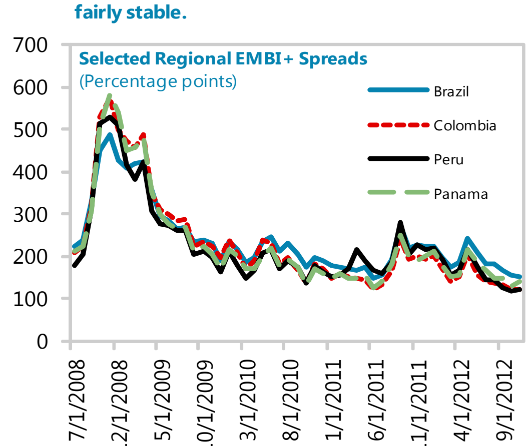
...with commerce continuing to represent the largest share of banks' loans portfolios, followed by mortgages.



Average interest rates and spreads are at historic lows.



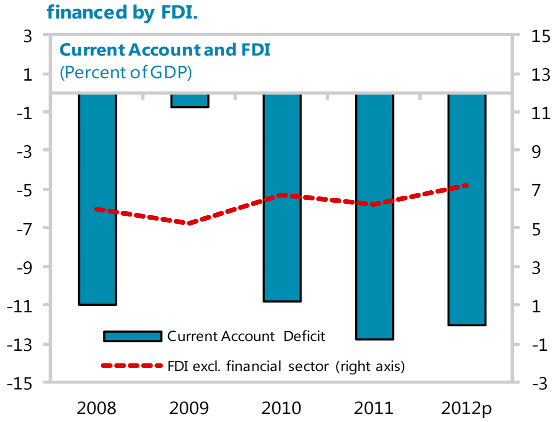
Spreads on sovereign debt remain low and fairly stable.



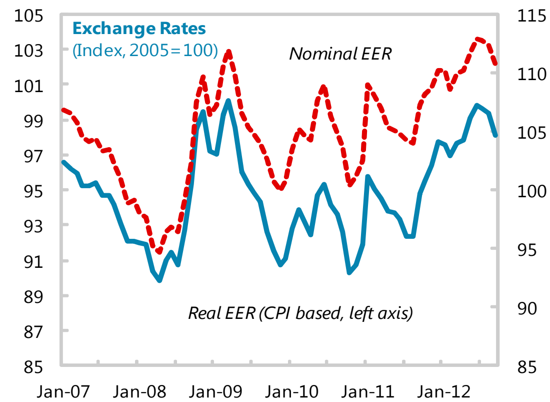
Sources: National Authorities, Bloomberg, and IMF staff calculations.

Figure 4. Panama: External Sector Developments

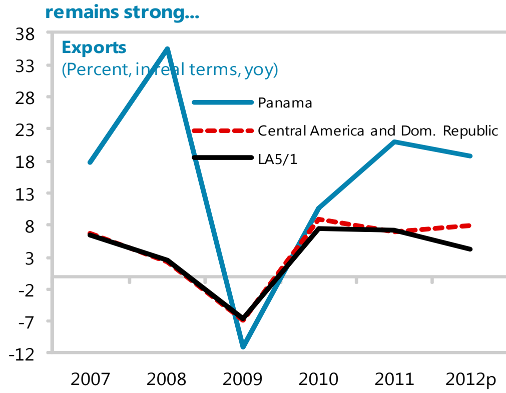
The current account deficit is driven by infrastructure-related imports, but is largely financed by FDI.



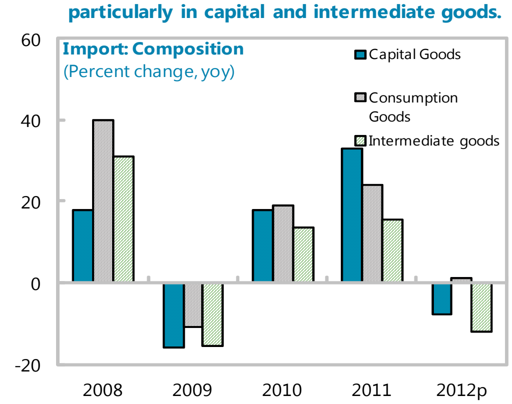
The NEER and REER are back to pre-crisis highs.



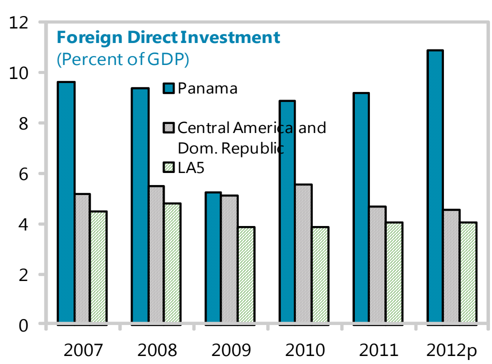
Export growth has slowed somewhat but remains strong...



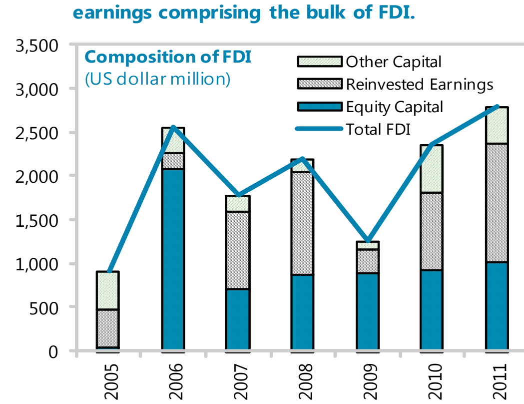
... and import growth has started to decrease, particularly in capital and intermediate goods.



Panama remains an attractive destination for FDI...

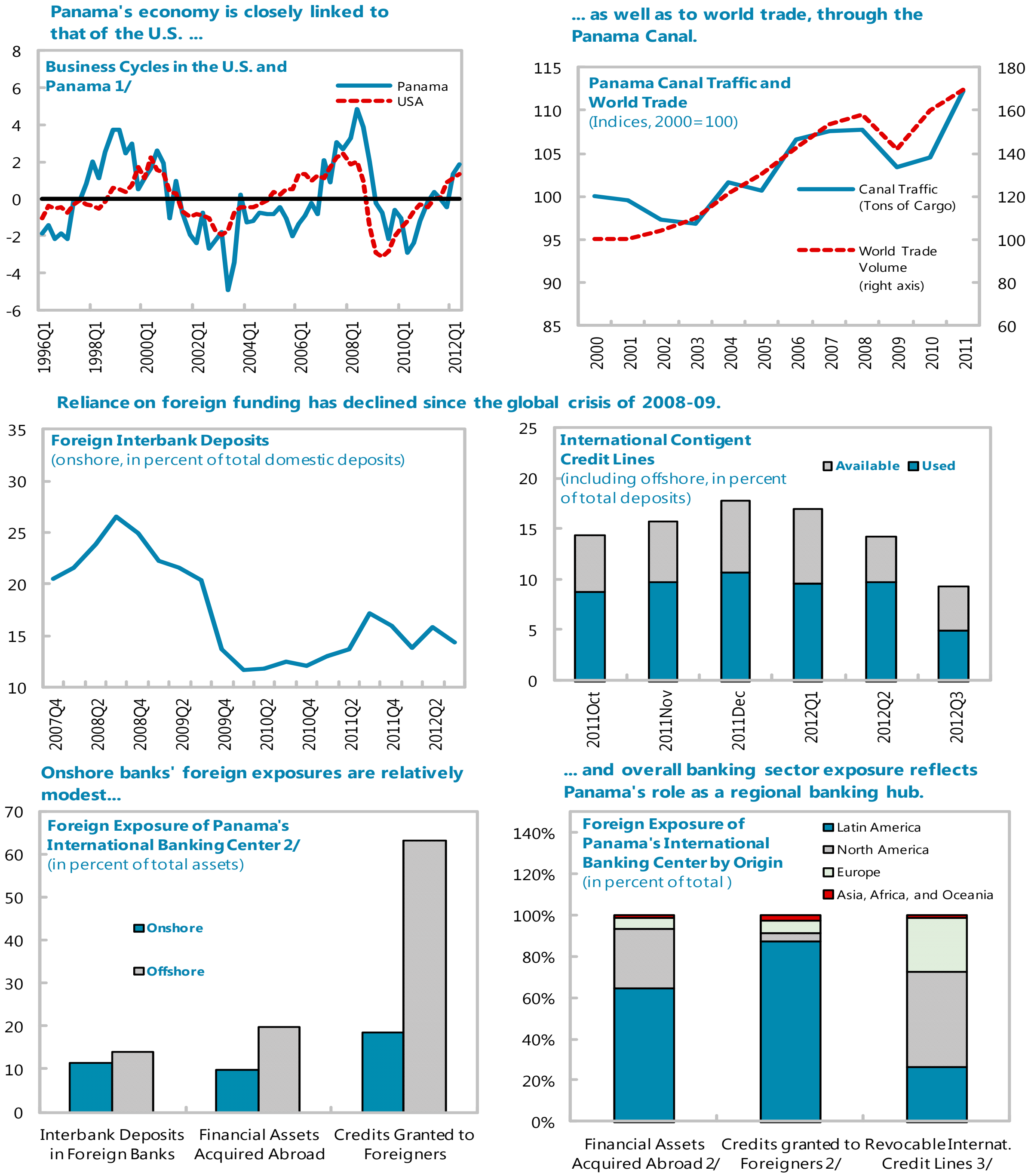


...with equity participation and reinvested earnings comprising the bulk of FDI.



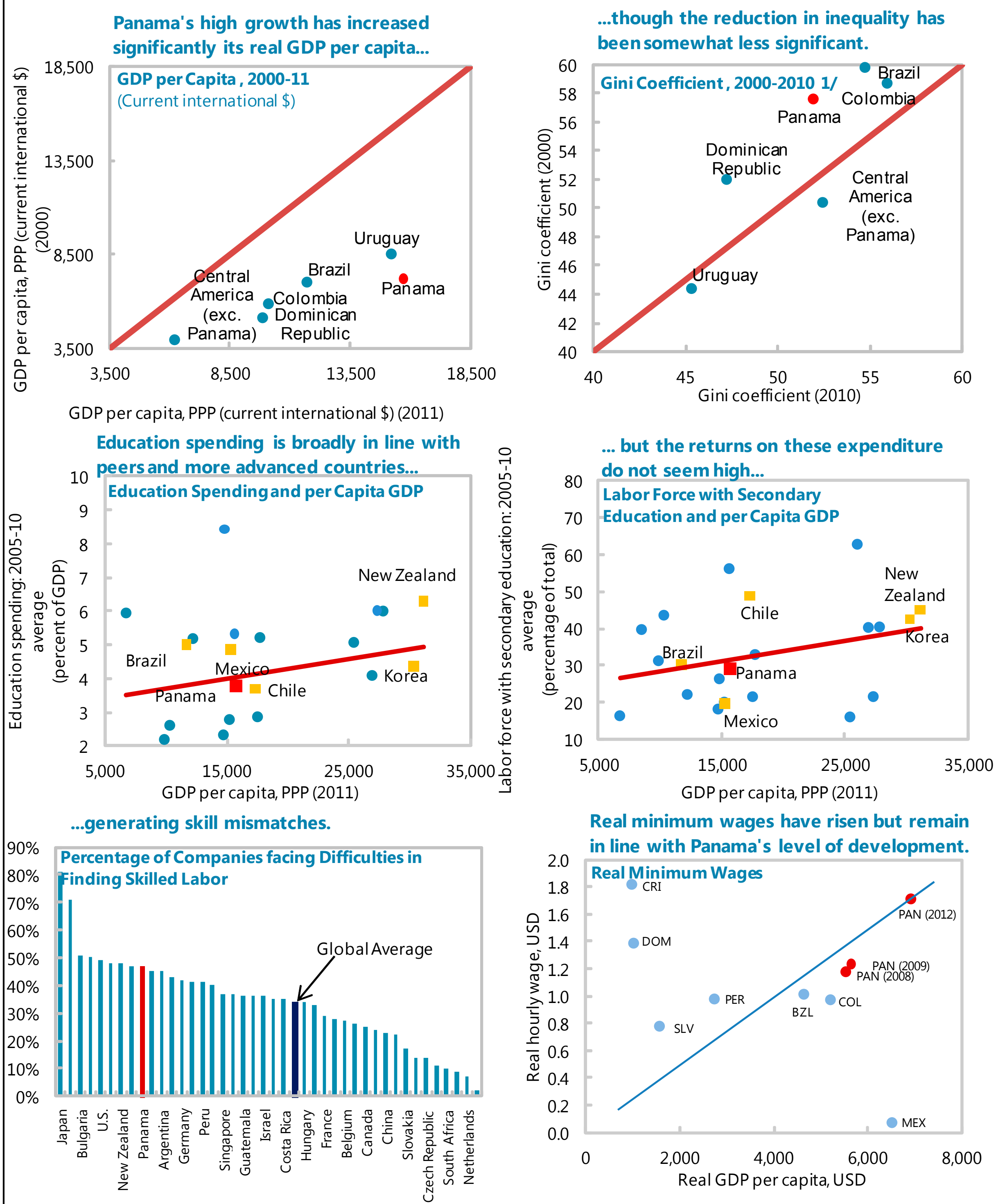
Sources: National Authorities and IMF staff calculations.
1/ LA5 refers to Brazil, Chile, Colombia, Mexico and Peru.

Figure 5. Panama: External Linkages



Sources: National Authorities and IMF staff calculations.
1/ Percentage deviation of real GDP from a Hodrick-Prescott trend (lambda=1600).
2/ As of September 2012.
3/ As of March 2012.

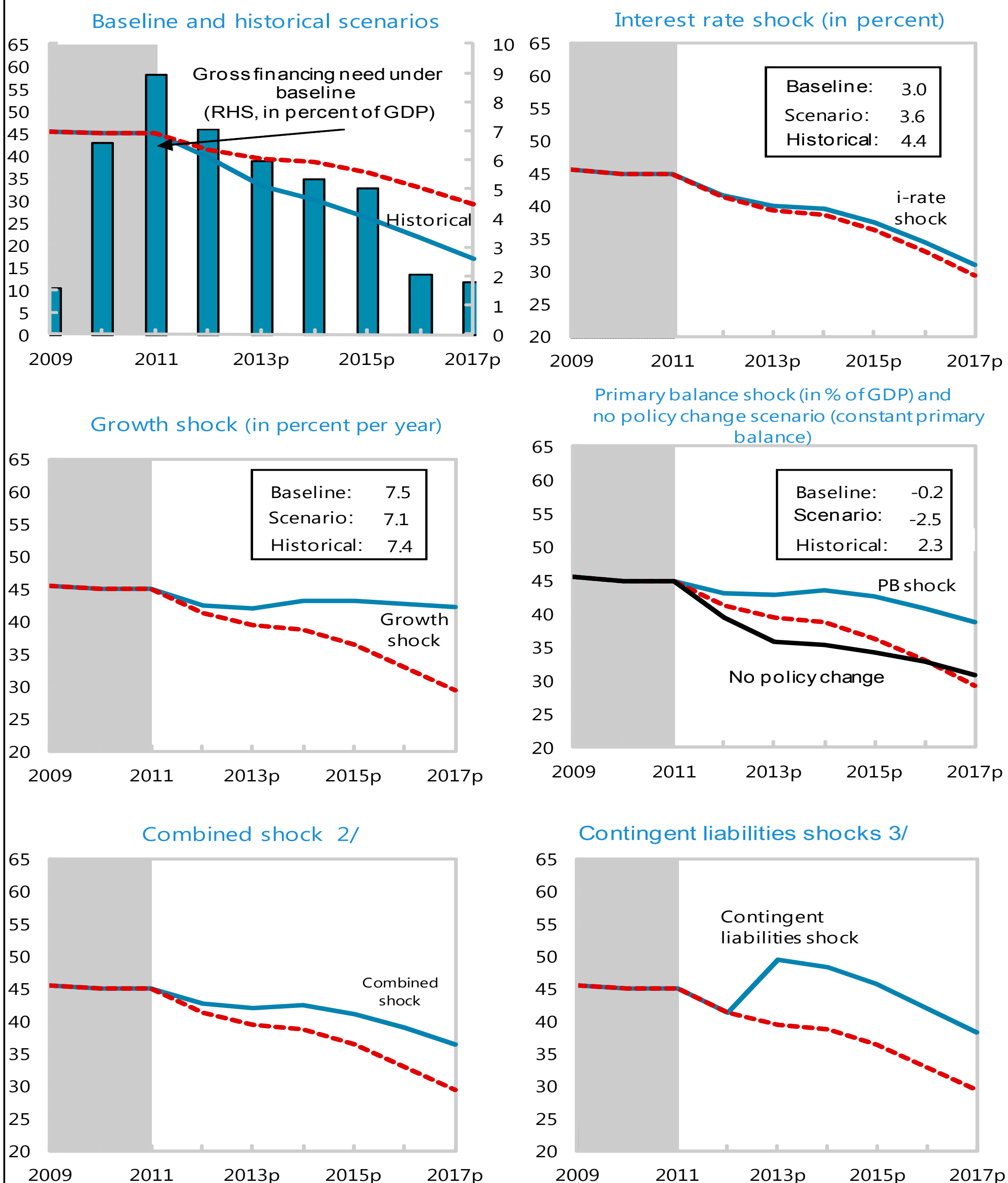
Figure 6. Panama: Social and Labor Market Indicators



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

Figure 7. Panama: Public Debt Sustainability: Bound Tests 1/

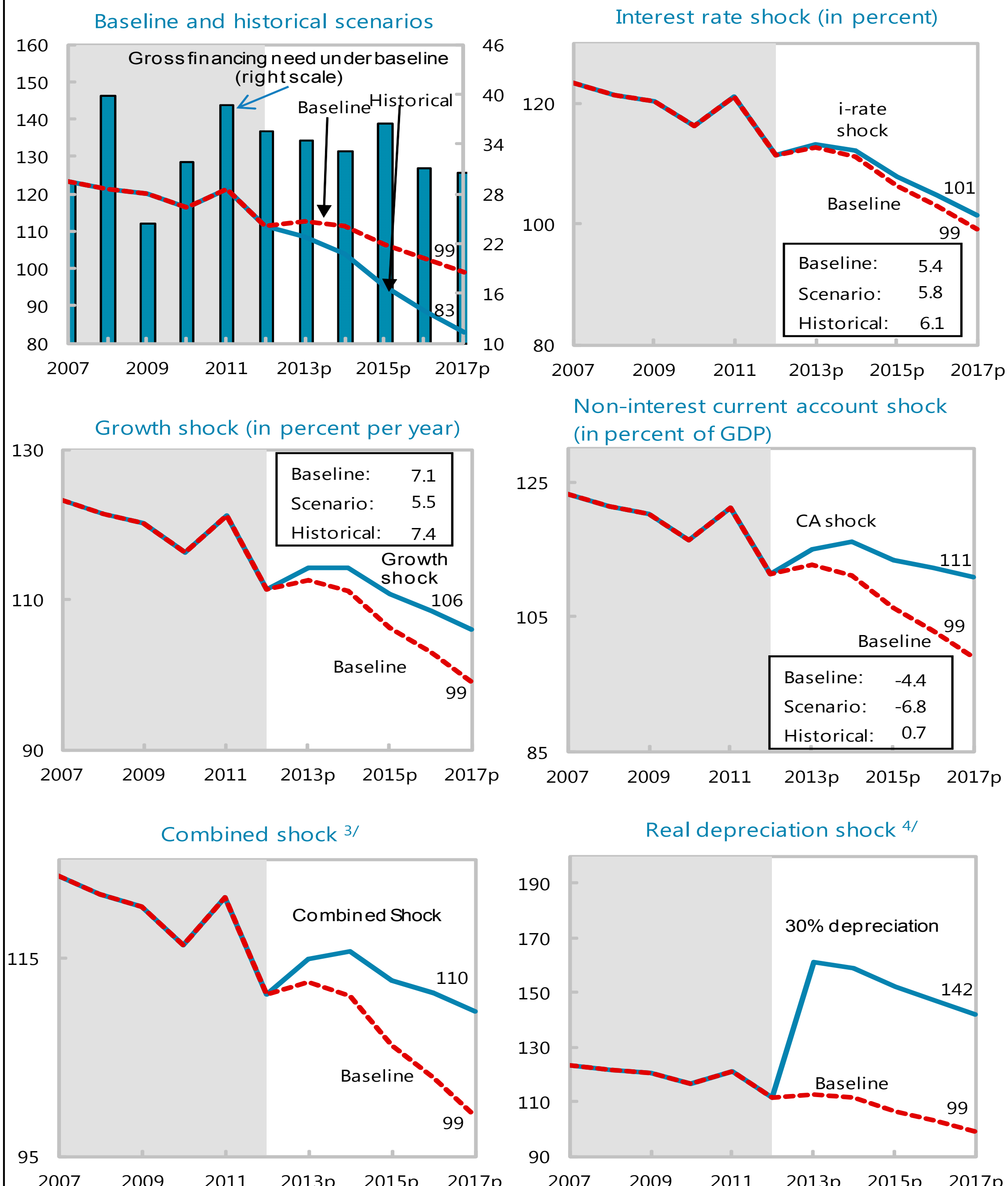
(Public debt in percent of GDP)



Sources: National Authorities and IMF staff estimates and calculations.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ A 10 percent of GDP shock to contingent liabilities occurs in 2013.

Figure 8. Panama: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: National Authorities and IMF staff estimates and calculations.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance

4/ One-time real depreciation of 30 percent occurs in 2012.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2010 census)	3.4	Poverty line (percent, 2008)	32.4
Population growth rate (percent a year)	1.6	Adult literacy rate (percent)	94.5
Life expectancy at birth (years)	75.4	GDP per capita (USD, 2011)	8,991
Total unemployment	4.0	IMF Quota (SDR, million)	206.6

					Proj.	
	2008	2009	2010	2011	2012	2013
			(Percent change)			
Production and prices						
Real GDP (1996 prices)	10.1	3.9	7.6	10.6	10.7	9.0
Consumer price index (average)	8.8	2.4	3.5	5.9	5.7	5.2
Consumer price index (end-of-year)	6.8	1.9	4.9	6.3	5.0	4.8
Domestic demand (at constant prices)						
Public consumption	2.6	4.1	12.2	21.1	20.1	12.5
Private consumption	-2.1	-2.8	24.4	2.8	2.6	11.9
Public investment 1/	58.3	17.2	35.6	23.3	12.4	3.4
Private investment	14.2	-13.4	-2.9	25.7	9.4	6.6
Financial sector						
Private sector credit	14.6	1.3	13.6	16.8	17.5	15.4
Broad money	18.5	9.4	11.6	8.1	11.7	16.6
Average deposit rate (1-year)	3.5	3.1	3.5	2.7	...	...
Average lending rate (1-year)	8.5	7.5	7.5	6.9	...	...
External trade						
Merchandise exports	75.5	-37.1	12.7	29.0	26.8	0.5
Merchandise imports	33.7	-16.1	19.1	26.2	14.7	7.7
			(In percent of GDP)			
Saving-investment balance						
Gross domestic investment	27.6	25.6	26.0	29.0	29.0	28.0
Public sector	8.2	9.4	12.0	14.0	12.7	13.7
Private sector	19.4	16.2	14.0	15.0	16.3	14.3
Gross national saving	16.7	24.9	15.2	16.2	17.0	16.6
Public sector	6.4	6.0	7.8	8.8	7.9	9.0
Private sector	10.3	18.9	7.4	7.4	9.1	7.6
Public finances						
Revenue and grants	34.9	33.5	33.1	32.9	31.9	31.9
Expenditure	32.4	33.9	36.4	38.4	37.0	36.7
Current, including interest	24.1	24.5	24.5	24.4	24.2	23.0
Capital	8.2	9.4	12.0	14.0	12.8	13.8
Overall balance	2.5	-0.5	-3.4	-5.5	-5.1	-4.9
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3	-2.9	-2.8
External sector						
Current account	-10.9	-0.7	-10.8	-12.8	-12.0	-11.4
Net exports from Colon Free Zone	0.0	8.0	1.8	1.0	2.7	2.6
Net oil imports	-1.0	0.1	0.3	0.9	1.3	1.5
Foreign direct investment	9.3	5.2	8.8	9.1	10.9	10.3
Total public debt						
Total debt 1/	45.4	45.4	44.9	44.9	41.3	39.4
External 1/	36.9	42.0	40.4	38.6	33.1	32.9
Domestic	8.5	3.4	4.5	6.2	8.1	6.5
Memorandum items:						
GDP (in millions of US$)	23,002	24,163	26,590	30,569	36,028	39,330

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

Table 2. Panama: Summary Operations of the Nonfinancial Public Sector 1/

(In percent of GDP)

	2008	2009	2010	2011	Proj. 2012	2013
Revenues	26.1	25.4	25.6	25.3	25.1	25.4
Current revenue	24.7	24.9	25.1	25.2	25.0	25.3
Tax revenue	10.6	10.9	11.6	11.6	12.6	13.3
Nontax revenue of central government	6.7	6.4	6.0	6.0	5.5	5.3
o/w: Panama Canal fees and dividends	3.0	3.2	3.1	3.4	2.6	2.4
Social security agency	5.8	5.7	6.2	6.7	5.9	5.7
Public enterprises' operating balance	1.2	0.9	0.7	0.5	0.5	0.5
Other 2/	0.4	1.0	0.5	0.4	0.4	0.4
Capital revenue	1.1	0.3	0.5	0.1	0.1	0.1
Expenditure	25.7	26.4	27.5	27.6	28.0	28.2
Current primary expenditure	15.6	16.2	16.4	16.4	17.0	16.4
Central government	8.3	8.5	8.9	9.4	10.2	9.6
Rest of the general government	7.2	7.7	7.5	7.0	6.8	6.8
Social security agency	6.5	6.9	6.8	6.4	6.2	6.1
Decentralized agencies	0.7	0.8	0.7	0.6	0.6	0.6
Interest	3.1	2.9	2.7	2.4	2.3	2.0
Capital	7.0	7.3	8.4	8.8	8.7	9.8
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3	-2.9	-2.8
Panama Canal Authority (ACP)						
Revenue	8.7	8.1	7.4	7.6	6.8	6.4
Current expenditure	2.4	2.2	2.2	2.1	2.0	1.8
Transfers to the government	3.0	3.2	3.1	3.4	2.6	2.4
Interest payments	0.0	0.0	0.0	0.1	0.2	0.3
Capital expenditure	1.2	2.1	3.6	5.2	4.1	4.0
Overall balance	2.1	0.5	-1.5	-3.2	-2.2	-2.1
Overall balance, including ACP	2.5	-0.5	-3.4	-5.5	-5.1	-4.9
Net financing, excluding ACP	-0.4	1.0	1.9	2.3	2.9	2.8
External	0.8	6.4	1.1	1.4	0.1	1.1
Domestic	-1.2	-5.4	0.8	0.9	2.8	1.6
Memorandum items:						
Savings (including ACP)	9.7	8.6	8.1	8.3	7.5	8.6
Primary balance (including ACP)	5.6	2.5	-0.6	-3.0	-2.6	-2.5
Primary balance (excluding ACP)	3.5	1.9	0.8	0.1	-0.6	-0.7
Structural primary balance 3/	3.1	2.4	1.5	0.4	-0.8	-1.0

Sources: Comptroller General, Ministry of Economy and Finance and IMF staff estimates.

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

2/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies.

3/ Structural primary balance adjusts for output gap.

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

	2008	2009	2010	2011	Proj. 2012	Proj. 2013
Revenues and grants	19.8	18.5	19.0	18.2	18.7	19.2
Current revenue	18.4	18.1	18.4	18.1	18.6	19.1
Taxes	10.6	10.9	11.6	11.6	12.6	13.3
Direct taxes	5.5	5.8	5.7	5.4	5.7	6.1
Income tax	4.9	5.2	5.0	4.8	5.1	5.5
Tax on wealth	0.5	0.6	0.7	0.6	0.6	0.6
Indirect taxes	5.1	5.1	5.9	6.2	6.9	7.2
Import tax	1.8	1.6	1.5	1.3	1.3	1.3
ITBMS	2.3	2.3	3.1	3.4	4.0	4.4
Petroleum products	0.4	0.5	0.4	0.3	0.3	0.3
Other tax on domestic transactions	0.7	0.7	1.0	1.2	1.3	1.3
Nontax revenue	7.8	7.2	6.8	6.5	6.0	5.8
Dividends	2.9	2.7	2.7	3.1	2.9	2.8
Of which: Panama Canal Authority	1.5	1.8	1.8	2.2	1.6	1.5
Panama Canal Authority: fees per ton 1/	1.5	1.4	1.3	1.2	1.1	1.0
Transfers from decentralized agencies	1.8	1.6	1.6	1.0	1.0	1.0
Other	1.5	1.4	1.2	1.3	1.1	1.1
Capital revenue	1.1	0.3	0.5	0.0	0.0	0.0
Grants	0.4	0.1	0.1	0.1	0.1	0.1
Total expenditure	19.5	19.9	20.9	21.8	22.0	22.2
Current	13.9	13.6	13.5	13.6	13.9	13.1
Wages and salaries	4.2	4.2	4.8	4.6	4.6	4.6
Goods and services	1.8	1.7	1.7	3.7	4.3	3.7
Pensions	1.9	1.6	1.0	1.0	1.1	1.0
Transfers to public and private entities	3.0	3.1	3.3	1.9	2.0	2.0
Interest	3.1	2.9	2.7	2.4	2.0	1.7
Domestic	0.4	0.4	0.1	0.2	0.2	0.1
External	2.7	2.6	2.5	2.2	1.8	1.6
Capital	5.6	6.3	7.4	8.2	8.1	9.2
Savings 2/	4.8	4.6	5.1	4.6	4.7	6.1
Overall balance	0.3	-1.4	-1.9	-3.6	-3.3	-3.0
Financing (net)	-0.3	1.4	1.9	3.6	3.3	3.0
External	0.6	6.5	1.1	1.4	0.1	1.1
Domestic	-0.8	-5.1	0.9	2.2	3.3	1.9
Memorandum items:						
Primary balance	3.4	1.5	0.7	-1.2	-1.3	-1.3
GDP (in millions of US$)	23,002	24,163	26,590	30,569	36,028	39,330

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

Table 4. Panama: Monetary Accounts 1/

	2008	2009	2010	2011	Proj. 2012	Proj. 2013
	(In millions of U.S. dollars at end-period)					
Net foreign assets	6,042	8,632	8,529	7,259	7,364	7,735
Short-term foreign assets, net	6,050	8,637	8,532	7,261	7,366	7,737
National Bank of Panama	2,695	3,406	2,945	2,665	2,671	2,691
Rest of banking system	3,355	5,231	5,586	4,597	4,695	5,046
Long-term foreign liabilities	8	5	2	2	2	2
National Bank of Panama	8	5	2	2	2	2
Net domestic assets	14,701	14,033	16,632	19,097	23,584	27,231
Public sector (net credit)	-2,465	-3,265	-2,740	-3,636	-3,345	-2,702
Central government (net credit)	-456	-672	-702	-550	141	784
Rest of the public sector (net credit)	-2,009	-2,593	-2,038	-3,086	-3,486	-3,486
Private sector credit	21,245	21,514	24,448	28,553	33,549	38,721
Private capital and surplus	-6,419	-5,573	-6,438	-6,931	-7,182	-9,408
Other assets (net)	2,340	1,356	1,361	1,111	563	621
Liabilities to private sector	20,335	22,240	24,813	26,834	29,982	34,967
Total deposits	20,274	22,073	24,699	26,745	29,959	34,942
Demand deposits	3,762	4,366	5,188	6,158	6,306	6,883
Time deposits	12,165	13,145	14,034	14,503	17,360	20,846
Savings deposits	4,347	4,562	5,477	6,084	6,294	7,212
Bonds	61	167	114	89	23	25
	(12-month change in relation to liabilities to the private sector at the beginning of the period)					
Net foreign assets	4.6	12.7	-0.5	-5.1	0.4	1.2
Net domestic assets	16.3	-3.3	11.7	9.9	16.7	12.2
Public sector credit (net)	-0.2	-3.9	2.4	-3.6	1.1	2.1
Private sector credit	15.8	1.3	13.2	16.5	18.6	17.3
Private capital and surplus	4.9	-4.2	3.9	2.0	0.9	7.4
Other assets (net)	5.6	-4.8	0.0	-1.0	-2.0	0.2
Liabilities to the private sector	18.5	9.4	11.6	8.1	11.7	16.6
	(12-month percent change)					
Memorandum items:						
M2 2/	18.5	9.4	11.6	8.1	11.7	16.6
Private sector credit	14.6	1.3	13.6	16.8	17.5	15.4
	(In percent of GDP)					
Total deposits	88.1	91.4	92.9	87.5	83.2	88.8
Private sector credit	92.4	89.0	91.9	93.4	93.1	98.5

Sources: Superintendency of Banks, National Bank of Panama, Savings Bank and IMF staff estimates.
1/ Domestic banking system only; comprises general license banks; does not include offshore banks; nonresident depostis, credit and investement are reported in the net foreign assets.
2/ M2 consists of resident bank deposits only; estimates of U.S. currency in circulation are not available.

Table 5. Panama: Commercial Bank Performance Indicators 1/

(In percent; end-of-period)

	2008	2009	2010	2011	2012		
	Dec.	Dec.	Dec.	Dec.	Mar.	June	Sept.
Asset quality							
Nonperforming loans as percent of total loans							
Banking system	1.6	1.4	1.1	0.9	0.8	0.9	0.8
Domestic banks	1.7	1.3	1.0	0.9	0.9	1.1	0.4
Foreign banks	1.7	1.5	1.1	0.8	0.8	0.8	0.8
Ratio of provisions to nonperforming loans							
Banking system	104.8	120.0	139.6	160.7	164.0	152.0	160.0
Domestic banks	120.2	150.3	160.2	157.7	156.0	132.0	150.4
Foreign banks	93.5	99.6	124.1	153.0	158.6	164.3	156.0
Profitability							
Pretax return on average assets							
Banking system	2.2	1.4	1.7	1.7	2.0	1.8	1.8
Domestic banks	2.9	1.4	1.4	1.5	2.5	1.8	1.8
Foreign banks	2.7	1.4	1.9	1.9	1.5	1.5	1.4
Liquidity							
Ratio of liquid assets to total deposits							
Banking system	28.4	28.4	25.2	23.5	22.3	22.2	21.0
Domestic banks	25.9	27.6	27.4	23.5	21.1	21.9	21.1
Foreign banks	30.6	29.3	23.1	23.5	23.4	22.5	20.9
Ratio of liquid assets plus marketable securities to total deposits 2/							
Banking system	43.0	42.9	40.0	37.9	37.0	36.3	34.0
Domestic banks	39.0	39.9	38.3	34.4	32.4	33.1	30.7
Foreign banks	46.2	45.7	41.7	41.4	41.2	39.4	37.4
Capital adequacy ratios							
Ratio of capital to risk-weighted assets							
Banking system	14.8	16.4	16.3	15.6	16.0	16.0	15.5
Domestic banks	17.1	18.4	19.1	17.6	18.3	18.0	17.0
Foreign banks	13.0	15.3	14.7	14.3	14.6	14.7	14.6
Ownership							
Foreign banks' share of domestic banking system assets	57.5	53.9	53.1	53.3	53.5	53.1	52.3

Sources: Superintendency of Banks and IMF staff estimates.

1/ Domestic banking system only, comprises general license banks; does not include offshore banks.
2/ Liquid assets, as defined in Article 75 of the 2008 Banking Law, also include marketable short-term securities (*Indice de Liquidez Financiera - Metodología del Cálculo)*.

Table 6. Panama: Medium-Term Balance of Payments

	2008	2009	2010	2011	Proj. 2012	2013	2014	2015	2016	2017
	(In millions of U.S. dollars)									
Current account	-2,513	-179	-2,862	-3,905	-4,335	-4,473	-4,620	-4,774	-4,496	-4,168
Trade balance excluding Colón Free Zone	-4,057	-4,123	-5,047	-6,301	-6,846	-7,661	-7,642	-7,976	-8,513	-8,405
Exports, f.o.b.	3,426	2,154	2,428	3,132	3,971	3,989	4,079	4,214	4,374	4,741
Imports, f.o.b.	-7,482	-6,277	-7,474	-9,433	-10,817	-11,651	-11,722	-12,190	-12,887	-13,147
Of which: related to canal expansion	-96	-106	-713	-1,189	-1,085	-1,150	-549	-230	-113	-113
Net exports from Colón Free Zone	8	1,942	492	291	986	1,010	1,070	1,140	1,230	1,327
Re-exports, f.o.b.	8,599	9,883	10,252	13,804	14,731	15,164	16,134	17,230	18,631	20,135
Imports, f.o.b.	-8,592	-7,941	-9,761	-13,512	-13,746	-14,154	-15,063	-16,090	-17,401	-18,808
Services, net	2,511	3,324	3,422	3,775	4,458	5,143	5,178	5,581	6,504	7,018
Travel, net	1,042	1,146	1,279	1,464	1,802	2,246	2,439	2,690	2,985	3,322
Transportation, net	1,215	1,922	1,799	2,158	2,482	2,703	2,528	2,662	3,272	3,427
Other services	254	256	344	154	174	194	211	228	248	268
Income, net	-1,507	-1,449	-1,859	-1,799	-3,011	-3,050	-3,320	-3,620	-3,827	-4,226
Private sector	-960	-844	-1,225	-1,195	-2,244	-2,446	-2,681	-2,922	-3,173	-3,431
Public sector	-547	-605	-634	-605	-767	-604	-639	-697	-654	-795
Of which : NFPS interest	-622	-620	-669	-671	-776	-613	-648	-707	-663	-805
Of which : related to Canal Expansion				-41	-84	-110	-114	-113	-115	-115
Current transfers, net	532	126	129	129	78	85	93	101	110	119
Capital and financial account	2,407	332	2,950	4,233	4,342	4,493	4,670	4,844	4,596	4,268
Financial account	2,351	302	2,908	4,224	4,333	4,484	4,662	4,835	4,587	4,259
Public sector	209	1,706	306	453	475	1,340	1,589	283	-90	-441
Nonfinancial public sector 1/	187	1,676	270	423	452	1,317	1,566	260	-113	-464
Other net flows	22	30	36	30	30	30	30	30	30	30
Private sector, medium and long-term	1,077	-78	4,040	3,047	4,143	4,395	4,238	4,427	5,108	5,438
Direct investment	2,147	1,259	2,350	2,790	3,910	4,036	4,151	4,459	4,870	5,223
Portfolio investment	-555	-1,021	-1,170	-646	-602	-676	-736	-803	-878	-962
Loans	-515	-316	2,859	903	835	1,035	823	771	1,115	1,177
Short-term flows	1,065	-1,326	-1,438	724	-286	-1,251	-1,165	125	-431	-737
Errors and omissions	778	558	-548	-609	0	0	0	0	0	0
Overall balance	673	711	-460	-281	6	20	50	70	100	100
Financing	-673	-711	460	281	-6	-20	-50	-70	-100	-100
Net foreign assets of the BNP	-667	-711	460	281	-6	-20	-50	-70	-100	-100
Memorandum items:	(In percent of GDP)									
Merchandise exports	14.9	8.9	9.1	10.2	11.0	10.1	9.4	8.9	8.6	8.6
Merchandise imports	32.5	26.1	28.1	30.9	30.0	29.6	27.1	25.9	25.2	23.8
Net exports from Colón Free Zone	0.0	8.1	1.8	1.0	2.7	2.6	2.5	2.4	2.4	2.4
Current account	-10.9	-0.7	-10.8	-12.8	-12.0	-11.4	-10.7	-10.1	-8.8	-7.5
Of which : related to Canal Expansion	-0.4	-0.4	-2.7	-4.0	-3.2	-3.2	-1.5	-0.7	-0.4	-0.4
Direct foreign investment	9.3	5.2	8.8	9.1	10.9	10.3	9.6	9.5	9.5	9.4
External public debt	36.9	42.0	40.4	38.6	33.1	32.9	32.8	30.0	26.8	23.3

Sources: Office of the Comptroller General and IMF staff estimates.
1/ Includes disbursements to ACP.

Table 7. Panama: Medium-Term Macroeconomic Framework

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					Proj.					
					(Percent change)					
Economic growth and prices										
Real GDP at market prices	10.1	3.9	7.6	10.6	10.7	9.0	7.2	6.7	6.4	6.2
CPI (period average)	8.8	2.4	3.5	5.9	5.7	5.2	4.8	4.0	3.7	3.5
CPI (end of period)	6.8	1.9	4.9	6.3	5.0	4.8	4.5	3.8	3.6	3.2
					(Percent of GDP)					
Savings and investment										
National savings	16.7	24.9	15.2	16.2	17.0	16.6	14.8	14.9	16.7	18.0
Public sector	6.4	6.0	7.8	8.8	7.9	9.0	8.6	9.2	10.9	11.3
Private sector	10.3	18.9	7.4	7.4	9.1	7.6	6.2	5.7	5.8	6.6
Gross domestic investment	27.6	25.6	26.0	29.0	29.0	28.0	25.5	25.0	25.5	25.5
Public sector	8.2	9.4	12.0	14.0	12.7	13.7	11.1	10.3	10.3	10.2
Of which: Canal Expansion	0.7	0.6	3.6	5.2	4.1	4.0	1.7	0.7	0.3	0.3
Private sector	19.4	16.2	14.0	15.0	16.3	14.3	14.4	14.7	15.2	15.3
External savings	-10.9	-0.7	-10.8	-12.8	-12.0	-11.4	-10.7	-10.1	-8.8	-7.5
Nonfinancial public sector, excluding ACP										
Revenue	26.1	25.4	25.6	25.3	25.1	25.4	25.1	25.6	26.2	26.2
Revenue, excluding ACP transfers	23.1	22.1	22.6	21.8	22.3	22.9	22.4	22.5	22.4	22.0
Expenditure	25.7	26.4	27.5	27.6	28.0	28.2	27.8	27.7	27.8	27.3
Primary balance	3.5	1.9	0.8	0.1	-0.6	-0.7	-0.5	-0.1	0.3	0.6
Overall balance	0.4	-1.0	-1.9	-2.3	-2.9	-2.8	-2.7	-2.1	-1.6	-1.1
Net external financing	0.8	6.4	1.1	1.4	0.1	1.1	1.3	-0.1	-0.9	-1.4
Net domestic financing	-1.2	-5.4	0.8	0.9	2.8	1.6	1.4	2.2	2.4	2.5
Panama Canal Authority (ACP)										
Revenue	8.7	8.1	7.4	7.6	6.8	6.4	6.2	6.0	6.8	6.6
Current expenditure	2.4	2.2	2.2	2.1	2.0	1.8	1.8	1.9	1.9	1.8
Transfers to the government	3.0	3.2	3.1	3.4	2.6	2.4	2.5	3.0	3.8	4.1
Interest payments	0.0	0.0	0.0	0.1	0.2	0.3	0.3	0.2	0.2	0.2
Capital expenditure	1.2	2.1	3.6	5.2	4.1	4.0	1.7	0.7	0.3	0.3
Overall balance	2.1	0.5	-1.5	-3.2	-2.2	-2.1	-0.2	0.2	0.6	0.3
Nonfinancial public sector, including ACP										
Overall balance	2.5	-0.5	-3.4	-5.5	-5.1	-4.9	-2.9	-1.8	-0.9	-0.8
Total public debt 1/	45.4	45.4	44.9	44.9	41.3	39.4	38.6	36.2	32.9	29.2
o/w: ACP	0.0	0.0	1.1	2.9	2.8	3.9	5.2	4.8	3.8	3.0
External										
Exports, f.o.b., excluding Colón Free Zone	14.9	8.9	9.1	10.2	11.0	10.1	9.4	8.9	8.6	8.6
Imports, f.o.b., excluding Colón Free Zone	-32.5	-26.0	-28.1	-30.9	-30.0	-29.6	-27.1	-25.9	-25.2	-23.8
Net exports of Colón Free Zone	0.0	8.0	1.8	1.0	2.7	2.6	2.5	2.4	2.4	2.4
Current account balance	-10.9	-0.7	-10.8	-12.8	-12.0	-11.4	-10.7	-10.1	-8.8	-7.5
Foreign Direct Investment	9.3	5.2	8.8	9.1	10.9	10.3	9.6	9.5	9.5	9.4
					(In millions of U.S. dollars)					
Memorandum items:										
Nominal GDP	23,002	24,163	26,590	30,569	36,028	39,330	43,208	47,082	51,068	55,314
External debt (public, percent of total non-bank external debt)	61.1	64.9	56.3	56.8	53.5	52.0	51.5	49.0	45.5	41.5
External Debt (excluding banks, percent of GDP)	60.3	64.7	71.7	68.1	61.9	63.3	63.7	61.1	58.9	56.1
External Debt (including banks, percent of GDP) 2/	167.9	166.4	171.4	168.9	154.9	155.3	153.4	148.1	144.5	140.5

Sources: Office of the Comptroller General, Ministry of Economy and Finance and IMF staff estimates.

1/ Including ACP and net of non-government assets formerly held by the Fiduciary Fund.

2/ Includes offshore banks.

Table 8. Panama: Debt of the Nonfinancial Public Sector 1/

	2008	2009	2010	2011	Proj. 2012
	(In millions of U.S. dollars)				
External debt	8,477	10,158	10,738	11,810	11,938
Multilaterals	1,350	1,646	1,825	2,039	2,255
IBRD	271	435	420	399	427
IDB	948	1,073	1,284	1,361	1,484
Others	130	138	121	280	343
Bilateral and guaranteed suppliers	210	223	325	381	363
Commercial banks	170	219	217	216	277
Global bonds	6,748	8,071	8,071	8,274	8,042
ACP	...	...	300	900	1,002
Domestic debt	1,960	821	1,190	1,904	2,925
Private creditors	828	519	894	1,422	2,443
Public financial institutions	1,132	302	296	482	482
Total Public debt 2/	10,437	10,980	11,928	13,714	14,863
	(In percent of GDP)				
Total	45.4	45.4	44.9	44.9	41.3
External	36.9	42.0	40.4	38.6	33.1
Domestic	8.5	3.4	4.5	6.2	8.1
Memorandum items:					
Held by Savings Fund (In percent of GDP)	3.9	3.7	0.5	0.3	0.3
Held by Social Security Agency (In percent of GDP)	3.1	1.1	2.4	2.6	2.2
External assets of FFD/FAP, net of government debt holdings	1.2	2.0	4.5	4.1	3.5
GDP (in millions of U.S. dollars)	23,002	24,163	26,590	30,569	36,028

Sources: Ministry of Economy and Finance and IMF staff estimates.
1/ Includes ACP.

Table 9. Panama: Vulnerability Indicators

	2008	2009	2010	2011	Proj. 2012
Financial indicators					
Broad money (12-month percent change)	18.5	9.4	11.6	8.1	11.7
Private sector credit (12-month percent change)	14.6	1.3	13.6	16.8	17.5
Deposit rate (6-month; in percent) 1/	3.5	3.1	3.5	6.9	...
External indicators					
Merchandise exports (12-month percent change)	75.5	-37.1	12.7	29.0	26.8
Merchandise imports (12-month percent change)	33.7	-16.1	19.1	26.2	14.7
Current account balance (in percent of GDP)	-10.9	-0.7	-10.8	-12.8	-12.0
Capital and financial account balance	10.5	1.4	11.1	13.8	12.1
Of which: direct investment	9.3	5.2	8.8	9.1	10.9
Public sector external debt (in percent of GDP)	36.9	42.0	40.4	38.6	33.1
In percent of exports of goods and services 2/	98.2	105.6	119.5	111.7	90.3
External interest payments					
In percent of exports of goods and services 2/	6.4	6.7	7.9	6.1	5.9
External amortization payments					
In percent of exports of goods and services 2/	10.7	2.2	1.9	4.8	2.9
REER, percent change (average, depreciation -)	-1.3	1.9	-2.3	1.7	1.7
Gross international reserves at end of period					
In millions of U.S. dollars 3/	2,710	3,424	2,975	2,733	2,686
In months of imports of goods and services	3.2	4.8	3.3	2.3	2.1
In percent of broad money 4/	13.3	15.4	12.0	10.2	9.0
In percent of short-term external debt 5/	50	63	40	34	30
	(In millions of U.S. dollars)				
Memorandum items:					
Nominal GDP	23,002	24,163	26,590	30,569	36,028
Exports of goods and services 2/	8,629	9,621	8,989	10,574	13,219

Sources: Ministry of Economy and Finance and IMF staff estimates.

1/ One-year average for the banking system, comprising of general license banks, excluding offshore banks.

2/ Includes net exports of the Colón Free Zone.

3/ Corresponds to gross foreign assets of the National Bank of Panama (a publicly-owned commercial bank).

4/ M2 consists of resident bank deposits only; estimates of U.S. currency in circulation are not available.

5/ Excludes off-shore banks' external liabilities. Short-term public external debt includes amortization in the following year.

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

	2008	2009	2010	2011	Proj. 2012
	(In percent of GDP)				
Net international investment position	-68.5	-61.1	-64.8	-71.8	-72.9
Assets	172.5	179.8	183.2	172.8	157.1
Portfolio investment abroad	32.9	36.5	37.7	35.0	31.3
of which: debt securities	32.6	35.9	37.0	34.2	30.7
Other investment	123.2	124.8	127.0	123.0	113.1
Trade credits	13.2	13.6	12.8	11.9	9.2
Loans (short term, to banks)	69.8	65.8	73.1	73.7	68.6
Currency and deposits	33.5	42.3	38.1	34.0	31.9
Other assets	6.8	3.1	3.1	3.4	3.4
Reserve assets	16.5	18.4	18.4	14.8	12.6
Liabilities	241.0	240.9	248.0	244.6	230.0
Direct investment inward	73.1	74.6	76.6	75.8	75.1
Portfolio investment	29.3	32.6	29.6	26.7	23.0
of which debt securities	29.3	32.6	29.6	26.7	23.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0
Other investment	138.6	133.8	141.8	142.2	131.8
Trade credits	4.7	4.4	4.5	4.3	4.1
Loans	35.4	33.1	52.2	52.2	49.2
Monetary authorities	0.4	0.3	0.2	0.2	0.2
General government	7.2	8.4	8.7	8.5	8.1
Banks	23.8	19.5	35.9	35.7	33.8
Long-term	14.2	12.0	19.4	19.0	18.1
Short-term	9.6	7.5	16.4	16.7	15.7
Other sectors	4.1	4.9	7.4	7.8	7.2
Currency and deposits	94.4	91.2	80.4	81.6	75.4
Other liabilities	4.0	5.1	4.7	4.1	3.1

Sources: National authorities, other reporting agencies and IMF staff estimates.

Table 11. Panama: Summary Operations of the Nonfinancial Public Sector, GFSM 2001 Classification 1/

(In percent of GDP)

	2008	2009	2010	2011	2012	2013	Proj. 2014	2015	2016	2017
Revenue	26.1	25.4	25.6	25.3	25.1	25.4	25.1	25.6	26.2	26.2
Taxes	10.6	10.9	11.6	11.6	12.6	13.3	13.5	13.8	13.8	13.8
Social contributions	5.8	5.7	6.2	6.7	5.9	5.7	5.5	5.3	5.2	4.8
Grants	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	9.4	8.6	7.8	7.0	6.5	6.3	6.0	6.5	7.2	7.5
Expenditure	25.7	26.4	27.5	27.6	28.0	28.2	27.8	27.7	27.8	27.3
Expense	15.6	16.2	16.4	16.4	17.0	16.4	16.2	16.1	15.9	15.6
Compensation of employees	6.1	6.2	6.6	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Use of goods and services	2.8	3.0	2.7	2.8	2.8	2.7	2.7	2.6	2.6	2.5
Consumption of fixed capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	3.1	2.9	2.7	2.4	2.3	2.0	2.2	2.0	1.8	1.7
Subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	4.9	4.8	4.5	2.9	3.1	3.1	2.5	2.6	2.6	2.6
Other expense	1.7	2.2	2.6	3.9	4.3	3.7	4.2	4.0	3.9	3.6
Net acquisitions of financial assets	7.0	7.3	8.4	8.8	8.7	9.8	9.4	9.6	10.0	10.0
Acquisitions of nonfinancial assets	7.0	7.3	8.4	8.8	8.7	9.8	9.4	9.6	10.0	10.0
Disposals of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumption of fixed capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating balance	10.6	9.2	9.2	8.9	8.1	9.1	8.8	9.6	10.3	10.6
Net operating balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending(+) /borrowing (-)	0.4	-1.0	-1.9	-2.3	-2.9	-2.8	-2.7	-2.1	-1.6	-1.1
Statistical Discrepancy	-0.2	0.4	1.0	0.6						
Transactions in financial assets and liabilities	-0.6	1.4	2.9	2.9	...	...	...	...	...	...
Net acquisition of financial assets	-0.1	-1.2	-0.2	0.8	...	...	...	...	...	...
Currency and deposits (foreign)	0.0	-0.1	-0.1	0.0	...	...	...	...	...	...
Debt securities (domestic)	-0.2	-1.1	-0.1	0.8	...	...	...	...	...	...
Net incurrence of liabilities	-0.5	2.6	3.1	2.1	...	...	...	...	...	...
Debt securities (foreign)	0.0	5.5	0.0	0.5	...	...	...	...	...	...
Loans (domestic)	-1.1	-3.8	2.0	0.7	...	...	...	...	...	...
Loans (foreign)	0.6	0.9	1.1	0.9	...	...	...	...	...	...

Sources: Comptroller General, Ministry of Economy and Finance and IMF staff estimates.

1/ Excludes Panama Canal Authority.

Table 12. Panama: Public Sector Debt Sustainability Framework, 2008-2017

(In percent of GDP, unless otherwise indicated)

	Actual												
	2008	2009	2010	2011			2012	2013	2014	2015	2016	2017	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	45.4	45.4	44.9	44.9			41.3	39.4	38.6	36.2	32.9	29.2	**-0.6**
Change in public sector debt	-7.5	0.1	-0.6	0.0			-3.6	1.9	0.7	2.4	3.3	3.7	
Identified debt-creating flows (4+7+12)	-9.9	-1.7	-0.8	-0.4			-2.0	2.5	0.4	-0.4	-2.3	-2.1	
Primary deficit	-5.6	-2.5	0.7	3.0			2.6	2.5	0.4	-0.4	-1.2	-1.1	
Revenue and grants	34.9	33.5	33.1	32.9			31.9	31.9	31.2	31.6	33.1	32.8	
Primary (noninterest) expenditure	29.2	31.0	33.7	35.9			34.5	34.4	31.7	31.2	31.9	31.7	
Automatic debt dynamics 2/	-4.3	0.7	-1.4	-3.4			-4.5	0.0	0.0	0.0	-1.1	-1.0	
Contribution from interest rate/growth differential 3/	-4.3	0.7	-1.4	-3.4			-4.5	0.0	0.0	0.0	-1.1	-1.0	
Of which contribution from real interest rate	0.4	2.4	1.7	0.7			-0.5	0.0	0.0	0.0	1.3	1.3	
Of which contribution from real GDP growth	-4.6	-1.7	-3.1	-4.1			-4.1	0.0	0.0	0.0	-2.4	-2.2	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	...			...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.4	1.8	0.2	0.4			-1.6	-3.0	0.2	-0.8	-1.2	-1.7	
Public sector debt-to-revenue ratio 1/	130.1	135.7	135.7	136.3			129.3	123.5	123.7	114.5	99.6	89.1	
Gross financing need 6/	2.3	1.6	6.6	8.9			7.0	5.9	5.3	5.0	2.0	1.8	
in millions of U.S. dollars	531	380	1,752	2,733			2,536	2,336	2,300	2,362	1,046	997	
Scenario with key variables at their historical averages 7/							44.9	39.5	33.1	30.0	26.0	21.7	**-0.4**
Scenario with no policy change (constant primary balance) in 2012-2017							39.4	35.7	35.3	34.1	32.7	30.8	**-0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline					10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	10.1	3.9	7.6	10.6	7.4	3.2	10.7	9.0	7.2	6.7	6.4	6.2	
Average nominal interest rate on public debt (in percent) 8/	6.9	6.8	6.6	6.2	6.9	0.4	6.0	5.4	6.1	5.6	5.5	5.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.3	5.6	4.3	2.2	4.4	1.6	-0.5	5.3	3.6	3.5	3.5	3.6	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.5	1.1	2.3	4.0	2.5	1.4	6.5	0.2	2.5	2.1	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.1	10.2	17.0	17.6	12.9	11.9	6.3	8.8	-1.3	5.1	8.7	5.6	
Primary deficit	-5.6	-2.5	0.7	3.0	-2.3	3.3	2.6	2.5	0.4	-0.4	-1.2	-1.1	

1/ Nonfinancial public sector, including Panama Canal Authority. Non-government assets formerly held by the Fiduciary Fund are not netted out.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 13. Panama: External Debt Sustainability Framework, 2008-2017

(In percent of GDP, unless otherwise indicated)

	Actual				Projections							
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017		**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	121.4	120.2	116.3	121.2	111.3	112.6	111.2	106.3	102.9	99.1		**-12.2**
Change in external debt	-1.9	-1.2	-3.9	4.9	111.3	1.3	-1.4	-4.9	-3.4	-3.8		
Identified external debt-creating flows (4+8+9)	-15.6	-10.3	-9.0	-11.5	-9.8	-8.1	-6.3	-6.2	-7.0	-7.8		
Current account deficit, excluding interest payments	3.5	-5.9	4.9	7.4	6.5	5.9	5.2	4.7	3.6	2.5		
Deficit in balance of goods and services	6.7	-4.7	4.3	7.3	3.9	3.8	3.2	2.7	1.5	0.1		
Exports	37.5	39.8	33.8	34.6	36.7	36.4	34.4	33.7	34.1	34.0		
Imports	44.2	35.1	38.1	41.9	40.6	40.3	37.7	36.3	35.7	34.1		
Net non-debt creating capital inflows (negative)	-9.3	-5.2	-8.8	-9.1	-10.9	-10.3	-9.6	-9.5	-9.5	-9.4		
Automatic debt dynamics 1/	-9.7	0.8	-5.1	-9.7	-5.5	-3.7	-1.9	-1.4	-1.0	-0.8		
Denominator: 1+g+r+gr	1.2	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1		
Contribution from nominal interest rate	7.5	6.6	5.8	5.4	5.5	5.5	5.5	5.5	5.2	5.1		
Contribution from real GDP growth	-10.7	-4.5	-8.3	-10.7	-11.0	-9.2	-7.4	-6.8	-6.3	-5.9		
Contribution from price and exchange rate changes 2/	-6.5	-1.4	-2.7	-4.4	...	...	...	...	...	...		
Residual, incl. change in gross foreign assets (2-3) 3/	13.7	9.1	5.2	16.4	-0.1	9.3	4.9	1.2	3.6	4.0		
External debt-to-exports ratio (in percent)	323.7	301.9	344.1	350.4	303.7	309.0	323.0	315.5	301.3	291.1		
Gross external financing need (in billions of US dollars) 4/	9.1	5.9	8.4	11.8	12.8	13.5	14.3	17.1	15.8	16.9		
in percent of GDP	39.8	24.3	31.7	38.8	35.6	34.4	33.1	36.4	31.0	30.5		
Scenario with key variables at their historical averages 5/					111.3	108.4	103.7	95.1	88.8	83.0		**-10.7**
Key Macroeconomic Assumptions Underlying Baseline											For debt stabilization	
Real GDP growth (in percent)	10.1	3.9	7.6	10.6	10.7	9.0	7.2	6.7	6.4	6.2	6.2	
GDP deflator in US dollars (change in percent)	5.5	1.1	2.3	4.0	6.5	0.2	2.5	2.1	2.0	2.0	2.0	
Nominal external interest rate (in percent)	7.0	5.7	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	
Growth of exports (US dollar terms, in percent)	26.6	11.5	-6.6	17.6	24.9	8.5	3.8	6.6	9.9	8.0		
Growth of imports (US dollar terms, in percent)	31.0	-16.6	19.4	26.5	14.1	8.4	2.7	5.2	6.4	3.7		
Current account balance, excluding interest payments	-3.5	5.9	-4.9	-7.4	-6.5	-5.9	-5.2	-4.7	-3.6	-2.5		
Net non-debt creating capital inflows	9.3	5.2	8.8	9.1	10.9	10.3	9.6	9.5	9.5	9.4		

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 dollars, e = nominal appreciation (increase in dollar value of domestic currency), a = share of domestic-currency denominated debt in total external debt and g = real GDP growth rate.

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 I. Panama: External Stability Assessment

Balance of Payments

The high external current account deficits projected for the near term are mainly investment-driven and financed by foreign direct investment (FDI) inflows, and do not pose a risk to external sustainability. The significant current account deficits reflect a temporary jump in import spending related to the Canal expansion (which is undergoing its most capital-intensive phase of construction during 2011-2012) and the import-heavy nature of ambitious public infrastructure investments. After adjusting for these factors (see Annex Table 1 below), the underlying current account balance is estimated at 7.3 percent (close to its historic norm) and is projected to converge to this value in the medium term without major policy adjustments. Panama is not reliant on either short-term, non-deposit debt or portfolio investment inflows— the two main sources of external finance that would be most affected should the global economy experience a relapse. Excluding the public sector borrowing associated to the Canal expansion, FDI represented 85 percent of total net capital inflows in 2011 (and accounted for 9.1 percent of GDP). Repatriation of profits and dividends and reinvested earnings associated with these FDI inflows (which averaged 6.5 percent of GDP over the past five years) contribute to relatively high structural current account deficits.

Furthermore, Panama's current account deficit may be overestimated given that BOP statistics do not factor in the credit flows associated with the repatriation and reinvestment of profits and dividends from residents' FDI abroad. According to inward FDI data reported by counterpart economies for the CDIS, the stock of Panama's outward FDI amounted to 78 percent of GDP as of end-2011. Similarly, the negative net international investment position of Panama (which reached 72 percent of GDP by end-2011) is likely overestimated.

Annex Table 1. Panama: Underlying Current Account (in percent of GDP)

	Average 2006-2008	2009	2010	2011
Current account balance (actual)	**-7.3**	**-0.7**	**-10.8**	**-12.8**
Panama Canal-related investment	0.3	0.6	3.6	5.2
Contribution to CA balance	-0.2	-0.4	-2.7	-4.0
Public Sector Capital Investment	5.9	7.3	8.4	8.8
Investment above Pre-Crisis Average		1.4	2.5	3.0
Contribution to CA balance		-0.7	-1.3	-1.5
Underlying current account balance	**-7.2**	**0.4**	**-6.8**	**-7.3**
Memorandum item:				
Foreign Direct Investment	11.2	5.2	8.8	9.1

Sources: National authorities, and IMF staff estimates.

Real Effective Exchange Rate

Panama's CPI-based Real Effective Exchange Rate (REER) has been appreciating since 2011, but remains in line with fundamentals with no evidence of misalignment. After depreciating during most of the decade due to fiscal consolidation and low inflation, higher deficits and inflation above trading partners translated into modest appreciation pressures in 2011 (1.7 percent). The REER appreciated by 3.5 percent as of September 2012 (y/y), and it is now at about the same level as in the base year (2005). Exchange rate assessment results from standard CGER methodologies show no evidence of misalignment (Annex Table 2). However, further real appreciation driven by inflation above trading partners could erode competitiveness.

Annex Table 2. Panama: REER Assessment Results (in percent) 1/

	CA Norm	Actual NFA	NFA-stabilising CA	Underlying CA	Gap	Elasticity	Misalignment
MB	-5.7%			-7.3%	-1.6%	-0.25	6.5%
ES		-76.3%	-7.2%	-7.3%	-0.1%	-0.25	0.5%
ERER							-9.0%

1/ The MB approach calculates the difference between the medium-term CA balance and an estimated equilibrium CA "norm". The ES approach calculates the difference between the actual CA balance and the NFA-stabilizing CA balance. The real exchange rate gap is calculated to bring the current account balance in line with its NFA-stabilizing level or medium-term MB norm. NFA is net foreign assets as a share of GDP (Lane and Milesi-Ferretti, 2011), with the 2007 NFA position assumed close to the long-run equilibrium. The ERER is estimated as a function of medium-term fundamentals.

International Investment Position and External Debt

The net international investment position has remained broadly stable over the past decade. Large gross FDI and net bank liabilities explain the overall negative position (Annex Figure 1). Going forward, the IIP is projected to deteriorate somewhat until 2014-15 as FDI liabilities associated with the public infrastructure projects expand and to stabilize as a share of GDP by the end of the projection period.

Results of the debt sustainability analysis indicate that external debt, while relatively high as a share of GDP, is sustainable over the medium term. The total stock of public and private external debt, net of offshore banks' foreign liabilities, represented close to 120 percent of GDP by end-2011. Non-resident deposits in Panama's on-shore banks accounted for 44 percent of total external debt and 65 percent of private external debt, and approximately 15 percent of these deposits were short-term (Annex Table 3). External debt should gradually decline as a share of GDP over the projection period, as a large part of the current account deficits is expected to continue to be financed by non-debt creating flows (FDI), and average annual real GDP growth is projected to be close to 7 percent.

Standard stress tests suggest that Panama's external indebtedness is resilient to a series of shocks. The results of standardized sensitivity tests do not fundamentally alter the external debt outlook. Shocks to interest rates, current account and growth have a contained impact on Panama's external debt-to-GDP ratio, which would remain within manageable levels. In most cases, the external debt would stay below 110 percent of GDP by the end of the projection period. The external debt outlook, however, is somewhat vulnerable to a large real devaluation of 30 percent, which would push up the debt-to-GDP ratio by 31 percentage points to 142 percent in 2017. Given that Panama is a fully-dollarized economy, however, this scenario would necessarily entail a large and sudden internal price and wage deflation.

Annex Table 3. Panama: External Debt (In percent of GDP)

	2008	2009	2010	2011	Proj. 2012
Total External Debt	**167.9**	**166.4**	**171.4**	**168.9**	**154.9**
Total Private External Debt	130.5	122.8	130.9	131.9	122.1
Banks	121.4	113.4	118.8	119.6	110.7
On-shore banks	75.0	67.2	63.7	71.9	67.9
Off-shore banks	46.5	46.2	55.1	47.7	42.7
Other Sectors	9.1	9.5	12.1	12.3	11.5
Memorandum item:					
Total External Debt excluding off-shore banks' liabilities	121.4	120.2	116.3	121.2	112.6
Short Term External Debt excluding off-shore banks	23.8	22.4	27.9	26.5	24.2

Sources: National Authorities and IMF staff calculations.

International Reserves

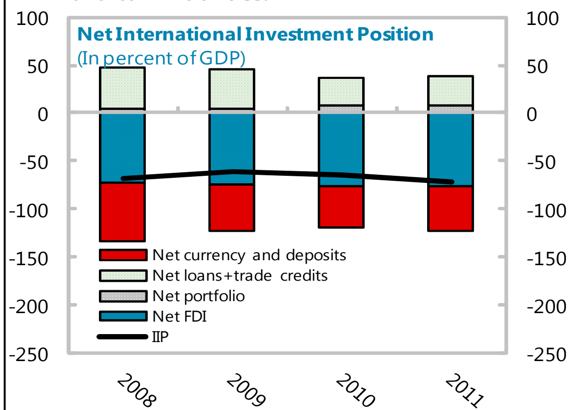
In Panama, international reserves are the liquid external assets of the National Bank of Panama (BNP). Official reserve assets amount to 9 percent of GDP, or about 35 percent of short-term public and private external debt. Official reserves were also 10 percent of total deposits, while individual banks' liquid assets amounted to an additional 21 percent of total deposits as of September 2012. Given the open current and financial accounts and the full dollarization of the economy, the balance of payments would adjust automatically to an external financing shock through a reduction in the money supply and lower domestic demand. In a fully dollarized economy, liquid assets would mainly serve to protect the banking system in case of a systemic liquidity shock and the ensuing credit crunch and contraction in economic activity.

Non-Price Competitiveness

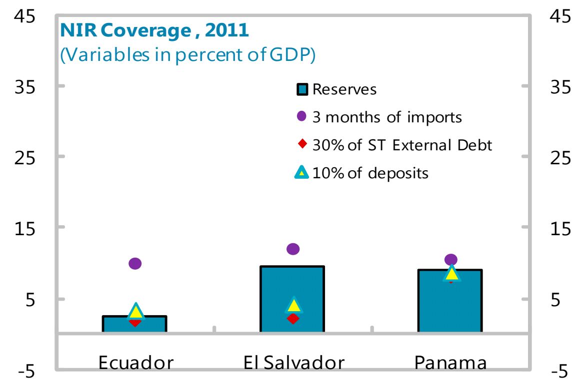
Survey-based competitiveness rankings improved in recent years (Annex Figure 1). Overall, Panama ranks better than most of its peers in South America except Chile. In terms of competitiveness areas, Panama ranks well on market efficiency, financial development, technological readiness and infrastructure. However, it ranks below peers in terms of labor market efficiency, access to health care, and primary education. Panama's governance indicators also compare favorably with most of its South American peers, particularly in terms of government effectiveness and regulatory quality, though there is room for improvement as regards control of corruption and rule of law.

Annex Figure 1. Panama: External Stability and Competitiveness

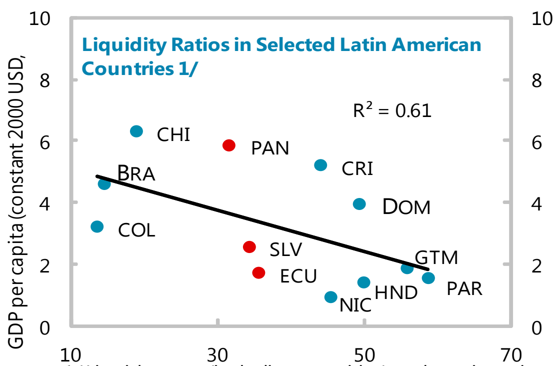
The IIP has remained stable and driven by FDI and bank liabilities.



NIR coverage is broadly in line with that of other dollarized economies in the region...



...and is complemented by ample bank liquid assets.



1/ Liquid assets (including securities) to deposits ratio (percent)

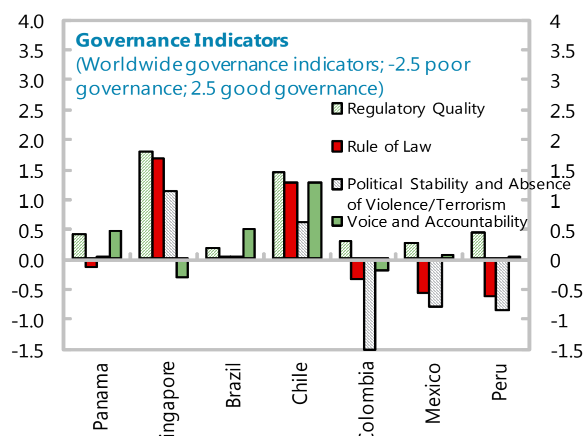
Panama's competitiveness ranking has improved and is better than all LA5 countries, except Chile.

Global Competiveness Rankings: Panama, Singapore and LA5 countries (2012)

	Panama	Singapore	LA5	Brazil	Chile	Colombia	Mexico	Peru
Overall GCI Ranking (2012)	40	2	53	48	33	69	53	61
2011 Ranking	49	2	55	53	31	68	58	67
Ranking on Pillars								
Health and Primary Education	69	3	81	88	74	85	68	91
Higher education and Training	69	2	67	66	46	67	77	80
Labor Market Efficiency	89	2	68	69	34	88	102	45
Financial Market Developments	23	2	49	46	28	67	61	45

The investment climate is on par with that of larger economies in South America...

...as are governance indicators, though there is still room for improvement.



Sources: World Economic Forum; World Bank Doing Business data and Worldwide Governance Indicators; U.S. Department of State Country Reports on Human Rights Practices; 2011 Republic of Panama Labor Rights Report;and IMF staff estimates.

INTERNATIONAL MONETARY FUND

PANAMA

January 10, 2013

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of November 30, 2012)

I. Membership Status: Joined: March 14, 1946; Article VIII

I. Membership Status: Joined: March 14, 1946; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	206.60	100.00
Fund holdings of currency (Exchange Rate)	194.75	94.27
Reserve Tranche Position	11.86	5.74

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	197.01	100.00
Holdings	170.87	86.73

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	Jun 30, 2000	Mar 29, 2002	64.00	0.00
EFF	Dec 10, 1997	Jun 20, 2000	120.00	40.00
Stand-By	Nov 29, 1995	Mar 31, 1997	84.30	84.30

VI. Projected Payments to Fund [1]

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

	Forthcoming			
	2012	2013	2014	2015
Principal				
Charges/Interest		0.02	0.02	0.02
Total		0.02	0.02	0.02

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative: Not Applicable

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

X. Safeguards Assessment
Under the Fund's safeguards assessment policy, the National Bank of Panama (NBP) was subject to the transitional procedures with respect to the Stand-By Arrangement, which was approved on June 30, 2000, and expired on March 29, 2002. The transitional procedures required a review of the NBP's external audit mechanism only. The assessment was completed on July 12, 2001 and concluded that NBP's external audit mechanism was at the time adequate.

Nonfinancial Relations

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

XII. Last Article IV Consultation
The 2011 Article IV consultation was concluded on February 22, 2012. Panama is on the standard 12 month consultation cycle. The 2011 Consultation was delayed in order to coincide with the Financial Sector Assessment Program (FSAP) process.

XIII. FSAP: A first-time FSAP was concluded in September 2011. It confirmed the banking sector's strength and resilience to potential shocks, noting nonetheless that data gaps prevent a full analysis of macro-financial linkages.

XIV. Technical Assistance
Panama is a large recipient of technical assistance (TA) directly through the Fund or CAPTACDR. Latest assistance concentrated in the area of the national accounts, both on output compilation and improvement of registering financial services. Assistance in the fiscal area included work on government financial statistics and steps necessary to implement requirements under the GFSM 2001 manual. Assistance in the area of the balance of payments included work on the appropriate classification of reserves. In the financial area, TA concentrated mostly on improving data compilation on a regional level, and of non-financial groups, as well as on IFRS adoption.

XV. Resident Representative: None.

RELATIONS WITH THE WORLD BANK-UNDER JMAP

Title	Products	Provisional Timing of Missions	Expected Delivery Date
Bank Work Program	Rural Productivity Project (GEF)	October 2011	June 2013
	Rural Productivity Project	November 2011	Processing extension of closing date to July 2014
	Metro Water and Sanitation Improvement Project	October 2011	September 2015
	Health Equity and Performance Improvement Project	May 2013	December 2014
	Enhanced Public Sector Efficiency Technical Assistance Loan		December 2016
	TA on Public Financial Management-SIAF	January 2012	January 2013

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 1, 2012)

The IDB estimates disbursements in 2012 for US$168.1 million. The preliminary projection of disbursements for 2013 is around US$275.0 million.

Panama: Relations with the Inter-American Development Bank

(In millions of U.S. dollars)

Operations

Sector	Approved	Disbursed	Undisbursed Amounts
Agriculture and rural development	51.1	41.6	9.5
Education	100.0	3.6	96.4
Energy	42.5	20.6	21.9
Environment and natural disasters	10.0	3.3	6.7
Health	50.0	0.0	50.0
Private firms and SME development	56.3	25.0	31.3
Reform/modernization of the state	94.3	25.3	69.0
Science and technology	19.7	9.7	10.0
Social investment	20.2	13.1	7.0
Trade	0.0	0.0	0.0
Transport	140.0	59.4	80.6
Urban Development and housing	30.0	7.8	22.2
Water and sanitation	234.0	93.4	140.6
Total	848.1	302.8	545.2

Source: Inter-American Development Bank.

Loan Transactions

	2008	2009	2010	2011	2012e	2013p
Disbursements	126.8	216.8	302.2	181.1	168.1	275.0
Repayments	89.4	91.4	92.9	100.5	150.1	112.0
Net lending	37.4	125.5	209.3	80.6	18.0	163.0
Interests and charges	45.9	45.4	49.7	49.0	48.4	43.2
Subscriptions and contributions	0.0	3.0	0.7	1.9	2.2	2.2
Net transfer	-8.6	77.1	158.9	29.6	-32.6	117.6

Source: Inter-American Development Bank.
Note: e: estimated; p: projected.

In 2012 the Bank had approved two loans for a total of U$187 million: A loan for Education (US$70) and other for Integrated Disaster Risk Management (US$100). For November 2012, the IDB expects to approve the program to Strengthen the Macro-Financial Management of Panama for a total of US$350 million (partial credit guarantee).

For 2013, the IDB is working on the preparation of three loans for a total of US$248 million in three different areas: A loan to Strength the Macro-Financial Management (US$100 million), Integrated Disaster Risk Management (US$100 million) and Water supply in rural and peri-urban areas (US$48 million).

STATISTICAL ISSUES

(As of December 18, 2012)

ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE
General: Data provided to the Fund has some shortcomings but is broadly adequate for surveillance. The accuracy, timeliness, and publication of economic statistics has improved, but weaknesses in national accounts, government finance, and balance of payment statistics need to be addressed.
Real Sector: Although the timeliness of real sector data provision has improved, the data are often subject to sizable revisions. The World Bank is supporting a project for changing the base year of the national accounts to 2007, which started in the second half of 2010 and should be completed by the third quarter of 2013. The IMF national accounts technical assistance mission conducted in 2010-11 noted slow progress in expanding coverage of financial activity as well as the overestimation of the deflator used to calculate the financial services output at constant prices. During 2011-2012, progress was made in compiling financial and insurance services following the *2008 System of National Accounts (2008 SNA)*, as well as in broadening the coverage of household output, employment, compensation of employees, and mixed income in informal activities for 2007-2008. Quarterly national accounts and the monthly economic activity index have benefited from the use of monthly VAT records as source data, and from the correct application of the proportional Denton method for aligning quarterly data to annual data (reducing further revisions) and ARIMA X-12 for seasonally-adjusting the quarterly series.
Government finance statistics: Further efforts are needed to improve the quality of fiscal data. Apart from timeliness, data consistency in terms of transfers between public sector units should be improved; and the coverage of the public enterprises should be made universal. Since September 2004, the operational balance of the Panama Canal Authority (ACP) was excluded from the official definition of the nonfinancial public sector (NFPS) used for fiscal policy purposes. Information on the ACP is only available in the Annual Report posted in its website (www.pancanal.com) on a fiscal year basis. There is a need to ensure a consistent and timely flow of ACP statistics on a calendar year basis. Moreover, in 2011, three public enterprises have been excluded from the NFPS accounts and public debt (Tocumen International Airport, ETESA, an electricity distribution company, and ENA, the National Highway company). It would also be necessary to compile and disseminate information on these entities in a timely fashion. The recent decree establishing a sovereign Savings Fund of Panama mandated reporting of deferred payment schemes (e.g. turnkey projects) in budget documentation. The authorities are receiving technical assistance from the IMF Statistics Department (STA) to implement the *Government Finance Statistics Manual 2001 (GFSM 2001)* and the Fiscal Affairs Department (FAD) conducted a mission on observance of fiscal standards and codes (ROSC) in October 2005. The authorities, however, cannot elaborate fiscal statistics in accordance with *GFSM 2001* without *a priori* reforming public accounting. In 2011-12, FAD assessed Panama's progress in implementing the Single Treasury Account (STU) and improving government accountability and internal audit. Further assistance on making the STU operational was received from CAPTAC during 2012. While the authorities took important steps in improving these areas, further work would be needed to achieve compliance with international best practices. The August 2012 CAPTAC report on fiscal statistics for financial programming also emphasized the need to increase the information and analysis of turnkey projects' impact on fiscal sustainability.

Monetary and Financial Statistics: Panama regularly reports monetary data for depository corporations using the standardized report forms (SRFs) for publication in the *International Financial Statistics*. Panama participated in a regional project for harmonizing monetary and financial statistics in Central America and the Dominican Republic, supported by CAPTAC. The aim was to facilitate cross-country comparison and regional analysis. The second stage of the harmonization project developed a work program to expand the institutional coverage to include the missing other depository corporations and all other financial corporations (OFCs). The authorities have recently submitted test SRF data for the OFCs, which are being reviewed by STA. Panama does not report Financial Soundness Indicators (FSIs) to STA. Nevertheless, the authorities informed STA that they are working on their compilation. Data gaps prevent a deeper analysis of systemic risks as the authorities do not collect adequate data on real estate prices, loan write-offs, loan-to-value ratios, and leverage indicators for households and corporates.
Balance of payments: Weaknesses in foreign trade flows calculations, particularly those involving the Colon Free Zone, need to be addressed. Substantial changes in the composition of trade flows over the last decade render the current methodology to estimate volume indices obsolete. Quarterly data are available with a delay of about one quarter, and are subject to revisions thereafter. Revised estimates in key trade and investment data may result in substantial revisions of the current account of the balance of payments. These revisions may reflect improvements in coverage, but they also suggest that there is room for improvement in quality control procedures. Data are not yet available on nonfinancial private sector debt and transactions involving financial derivatives, resulting in large swings in errors and omissions. Data on outward FDI and repatriation of profit and dividends from these investments are not yet being collected, implying that the current account deficit and the International Investment Position (IIP) are likely being overestimated. Quarterly IIP data have been compiled since 2002, and annual data are available since 1998. The definition of international reserves is currently being revised with TA support from STA, to ensure that the reserve assets reported by the National Bank of Panama are consistent with those published by the Contraloria, and that they meet the criteria defined in the international reserves template. STA also recommends that the Contraloria should be the only agency in charge of compiling and disseminating international reserves data.
DATA STANDARDS AND QUALITY
Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000, but the metadata need to be updated. Following an SDDS assessment mission conducted by STA in April 2011, the authorities have a work program aimed at meeting the requirements for Panama's subscription to the SDDS. A data ROSC was published in October 2006.

Panama: Table of Common Indicators Required for Surveillance

(As of November 30, 2012)

	Date of latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items:	
						Data Quality–Methodological Soundness[7]	Data Quality–Accuracy and Reliability[8]
Exchange Rates	Fixed	NA	NA	NA	NA		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/2012	11/2012	M	M	A		
Reserve/Base Money	NA	NA	NA	NA	NA	NA, O, NA, LO	LO, O, O, O, NA
Broad Money	10/2012	11/2012	M	M	M		
National Bank of Panama Balance Sheet	10/2012	11/2012	M	M	A		
Consolidated Balance Sheet of the Banking System	10/2012	11/2012	M	M	M		
Interest Rates[2]	10/2012	11/2012	M	M	M		
Consumer Price Index	11/2012	12/2012	M	M	M	O, LNO, LO, LO	LO. LO. LO. O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	9/2012	11/2012	Q	Q	Q	LO, LNO, LO, O	O, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	9/2012	11/2012	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/2012	11/2012	M	M	M		
External Current Account Balance	9/2012	12/2012	Q	Q	Q	LO, LO, O, LO	LO, O LO, LO, LNO
Exports and Imports of Goods and Services	9/2012	12/2012	M	M	M		
GDP/GNP	Q2/2012	6/2012	Q	Q	Q	O, O, O, LO	LO, LO, LNO, LO, LNO
Gross External Debt	10/2012	11/2012	M	M	M		
International Investment Position [9]	2012	6/2012	A	A	A		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the no values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[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] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC, published in October 2006 based on the findings of the mission that took place during February 7–23, 2006. For the dataset corresponding to the variable in each the assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), larg not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
[9] Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore bank.

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

IMF Executive Board Concludes 2012 Article IV Consultation with Panama

On January 25, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.[1]

Background

Panama's growth performance continues to exceed expectations, buoyed by the Panama Canal expansion and large public infrastructure projects. Annual real Gross Domestic Product (GDP) growth averaged about 9 percent over the past five years, the highest in Latin America. Unemployment is at historic lows, and the output gap has closed. Rapid economic growth and stronger social safety nets have helped reduce poverty. Over the medium-term, recent and forthcoming Free-Trade Agreements with major trading partners are expected to boost trade in services and Foreign Direct Investment (FDI). The recent creation of a Sovereign Wealth Fund to save additional revenue from the expanded Canal aims at further strengthening the economy's resilience to external shocks.

Panama's economy expanded by 10.6 percent in 2011, and continued to grow at the same pace in the first three quarters of 2012. Construction, commerce, and transportation, storage and communications have been the most dynamic sectors. Canal traffic and activity in the Colón Free Zone have been supported by strong demand from South America and emerging

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

Asia. Rising world commodity prices and domestic demand pressures have kept inflation at relatively high levels through 2011 and most of 2012. Headline and core inflation started declining in the third quarter, mostly owing to lower food and domestic services price pressures, with inflation in 2012 projected at 5 percent (year-on-year). Panama's financial sector remains well-prepared to absorb even large external shocks; banks remain well-capitalized, liquid and profitable. After widening to 12.8 percent of GDP in 2011, the current account deficit improved somewhat in the first nine months of 2012. A sharp improvement in the goods and services balances was almost offset by a deterioration in the income balance, associated with a 56 percent increase in FDI flows.

Panama's baseline outlook is positive, with broadly balanced risks. Implementation of large public infrastructure projects and strong domestic demand in the context of loose imported monetary conditions are expected to continue to support growth and domestic demand. Overheating pressures would moderate as public investment unwinds. At the same time, the global economy remains weak, and downside risks have intensified. Panama's trade and financial openness increases the country's vulnerability to external shocks, though strong domestic fundamentals would mitigate their impact. A key medium-term challenge is to ensure the transition to more sustainable and inclusive growth, including through further improvements in education and training.

Executive Board Assessment

The Executive Directors commended Panama's impressive economic performance over the past decade, underpinned by strong fundamentals and sound policies. Large public investments are expected to continue to drive growth this year, despite a weak external environment. Directors encouraged the authorities to take advantage of the favorable conjuncture to strengthen policies and buffers. They agreed that, in the near term, policies need to be geared toward building up fiscal space and enhancing crisis prevention tools. Going forward, a key challenge will be to foster sustained and more inclusive growth.

Directors saw merit in a tighter fiscal stance for 2013–14 to forestall overheating and recommended keeping overall deficits below the revised ceilings. Further improvements in tax administration and expenditure management could support the needed adjustment. More broadly, Directors agreed that frequent revisions to the legal deficit ceilings could undermine the credibility of the fiscal framework. They also agreed that the recently-established sovereign wealth fund would help reduce policy pro-cyclicality and further shield the economy from shocks going forward.

Considering Panama's extensive financial linkages, Directors emphasized the importance of further strengthening the financial safety net. They welcomed the progress in implementing the recommendations from the 2011 Financial Sector Assessment Program, including the plans to establish a facility for emergency liquidity assistance. Directors also acknowledged recent steps to enhance the monitoring of systemic risks and noted the importance of closing existing data gaps. Improving the supervision of non-banks, strengthening the mandate of the Council of Supervisors, and further developing macroprudential tools remain important policy priorities. Directors also welcomed the ongoing efforts to upgrade tax transparency and the legal framework for combating money laundering and the financing of terrorism.

Directors welcomed recent and prospective trade agreements between Panama and its major trading partners that should help support inward foreign direct investment and ensure sustained growth as large public projects unwind. Directors took note of the staff's assessment that the projected current account deficit and external debt paths are consistent with medium-term external sustainability but that further appreciation of the real exchange rate could undermine recent gains in external competitiveness.

Directors underscored the importance of continued efforts to reduce poverty and inequality, and to tackle youth unemployment. In this context, ongoing training and education reforms should help alleviate skills mismatches, while targeted assistance to the poorest through conditional cash transfers should improve living standards in rural and indigenous areas.

Panama: Selected Economic Indicators

				Proj.
	2009	2010	2011	2012
	(Annual percent change)			
Real economy				
Nominal GDP	5.0	10.0	15.0	17.9
Real GDP (1996 prices)	3.9	7.6	10.6	10.7
Consumer price index (average)	2.4	3.5	5.9	5.7
Consumer price index (end-of-year)	1.9	4.9	6.3	4.6
Money and credit				
Private sector credit	1.3	13.6	16.8	17.5
Broad money	9.4	11.6	8.1	11.7
Average deposit rate (1-year)	3.1	3.5	2.7	…
Average lending rate (1-year)	7.5	7.5	6.9	…
	(Percent of GDP)			
Saving and investment				
Gross domestic investment 1/	25.6	26.0	29.0	29.0
Gross national saving	24.9	15.2	16.2	17.0
Nonfinancial public sector				
Revenue and grants	33.5	33.1	32.9	31.9
Expenditure	33.9	36.4	38.4	37.0
Current, including interest	24.5	24.5	24.4	24.2
Capital	9.4	12.0	14.0	12.8
Overall balance	-0.5	-3.4	-5.5	-5.1
Overall balance, excluding ACP	-1.0	-1.9	-2.3	-2.9
External sector				
Current account	-0.7	-10.8	-12.8	-12.0
Capital and financial account	1.4	11.1	13.8	12.1
Real effective exchange rate (depreciation -)	1.9	-2.3	1.7	...
External public debt 2/	42.0	40.4	38.6	33.1
Memorandum items:				
GDP (in millions of US$)	24,163	26,590	30,569	36,028

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

1/ Includes Panama Canal Authority (ACP).

2/ Including ACP and net of Fiduciary Fund' holdings of non-government assets.

Statement by Mr. Nogueira Batista, Executive Director,
Mr. Oliveira Lima, Alternate Executive Director and Mr. Maciá, Advisor
on Panama
January 25, 2013

1. Our authorities thank the IMF staff for their continued assistance and advice on economic policy and other related issues.

2. Panama's economic growth remains solid despite the unstable world economy. Real GDP growth is estimated to have reached 11 percent in 2012, one of the highest in the world, outperforming by far all other Latin American economies. This growth is supported by the ongoing Panama Canal expansion, the execution of an ambitious public investment plan, increasing FDI inflows and the consolidation of the country as a financial and logistics hub. The authorities expect GDP growth to be 8.5 percent in 2013.

3. High economic growth rates have led to rapid increases in employment and wages. The unemployment rate currently stands at 4 percent – an all-time low. Poverty levels have experienced a significant decline. According to the most recent figures, extreme poverty declined from 15.3 percent in 2009 to 10.4 percent in 2012, while general poverty declined from 33.4 to 25.8 percent. The strong economic performance and the effectiveness of conditional cash transfers have served as catalysts for the reduction in poverty levels.

4. Inflation was moderate in 2012 in face of a more benign external scenario of lower food and fuel prices. CPI inflation (end-of-year) declined from 6.3 percent in 2011 to 4.6 percent in 2012. The current account deficit decreased slightly from 12.8 percent in 2011 to approximately 12 percent of GDP in 2012. For 2013, this figure is expected to be closer to 11 percent given lower capital-goods imports as large public projects begin to unwind and the expansion of the Panama Canal is more than 50 percent complete. External transactions are expected to grow with the implementation of the US-Panama Trade Promotion Agreement, the free trade agreement with Canada and the association agreement with the European Union.

5. Fiscal policy has remained prudent in 2012. Given the still fragile global economy and concerns related to possible external shocks, the fiscal deficit ceilings were revised up to 2.9 and 2.8 percent of GDP for 2012 and 2013 respectively. These modifications reveal the authorities' readiness to respond to a less favorable international scenario. Nonetheless, they remain committed to a fiscal deficit close to 2.5 percent of GDP, considerably lower than the new ceiling for 2012, and in line with IMF staff's recommendations. The public debt to GDP ratio has been decreasing for more than a decade and is estimated to have fallen to 39.5 percent in 2012. Further development of the domestic capital market remains a priority going forward. The Ministry of Economy and Finance (MEF) is in preliminary discussions with an international clearing agency with the objective of making domestic public debt and other asset classes tradable in international markets, thus increasing their accessibility and expanding the investor base.

6. Public revenues continued to rise in 2012 as a result of the implementation of fiscal reforms, the ample utilization of fiscal cash registers for businesses and the recent creation of a large taxpayers' unit. Ongoing steps to strengthen the tax directorate (Dirección General de Ingresos) should allow it to evolve into a more autonomous and independent tax revenue authority, enhancing tax collection effectiveness and reinforcing oversight. Preliminary figures show that total current revenues increased by 16.1 percent in 2012 relative to 2011. Likewise, tax revenue increased by 26.9 percent.

7. The banking system has remained reliable, well capitalized and resilient to external shocks. Capital adequacy ratios are well above statutory thresholds and, in spite of the growth in private sector credit, non-performing loans remain at low levels and are well provisioned. Furthermore, considerable progress has been made on the FSAP recommendations. The authorities, assisted by CAPTAC-DR, have elaborated draft regulations on operational risk, supervision of conglomerates, and international financial reporting standards.

8. With the support of the IMF, the Government is in the process of designing a contingent liquidity facility for the national banking system. A high-level committee comprised of officials from the MEF, the General Manager of the National Bank of Panama and the Superintendent of Banks, with guidance from IMF staff and an international consultant, will design the facility and move toward consensus building with key stakeholders to fulfill this goal in 2013.

9. Panama has continued to strengthen its legal framework in compliance with the Global Forum of the OECD. The country signed double taxation agreements with the Czech Republic and the United Arab Emirates, bringing the total number of signed agreements to 15. The authorities will propose legislation to enhance the control on bearer shares and prevent money laundering. The new legislation will require bearer shares to be registered with a custodian and beneficial ownership to be disclosed. It will be presented to the Cabinet for approval shortly. Similarly, anti-money laundering and terrorist financing legislation will be strengthened in compliance with the Financial Action Task Force guidelines.

10. The latest credit rating reviews for Panama reaffirmed the country's investment grade status. In 2012, Fitch maintained Panama's BBB investment grade rating with a stable outlook. Meanwhile, Standard & Poor's upgraded Panama's credit rating from BBB- to BBB with a stable outlook and Moody's also upgraded the sovereign debt rating to Baa2 from Baa3. The rating agencies have recognized the country's strong macroeconomic performance, stable growth perspectives and the declining public debt burden.

11. In conclusion, Panama's economy is fundamentally solid with sustainable macroeconomic performance and the ability to continue with an ambitious investment program that will increase potential output and the country's medium and long term growth prospects.