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Staff Country Reports

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PANAMA

2011 ARTICLE IV CONSULTATION

April 2012

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 2011 Article IV consultation with Panama, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 18, 2011, 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 24, 2012. 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 February 22, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Panama.

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
Washington, D.C.

PANAMA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

January 24, 2012

KEY ISSUES

Background. Panama's economy rebounded strongly from the 2009 slowdown, and is now one of the fastest-growing in the region. Rapid growth and prudent fiscal policy have lowered public debt to under 40 percent of GDP and rating agencies have placed Panama's sovereign debt one notch above investment grade. A recent Financial Sector Assessment Program (FSAP) mission confirmed the strength and resilience of the banking sector.

Near-term outlook and risks. Boosted by the Panama Canal expansion and other large public infrastructure projects, output growth may reach 10 percent in 2011 and is expected to moderate to 7–7½ percent in 2012. The neutral fiscal stance envisaged for 2012–13 is broadly appropriate, though a tighter stance would have been preferable to rebuild buffers and contain inflation. Direct real and financial links with Europe are not large, but the economy may be affected by knock-on effects on emerging Asia and South America of a further deterioration in global conditions.

Medium-term challenges

Continue strengthening the fiscal framework. Effective implementation of the public investment program will require further improvements in the budget framework, spending efficiency and revenue management. The envisaged creation of a Sovereign Wealth Fund (SWF) to save additional Canal resources is welcome; the SWF should be incorporated in the budget framework.

Upgrading financial sector regulation, supervision, and infrastructure. Improvements in risk-based and consolidated cross-border supervision, and strengthening the Superintendency of Banks' capacity to identify and monitor financial system risks should be key priorities. Creating a fund to respond to possible bank liquidity shortages would help strengthen the system's resilience to shocks.

Further enhancing competitiveness and broadening growth prospects. Stepping up ongoing efforts to improve the quality of education and availability of training would be essential to address skilled labor shortages and improve key social indicators.

Approved By
Miguel Savastano and Jan Kees Martijn

Discussions took place in Panama City during November 7–18, 2011. The staff team comprised Mmes. Deléchat (head), Muthoora and Vtyurina (all WHD). Messrs. Hamann and Wezel (all MCM) joined for financial sector discussions. Mr. Macia (OED) also participated in the meetings.

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RECENT DEVELOPMENTS

1. **Panama's growth rates are among the highest in the region, largely owing to strong fundamentals and prudent policies.** Real GDP growth has averaged 8 percent over the past five years which, together with successful fiscal consolidation, has resulted in a rapid decline in debt ratios. Partly for this reason, Panama's sovereign debt is now rated one notch above investment grade, on par with Brazil and Mexico.[1] The recent ratification of a bilateral Free-Trade Agreement (FTA) by the U.S. Congress will help sustain private investment (Box 1). In July 2011, Panama was taken off the OECD's "grey list" of tax heavens upon signing 12 double taxation treaties, though it still has to complete the peer review process.[2]

2. **The government's economic strategy for 2009–14 aims at positioning Panama as a world-class financial and logistics hub, while alleviating social exclusion.** Cumulative public investment in physical and social infrastructure during this administration is expected to reach 50 percent of 2010 GDP (US$13.6 billion, excluding the US$5.3 billion Panama Canal expansion) by 2014. Tax reforms enacted in 2009-10 are expected to increase tax revenue by about 1.4 percent of GDP by 2013. The Panama Canal expansion will double existing transit capacity and increase transfers to the budget. In the social area, the government is expanding safety nets. Implementation of the economic reform agenda has not been disrupted by the breakup of the two-party ruling coalition in September 2011, as President Martinelli's party rapidly regained majority in the National Assembly. Nonetheless, recent legislative initiatives have met unexpected resistance.[3]

3. **The authorities were appreciative of staff's advice in the context of previous Article IV consultations and technical assistance (TA) missions.** Countercyclical fiscal policy in 2009 helped mitigate the impact of the crisis, but a modest consolidation, as advised by staff, would have been appropriate in 2010 in light of the strong recovery. At the same time, the authorities are seeking Fund advice on the establishment of a Sovereign Wealth Fund (SWF) to safeguard the additional revenues from the expanded Panama Canal, and are heeding long-standing Fund recommendations to strengthen the financial safety net.

4. **Economic growth in 2010-11 continued to surprise on the upside.** Real GDP grew by 7.5 percent in 2010 and by 10.5 percent during January-September 2011 (Figure 1). The construction, commerce and transportation sectors have shown the most dynamism. Canal traffic remained strong (8.1 percent growth

[1] Fitch and Moody's further upgraded Panama in June and August 2011, respectively.

[2] The OECD's Global Forum on Transparency and Exchange of Tax Information conducts a two-stage peer review of (i) whether a country's legal framework complies with international standards; and (ii) implementation of the framework. Panama is in the process of completing the first stage.

[3] Draft mining and public-private partnerships laws had to be withdrawn from the National Assembly following opposition from grassroots groups and public sector workers.

during January-September) with a 20 percent growth in toll revenue (January-September, cumulative, compared to the same period in 2010). West-East and South-East traffic increased reflecting buoyant growth in emerging Asia and South America. GDP growth in 2011 is projected to be around 10 percent, closing the output gap created during the 2009 slowdown.

5. **Inflation remained above historical averages.** Headline inflation rose from 2.4 percent in 2009 to 6.3 percent at end-2011 (y/y), reflecting in part high world food and fuel prices, the increase in the VAT rate, and a large

Box 1. The U.S.-Panama Free-Trade Agreement

In October 2011, the U.S. Congress ratified a long-pending FTA with Panama. The agreement, which was signed in 2007, is expected to come into effect in the second quarter of 2012.

Upon its implementation, the FTA will provide for immediate duty-free access of the majority of bilateral exports. Its immediate effect on Panamanian exports is likely to be limited since most already enter the U.S. tariff-free on account of existing trade preference regimes (e.g. Caribbean Basin Initiative). For some sensitive products, mostly agricultural, the FTA provides for a more gradual phasing out of existing tariffs over a 15-year period.

In the short-term, Panama's tariff revenues (about 1.5 percent of GDP) are expected to decline. Total U.S. exports to Panama in 2010 amounted to US$2½ billion, while Panama's exports to the U.S. were only US$211 million.

Over the medium-term, bilateral trade and investment flows are expected to expand and, for Panama, likely offset short-term costs.

- **Increased imports will increase product variety, though their effect on domestic prices is unclear**. There is some evidence that prices in Panama tend to be sticky downwards as declines in international prices are not fully passed on to consumers.
- **Panama's agricultural sector may need a proactive strategy to shift production toward non-traditional crops.** Panama's agricultural output has been declining in recent years. Lower domestic demand for less competitive Panamanian produce and difficulties in complying with phyto-sanitary requirements for exports may compound the woes of the sector. Moving towards higher value-added crops would help mitigate these effects, but would require investments in seeds, fertilizers and training for farmers.
- **Panama's services sector and, possibly light manufacturing, are expected to benefit in the medium-term.** The FTA, boosted by synergies from the development around the Canal could make it profitable for multinational firms to relocate in Panama, to export pharmaceuticals, light manufacturing goods, and logistics services to the U.S..

(19 percent) increase in the minimum wage in 2010; core inflation reached 4.1 percent in 2011 (Figure 1). During 2011, the authorities took steps to alleviate the impact of price increases on the population by introducing a price threshold for the most demanded grade of gasoline, whereby taxes were adjusted downwards when the market price increased.[4] Further increases in gasoline and electricity subsidies were announced in November 2011.

6. **The fiscal stance remained moderately expansionary.** The deficit of the non-financial public sector (NFPS) was 1.9 percent in 2010 and was targeted to stay at about 2 percent in 2011.[5] Nonetheless, owing to higher-than-anticipated capital spending execution[6] and somewhat disappointing tax collection, the deficit of the NFPS rose to 3½ percent of GDP at end-September 2011. Record-high Panama Canal dividend transfers (US$1,043 billion or 3.3 percent of GDP) and measures to restrain investment spending and related operational costs are expected to help contain the deficit in the last quarter of 2011. Nonetheless, the end-year outturn is likely to have remained somewhat above the authorities' target but below the deficit ceiling allowed by the SFRL.[7] In cyclically-adjusted terms, the deterioration of the primary balance is projected to be about 2.2 percentage points of GDP during 2010–11 (Table 2).

7. **Panama's financial system showed resilience during the global crisis, due in part to prudent policies and good supervision**. Financial soundness indicators remained robust, with a very low and stable NPL ratio (Figure 3). As of end-October 2011, bank credit growth reached 17 percent, slightly above nominal GDP, while deposit growth slowed from 11 percent in 2010 to about 8 percent. Deposit interest rates have been declining in line with global market developments, but lending rates have remained broadly stable (Figure 4).

8. **The external current account deficit has widened, largely owing to the rapid growth of imports related to the Canal expansion.** The current account deficit rose to -10.7 percent of GDP in 2010 and is projected to peak at -13 percent in 2011 (Figure 5). The deficit is almost fully financed by Foreign Direct Investment (FDI) flows, which grew by 17 percent (y/y) in nominal terms by end-September 2011.

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[4] The budget recuperates the subsidy when the price goes below the established threshold.

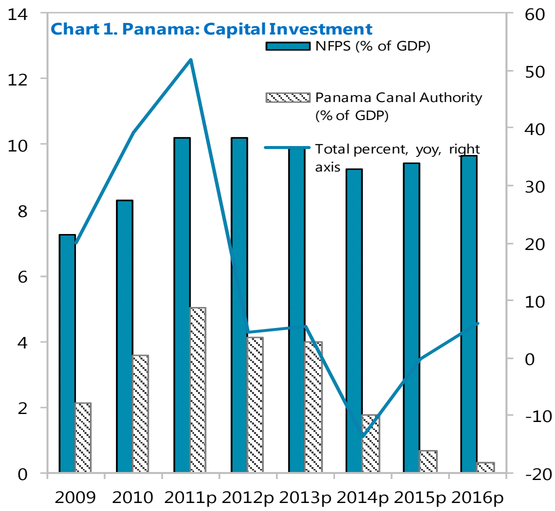
[5] The Social and Fiscal Responsibility Law (SFRL), approved in 2008, establishes a limit for the NFPS deficit of 1 percent of GDP. The law contains escape clauses that allow the deficit limit to increase to up to 3 percent of GDP, with a gradual adjustment path back to the norm, in case of (i) a sharp drop in Panama's economic growth, (ii) a sharp decline in growth of the global economy, or (iii) a national emergency. Such clauses were invoked in 2009 and 2010, raising the deficit ceiling to 2.5 and 3 percent of GDP in 2010 and 2011, respectively.

[6] In previous years, the authorities anticipated executing only about 70 percent of the budgeted investment envelope, but this ratio has increased significantly (to about 86 percent in 2011) thanks to improved capacity.

[7] Twenty percent of total revenue is collected in Q4, including dividends from state enterprises.

MACROECONOMIC OUTLOOK AND RISKS

9. **Panama's macroeconomic outlook is favorable, with broadly balanced risks.** The Canal expansion and the large public investment program, which will peak in 2011–12, will continue to sustain domestic demand (Chart 1). While there are still some risks of overheating related to the fast growth pace, these are likely to be broadly offset by the easing of pressures on world commodity prices and by global risks to activity and financial stability (Box 2).



- *Economic growth is projected to slow down gradually starting in 2012 towards its medium-term potential of about 5–6 percent.* Real GDP growth is expected to moderate to about 7–7½ percent in 2012 owing to lower external demand. Panama's growth would be vulnerable to a sharp global slowdown insofar as it affects demand in emerging Asia and the Americas. Such a shock would affect activity in the ports and the Colón Free Zone (CFZ), as well as Canal traffic, with knock-on effects on revenue, investment spending, credit and real activity.[8]

- *Risks to inflation from both external and domestic sources remain on the upside.* Imported inflation is expected to decelerate as commodity prices stabilize, but there is a high degree of uncertainty surrounding international prices. Strong domestic demand and a 17 percent minimum wage increase which took effect in January 2012 also may exert pressure on core inflation, especially as spare capacity and total unemployment (4.5 percent in August 2011) are at historic lows.[9]

- *The 2012 budget envisages an NFPS deficit of 2 percent of GDP by year-end, in line with the gradual return to the ceiling of one percent established in the SFRL.* With limited fiscal space, further increases in untargeted subsidies would have to be offset by adjustments in other spending categories. Public debt vulnerabilities would remain low, also thanks to prudent liability management.

- *The external current account deficit as a share of GDP is projected to start declining in 2012 and to stabilize at about 8 percent of GDP by 2017.* FDI flows are expected to remain buoyant and finance the bulk of those deficits, although they may be vulnerable to abrupt changes in sentiment in originating countries (about 40 percent of FDI flows come from the U.S. and Spain). A sudden decline in FDI flows

[8] China and U.S. trade account for between 60 and 70 percent of Canal traffic.

[9] By law the minimum wage is adjusted every two years, following consultations with stakeholders.

would prompt a concomitant adjustment in private demand, though the final effect on domestic demand would be mitigated by the works on the Canal expansion, which are fully pre-financed.[10]

- *The banking system's diversified ownership structure, high reliance on deposit funding, and low exposure to European banks are expected to limit near-term spillover risks from a further deterioration in financial conditions.*[11] Stress tests conducted as part of the FSAP confirmed that high levels of capitalization would cushion heightened credit risks arising from the impact of a major tail event, although some onshore banks would be vulnerable to short-term liquidity pressures, and liquidity concentration in a few international banks may pose some risks (Box 3). Interbank contagion analysis revealed only limited risks for onshore banks stemming from illiquidity or insolvency of offshore or international banks.[12] Nonetheless, as in 2008–09, the drying up of foreign credit lines could affect domestic lending and real activity. It could also push interest rates up, which would squeeze bank margins and increase credit risk, as most loans carry floating rates and household indebtedness is rising.

[10] The US$5.3 billion (20 percent of 2010 GDP) project is financed by the ACP's own resources and loans from multilateral institutions.

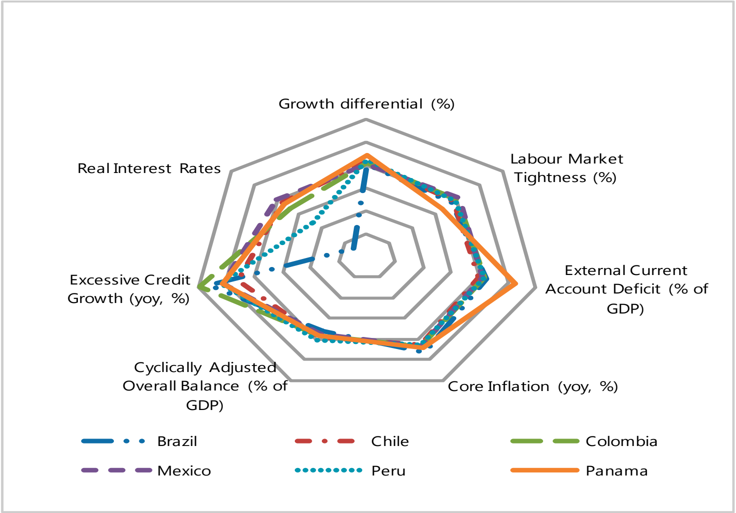
[11] There is only one on-shore Spanish bank (BBVA) in Panama, holding 4 percent of total system's assets.

[12] With total assets of about 50 percent of 2010 GDP, offshore banks are supervised both by the home country and Panama's Superintendency of Banks. They are not allowed to operate in Panama, but they participate in the relatively small interbank market.

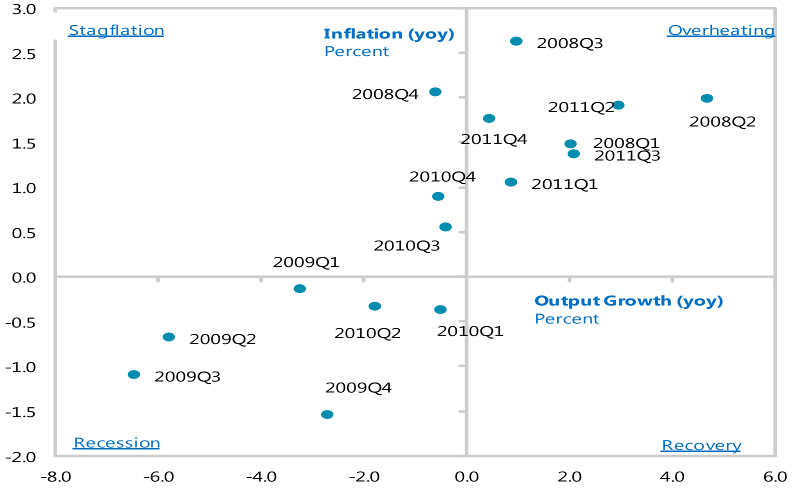
Box 2. Overheating Indicators, 2008–11

Overheating indicators for Panama in 2011 are broadly comparable to those of other fast-growing economies in Latin America (LA). Nonetheless, overheating pressures in Panama are somewhat lower than during the pre-crisis. high-growth episode. As in other LA countries, growth in Panama started to slow down around mid-2011 (Figure 1); and is projected to continue to decelerate in the context of weaker external demand

Overheating Indicators in Panama and Selected Latin American Countries, 2011 /1



Output and Core Inflation in Panama (Deviation from Averages/2)



Source: IMF staff estimates based on The Economist's Overheating Index, authorities' data, World Economic Outlook, International Financial Statistics, and IMF staff projections.

1/ Points that are closer to the center indicate less overheating pressures.
2/ The Growth Differential is captured by the difference between the average growth in 2007-2011 and the average growth rate between 1997-2007. Labour Market Tightness is measured by the difference between the current unemployment rate and the average unemployment rate between 1997-2007. Excessive Credit Growth is the difference between the growth of credit to the private sector in real terms and real GDP (based on latest available observation in 2011). External Current Account Deficit is based on IMF staff projections for 2011. Core Inflation is the average for 2011. Real Interest Rates are captured by the difference between lending rates and the inflation rate in 2010 and rescaled so that lower values correspond to lower overheating pressures.

Box 3. Panama's FSAP: Main Findings and Reform Priorities

A first-time FSAP was concluded in September 2011, and included modules on Basel Core Principles and Insurance. The authorities have committed to completing an AML/CFT assessment as part of the FSAP process by end-2012.

Overall, stress tests confirmed Panama's banking sector's soundness.

- *Credit risks are relatively low.* The main credit risk scenario assumed the re-occurrence of the 2008-09 economic downturn. Reflecting high levels of capitalization and robust profits, only three small banks would have difficulties meeting the minimum 8 percent of risk-weighted assets to capital ratio in such scenarios.
- *Market and sovereign risks are negligible,* reflecting banks' low exposures to sovereign debt and quick re-pricing of assets and liabilities.
- *Banks are highly liquid.* Nonetheless, systemic liquidity has been declining and some banks, accounting for about 15 percent of total liquidity, are vulnerable to short-term deposit withdrawals.
- *Interbank contagion and cross border risks, including liquidity concentration,* were tested by analyzing linkages, exposures and risk of default among onshore, offshore and international banks. Overall, the tests showed that contagion to onshore banks would be limited to a few medium-sized banks, although high liquidity concentration in certain international banks is a concern.

Despite the authorities' recent efforts, several shortcomings were observed in the regulatory sphere and market infrastructure. Key recommendations include:

Strengthen Financial Sector Surveillance

- *Improve risk-based supervision*, by adopting regulation on operation and market risks as well as setting concentration limits for interbank deposits.
- *Strengthen cross-border supervision*, including through establishing a holding company capital standard and consolidated regulatory reporting at the holding company level, and expanding the supervisory sphere by including securities, insurance, and foreign exchange houses supervisors. Together with other regional supervisors, the Superintendency of Banks of Panama (SBP) should also design more detailed arrangements for the supervision of individual groups specifying which regulator is in charge of each entity in the group, and for making decisions on groups where the SBP is not in a position to assume supervision.
- *Develop an institutional framework for macroprudential policy and instruments to safeguard against systemic risks*, in particular, through improving off-site supervision, and closing data gaps (e.g. housing prices, household and corporate debt).
- *Establish a financial safety net for emergency liquidity assistance*, notably by pooling a fraction of banks' liquidity holdings (Box 4);
- *Improve sharing of information across agencies and broaden the perimeter of financial oversight,* including by regulating and supervising more closely cooperatives, and amending the draft insurance law.

Develop Domestic Financial Markets

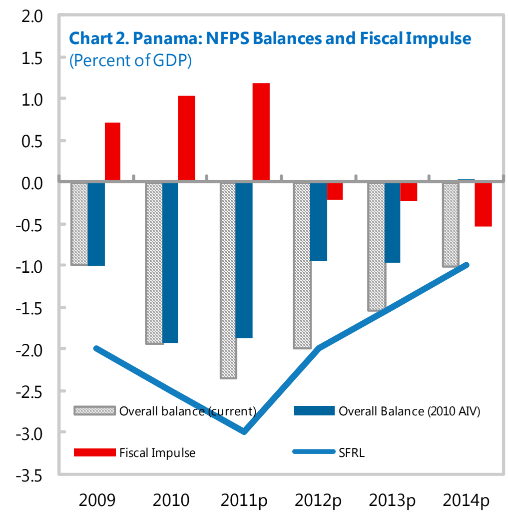
- *Formulate a capital market development strategy* aimed at achieving better efficiency of the secondary market, upgraded market making, and effective securities lending. Develop a framework for repo operations.
- *Upgrade the payments system,* by adopting a law that would guarantee payment finality and by introducing a real-time gross settlement system, as well as a law facilitating electronic presentation of checks among banks.

POLICY DISCUSSIONS

Effective implementation of its ambitious agenda hinges on the government's ability to maintain macroeconomic stability while reducing growth bottlenecks. This poses significant policy challenges, which were at the center of discussions with the authorities. The near-term priority is keeping fiscal policy firmly anchored while building buffers and strengthening crisis-prevention tools. Over the medium-term, efforts should focus on (i) strengthening the fiscal framework to enhance efficiency of public spending, while improving revenue management; (ii) upgrading financial supervision and infrastructure in line with international best practices; and (iii) implementing structural policies to improve competitiveness, and foster sustainable growth.

A. Near-Term Policies

10. **The pace of fiscal consolidation envisaged in the authorities' medium-term budget framework is broadly appropriate, but over-performing on fiscal targets would allow to rebuild buffers**. The envisaged path for the NFPS deficit would imply a broadly neutral fiscal stance in 2012–13 (Chart 2). Nonetheless, staff noted that, with output now at capacity and a stronger-than-anticipated fiscal impulse in 2011, demand driven by the implementation of large public infrastructure projects, together with the forthcoming minimum wage increase, would likely put further pressures on prices and the external current account (Box 2). In the absence of a monetary policy, over-performing on fiscal objectives could help dampen inflationary pressures while creating additional fiscal space. The authorities pointed out that a number of factors were mitigating potential overheating risks, including the fact that the public investment program was expanding productive capacity, and that flexible labor markets would help alleviate skilled labor shortages. They also cautioned that a faster fiscal tightening could be contractionary, which would not be appropriate given the deteriorating global outlook.



Sources: National Authorities and IMF staff calculations.

11. **Fiscal policy should remain firmly anchored on a strengthened SFRL**. While recognizing that fiscal deficits of moderate size would not compromise fiscal solvency, staff expressed concern that continued activation of the SFRL's escape clauses risks eroding its value as a fiscal anchor. The authorities pointed out that the SFRL waivers had been activated only twice in strict application of the law in light of unforeseen shocks, and that both times the actual deficit closed well under the admissible limit. Beyond 2014, the authorities and staff agreed that the SFRL

would have to be modified, along with the creation of a SWF, to anchor the overall surpluses implied by the baseline projections given higher Canal transfers.

12. **Crisis prevention tools could be strengthened in line with FSAP recommendations** (Box 3). Although near-term financial sector vulnerabilities are low, the FSAP highlighted that the supervisory authorities' capacity to monitor systemic risk is hampered by the current institutional and policy framework and data gaps. Staff encouraged the authorities to implement enabling legislation that would allow the newly-established council of supervisors to effectively oversee the whole financial system, and build up the capacity of individual supervisory agencies. In the near term, the SBP should continue to strengthen its analysis of macro-financial linkages.

13. **Macro-prudential instruments can help prevent the emergence of credit-related asset price bubbles** (Annex I). While voluntary exposure limits have been effective in avoiding excessive bank leverage in real estate lending thus far, staff recommended monitoring property markets more systematically, including through a reliable housing price index and other indicators, such as household and corporate leverage ratios. [13] The authorities noted that rising property prices were fueled by effective demand, not credit expansion, and did not see evidence of asset price bubbles. They indicated that banks' conservative loan-to value ratios with additional caps on maximum loan size effectively transferred most of the risk to developers and buyers. Nonetheless, they agreed that there is a need to develop a housing price index, and were open to consider macro-prudential tools if the need arose.

14. **Plans to establish a fund to respond to possible bank liquidity shortages are welcome** (Box 4). By not having a central bank, Panama lacks both a traditional lender of last resort and a mechanism to mitigate systemic liquidity shortages. The authorities emphasized that these features had contributed to the strength and resilience of the system, which relies on banks holding high levels of liquidity beyond the prudential requirement of 30 percent of short-term deposits.[14] Nonetheless, the authorities and staff agreed that the current arrangement entailed substantial opportunity costs and could work to the detriment of Panamanian banks, and that the absence of a lender of last resort limits considerably the state's ability to preserve financial system stability. The authorities also agreed that the creation of a domestic liquidity fund would help address those concerns. While agreeing that limited public resources could be used in the start-up phase of the fund, staff stressed that pooling part of the liquid reserves currently held by banks to address idiosyncratic, temporary liquidity shortfalls, would be both efficient and help reduce moral hazard. Staff also suggested that consideration should be given to

[13] There are no lending standard surveys or housing price indices in Panama. The official statistical agency collects data on new constructions as provided by the builder, but data on market prices is unavailable.

[14] Using the statutory definition, liquidity coverage includes repayments due on six-month obligations and securities, and stands at 63 percent of short-term liabilities. Excluding loan obligations and securities, and dividing by deposits of all maturities lowers the ratio to about 20 percent at end-September 2011.

completing the safety net, including by introducing a deposit insurance scheme and strengthening the bank resolution process.

Box 4. Liquidity Provision Facilities in El Salvador and Panama

As a fully dollarized economy, Panama does not have a central bank or a Lender of Last Resort (LOLR). Unlike in some other fully dollarized economies, e.g. El Salvador, Panama's financial system does not have formal safety nets, such as reserve requirements or deposit insurance. Because of this, Panamanian banks hold relatively high levels of liquidity as self-insurance.

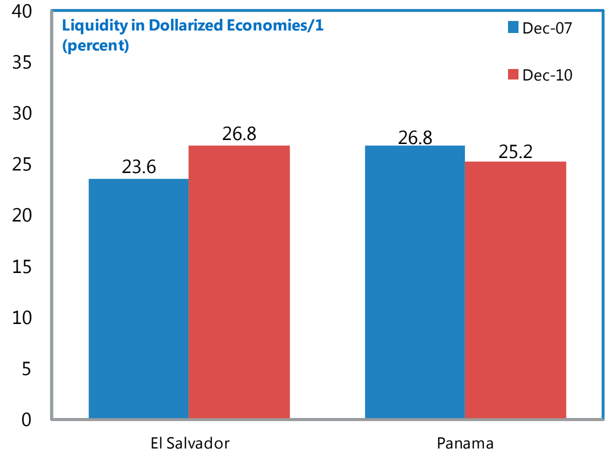
During the 2008-09 global financial crisis, a few Panamanian banks experienced liquidity shortages, due to the sudden freeze of external credit lines. In response, the Superintendency of Banks set up a daily bank-by-bank reporting system focusing on short-term liquidity in October 2008, and enacted temporary changes in regulations to reduce the impact of global financial volatility on banks' equity positions. In addition, the state bank, the National Bank of Panama (BNP), established a collateralized line of credit for US$400 million to replace some of the lost export financing. In January 2009, the government set up a liquidity fund (PEF) for a total of US$1.1 billion (5 percent of total deposits) for on-lending for productive investment and working capital needs. The fund pooled resources from the Interamerican Development Bank (US$500 million) and Andean Development Corporation (US$210 million) as well as the BNP. However, high interest rates, uncertainty about acceptable collateral, and a quick resumption of access to private foreign credit lines deterred demand; the PEF disbursed less than US$100 million before closing at end-2010.

El Salvador also created vehicles of liquidity support during the crisis. The liquid asset requirement was temporarily eliminated; and the IMF and IDB provided precautionary external funding.

The 2008-09 episodes highlighted the desirability of permanent liquidity facilities in fully dollarized economies. The Salvadorian authorities are currently working on setting up a liquidity fund and an LOLR as part of a comprehensive liquidity management strategy. The Panamanian authorities are receiving technical assistance to establish a liquidity facility.

- *In El Salvador*, the liquidity fund under consideration would be funded by pooling a fraction of current reserve requirements (3 percent of deposits). This fund would provide liquidity to solvent banks facing liquidity pressures for up to 90 days, charge interest penalties, and be collateralized with investment grade assets. A second facility, an LOLR, would gradually provide coverage for up to 8 percent of total deposits (over the next four years) and grant emergency liquidity for up to 90 days—(renewable once) to banks that have accessed the liquidity fund. The facility is expected to be funded with contingent credit lines from abroad and through the central bank's holdings of tradable government bonds.

- *In Panama,* the liquidity facility should provide coverage only to on-shore general license banks with temporary liquidity problems. Contrary to the PEF, it should not require on-lending of resources. International experience suggests that the facility should have resources equivalent to about 10 percent of total on-shore deposits (approximately US$3 billion). Although various options are still under consideration, funding could include contributions from the state as well as pooling part of the banks' existing assets, replicating centralized reserve requirements. Based on the PEF's experience, this will also require standardization and availability of more liquid collateral.



1/ For El Salvador, constructed as a ratio of a sum of total reserve requirement, 3 percent liquidity requirement and total cash assets to total deposits.
For Panama, consitutes a ratio of liquid assets to total deposits.
Source: IMF staff calculations.

B. Measures to Strengthen the Fiscal Framework

15. **The authorities and staff agreed that undertaking the ambitious public investment program within the limits established by the SFRL posed significant fiscal management challenges**. In particular, they discussed measures that would further improve the budget framework, public spending efficiency, and revenue management.

Enhancing the budget framework and the quality of social spending

- *Adequate coverage in the fiscal accounts of public enterprises and public-private partnerships would improve liability management and planning*. In this regard, staff cautioned against the exclusion of a growing number of public enterprises from the definitions of the public sector balance and public debt subject to SFRL limits. Staff noted that the practice hindered a comprehensive monitoring of public sector activities and fiscal risks, especially if the excluded entities borrowed from the markets.[15] The increasing resort to turnkey arrangements to execute public infrastructure projects, with total commitments amounting to about US$2 billion as of mid-2011, raises similar concerns.[16] Staff advised the authorities to continue monitoring closely contingent liabilities, and to incorporate them into the public debt accounting framework.
- *The authorities' efforts to improve the targeting of subsidies and to further expand the existing conditional cash transfer program are cost-effective ways to enhance the effectiveness of social spending*. Subsidies on fuel, water and electricity cost more than 1 percent of GDP and are largely regressive. The authorities indicated that they plan to gradually reduce the electricity subsidy provided to households consuming less than 500 KWH,[17] and to introduce means-tested pre-paid gas payment cards.
- *Staff encouraged the authorities to develop a roadmap to strengthen public financial management*. Recent technical assistance missions from the Fund have highlighted the importance of strengthening medium-term expenditure and budget frameworks, establishing a Single Treasury Account, and enhancing the quality and coverage of government finance statistics in line with the move to the 2001 GFSM classification. Given limited institutional capacity, the authorities agreed with staff's advice to develop a prioritized action plan to make those improvements.

[15] Three entities were excluded from the fiscal accounts since 2010: the electricity transmission company, the international airport and the newly-created highway company. Two of the entities broadly met the criteria of being profitable commercially run enterprises, with relatively small debts of 1.5 percent of GDP as of end-2010. The highway company plans to borrow US$1.07 billion during 2011–12, but the debt does not carry a state guarantee and would be fully backed by future toll revenue.

[16] A turnkey project involves contracting public infrastructure projects to private companies, which receive full payment from the state upon final delivery.

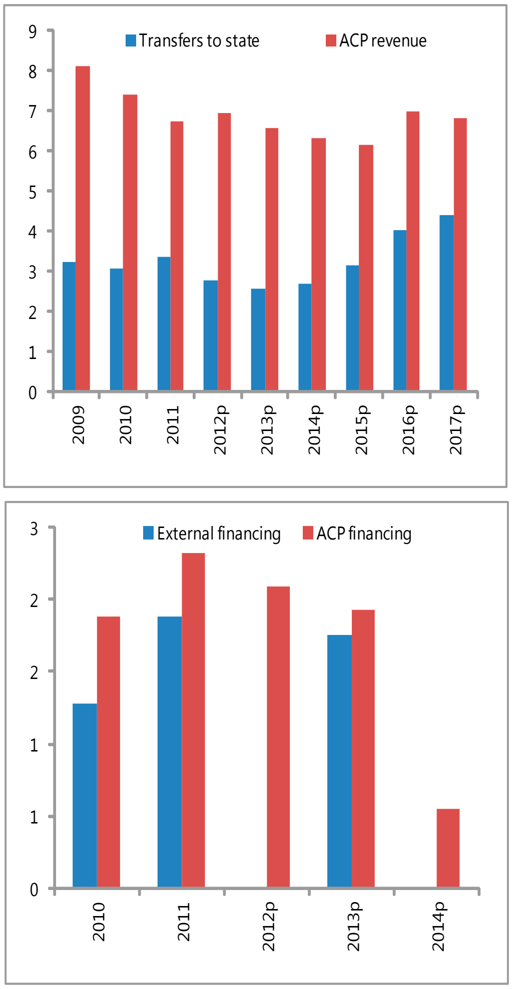
[17] The threshold is planned to be reduced by 50KWH every two quarters starting in second quarter of 2012 until it reaches 300KWH. This is estimated to generate US$30 million in annual savings.

Strengthening revenue management

16. **Stronger revenue collection would create additional fiscal space for spending on social programs and infrastructure.** Staff welcomed recent progress in raising Panama's tax revenue collection through the implementation of two tax reforms. Notwithstanding this progress, Panama continues to have one of the lowest tax ratios in the region (Figure 2). Foregone income related to tax evasion is estimated at about 5 percent of 2011 revenue. Staff encouraged the authorities to quickly initiate operations of the Large Taxpayer Unit and strengthen fiscal controls. The authorities noted that the introduction of fiscal cash registers in most retailers would help tackle tax avoidance and fraud. They are tightening controls on incoming goods in the Colon Free Zone and making progress in registering and valuing land at market prices. The authorities were also encouraged to prepare estimates of tax expenditures and include them in budget documents.

17. **The authorities' plan to create a Sovereign Wealth Fund to save part of the additional resources expected from the Panama Canal expansion is welcome (Chart 3).** The mechanism would improve control over the Canal resources and create a buffer for stabilization purposes and potentially for the coverage of future pension liabilities (Box 5).[18] The authorities agreed with staff on the need to integrate the SWF into the budget framework. This would require modifying the SFRL, which the authorities intend to propose to the National Assembly in 2012.

Chart 3. ACP Expansion: Revenue and Financing
(percent of GDP)



Sources: ACP and IMF staff calculations.

[18] The Social Security System (CSS) was overhauled in 2007-08 through the introduction of individual savings accounts and a reform of the defined benefit system. Currently CSS receives US$140 million annually from the budget to compensate for the deficit of the defined benefit system. Further reform of the system would be needed to prevent these deficits from continuing to increase after 2030.

Box 5. Panama' Sovereign Wealth Fund: A Fiscal Perspective

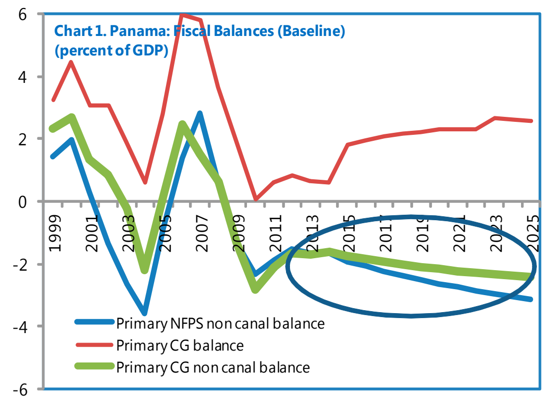
Starting in 2015, permanent and relatively stable higher transfers to the budget following the Canal expansion create important challenges for fiscal policy design and implementation in Panama. Canal revenues (tolls, fees and dividends) are not dependent on domestic economic activity but may generate domestic spending pressures if they are made available in full for public spending.

As part of technical assistance on this matter, staff constructed three long-term scenarios to assess what fraction of incremental revenue could be spent contemporaneously without creating excessive domestic demand pressures. All scenarios assumed the overall fiscal deficit complies with the one percent of GDP limit established in the SFRL until 2015.

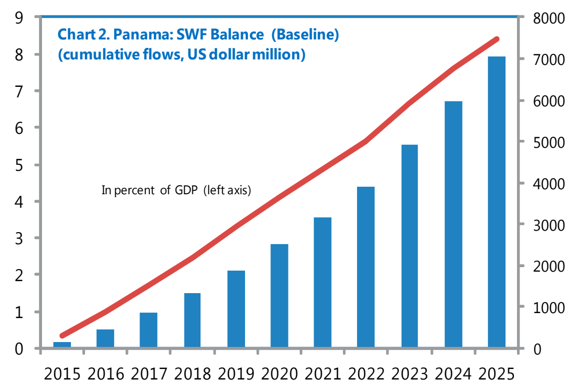
- In staff's *baseline* scenario, once canal revenue starts to expand in 2015, expenditure is assumed to increase in line with nominal GDP growth. This would result in gradually rising overall fiscal surpluses.
- *Scenario 1* assumes that the overall fiscal balance posts deficits of one percent of GDP until 2025. With higher revenues from the Canal, this policy implies an additional 5 percent increase in nominal government spending starting in 2015 relative to the baseline. This sizable and steady increase in government spending would crowd out private demand and none of additional revenue would be saved.
- *Scenario 2* assumes a yearly increase in canal dividends of 25 percent starting from 2015, and the path for the fiscal balance as in the baseline scenario. Expenditure in 2015 would be about 3 percent higher than in the baseline scenario and also crowd out private demand.

The simulations suggest that the creation of a SWF would require modifying the fiscal rule and the SFRL. The estimates in the baseline scenario are consistent with setting a target for the *non-canal fiscal balance* at about -3 percent of GDP, which fits the historical pattern (Chart 1). An alternative would be to adopt an expenditure rule that sets the rate of growth of total expenditure at the rate of nominal GDP growth, supplemented with an overall balance target, and with a cap on canal transfers. Under the baseline scenario, accumulated resources of the SWF would amount to about 8 percent of GDP by 2025 (Chart 2).

The design of the SWF should conform to international best practices. In particular, (i) the fund's main objective should be macroeconomic stabilization and/or coverage of future pension liabilities; (ii) it should invest the resources abroad; (iii) it should operate as a financing fund and not have the capacity to spend; and (iv) there should be no earmarking of transfers.



Source: Authorities and IMF staff calculations.
Adjusted for windfall CG capital revenue in 2007.



Source: IMF Staff calculations.

C. Building a World-Class Financial Center

18. **Panama has established itself as an important regional hub for banking services but will need to upgrade oversight and financial infrastructure to compete globally**. For the most part, banks follow a fairly traditional business model, while insurance, equity, and capital markets are relatively small and/or underdeveloped. However, to be competitive in a broader range of investment and wealth management services, Panama would have to make improvements in several areas. According to the FSAP these include: (i) bringing financial system oversight more closely in line with international best practices; and (ii) upgrading all non-bank segments of the financial system. The authorities welcomed the FSAP recommendations (Box 3), and the SBP is currently preparing a reform action plan based on them.

19. **Strengthening risk-based and consolidated cross-border supervision, and extending the perimeter of supervision to large nonbank deposit-taking institutions should be key priorities**. Panama's legal framework is strong and supportive of banking supervision, and compliance with Basel Core Principles is good. However, risk-based supervision is in its initial stages and it will take some time before new regulations are fully phased in. The SBP also agreed on the need to regulate operational and market risks, and setting concentration limits for interbank deposits. Panama is host to several large regional financial groups and cross-border supervision is broadly in line with international best practices. Nonetheless, the FSAP recommended further improvements, notably: (i) adopting capital adequacy standards at the holding company level and setting related-party exposure and concentration limits for regional groups; and (ii) expanding the supervisory sphere by including securities, insurance, and foreign exchange houses supervisors. The authorities noted that the Ministry of Commerce was working on measures to strengthen the supervision of cooperatives.

20. **Recent and planned legal reforms aimed at strengthening the insurance sector and securities markets are timely, but additional reforms are needed.** The FSAP found that both insurance and securities market oversight fell short of minimum international standards, which could create reputational risks. Recent and ongoing legislative efforts to increase the autonomy and resources of sector regulators would help improve compliance, but staff also called for further strengthening prudential regulation, particularly with regard to the determination of solvency margins and regulating the investment of capital. The capacity of insurance and capital market supervisors should also be enhanced.

21. **Staff welcomed recent steps to develop domestic capital markets**. The establishment of a market maker program, including the re-launching of domestic debt placements and the creation of custodian arrangements to enhance connectivity with international markets has already increased the volume of secondary market transactions. These advances would benefit from further upgrades in payment systems infrastructure.

22. **Maintaining a strong AML/CFT regime in line with international standards is essential to support the further development of Panama's financial sector.** In this regard, staff welcomes the authorities' commitment to completing an AML/CFT assessment as part of the FSAP process by end-2012.

D. Boosting Competitiveness and Sustaining Growth

23. **Panama's competitiveness has improved in recent years (Annex II).** The trend real effective exchange rate (REER) has depreciated since 2009, although rising domestic inflation has mitigated the fall. Export growth has been strong, and Panama remains an attractive destination for FDI (Figure 5 and Annex II, Figure 1). Econometric estimates based on the standard CGER methodologies do not suggest a significant exchange rate misalignment, although competitiveness could deteriorate if inflation remains significantly above that of trading partners. Survey-based competitiveness indicators and rankings show that, overall, Panama's competitiveness position has been improving in recent years, and compares well with the largest economies in the region. Those surveys highlight political stability, infrastructure, and financial development as Panama's strengths.

24. **Going forward, the recently-approved FTA with the U.S. is expected to boost Panama's status as a regional logistics hub** (Box 1). Simplified procedures and taxation regimes should attract further investments in the services sector and light manufacturing, building on the enhanced interconnectedness provided by the expansion of the Canal and ports facilities. The authorities have established a logistics secretariat tasked with removing remaining bottlenecks to support the expansion of these sectors. Promotion of non-traditional exports would be necessary for the agricultural sector to reap the benefits of the FTA.

25. **At the same time, Panama needs to make improvements in the areas of human capital, access to basic services, and institutions**. Staff noted that some key indicators of social progress and educational achievement are low, both in relation to Panama's impressive improvements in real per capita income and compared with peers (Figure 6).[19] The authorities argued that the results of a recent study showed that poverty and inequality had declined significantly.[20] They noted that the government's emphasis on building comprehensive safety nets was starting to show positive results, and indicated that they are implementing measures to improve security and reinforce the legal and judicial framework.

26. **It was agreed that a strategy to enhance human capital through labor**

[19] In of the tests of the OECD Program for International Student Achievement (PISA) conducted in 2009, Panama scored fourth and second last in reading and science, and math tests, respectively, out of 65 participating countries (www.pisa.oecd.org).

[20] The World Bank's 2011 study uses 2008 data (*Panama Poverty Assessment*, Report No. 62955 – PA).

market and education reforms was necessary. The coexistence of high rates of youth unemployment (14.9 percent in 2011) with very low total unemployment points to growing skill mismatches.[21] The authorities and staff concurred that improvements in human capital and labor productivity are essential to ensure that the benefits of Panama's economic success are widely shared by the population and to sustain high growth rates over the medium term. The authorities noted that recent programs such as cash transfers for all school children were improving enrollment and reducing drop-out rates, and pointed at joint efforts with the private sector to increase availability of vocational and on-the-job training.

STAFF APPRAISAL

27. **Panamas' economy has shown impressive resilience to external turbulence in recent years.** Strong fundamentals, including Panama's strategic position as a regional logistics and banking hub, political stability, steady fiscal consolidation and prudent liability management, have contributed to some of the highest growth rates in the region and lowered public debt levels.

28. **Overall vulnerabilities are low and the outlook is favorable, with broadly-balanced risks.** The large-scale public investment program and the Panama Canal expansion are expected to continue to drive demand and growth in 2012, and thus mitigate the adverse impact of the weak global outlook. Stress tests confirm Panama's banking sector's soundness, though some liquidity risks warrant heightened vigilance. Panama's current account developments seem consistent with external stability, and there are no major external vulnerabilities Nonetheless, a large external shock affecting global trade and liquidity could cause serious disruptions.

29. **In the near term, policies should focus on building buffers and strengthening crisis-prevention tools.** With output now at capacity, the neutral fiscal stance envisaged for 2012 is broadly appropriate, though a tighter fiscal stance would be preferable to help rebuild buffers and contain second-round inflation pressures. Although there is no evidence of asset price bubbles and conservative lending practices by banks limit exposure to fast-growing sectors, the capacity to analyze macro-financial linkages and monitor systemic risk should be strengthened by improving the regulatory framework and closing data gaps. Macro-prudential tools could play a useful role in managing rapid credit growth in some sectors in the absence of monetary policy, while establishing a fund to respond to temporary liquidity shortages would bolster financial system stability.

[21] According to Manpower Co., Panama ranks second after Brazil in businesses' hiring intentions in Q4 2011 in the Americas, and fifth globally. Thirty eight percent of companies in Panama struggle to find skilled labor. In addition, Panamanian companies are only allowed to hire 10 percent of their labor force from abroad.

30. **Strengthening the fiscal framework, enhancing financial sector supervision, and removing growth bottlenecks are the key medium-term challenges.**

- *In the fiscal area,* maintaining the government's ambitious investment program within the limits of the SFRL calls for continuing enhancements in the quality and effectiveness of spending, including through plans to better target subsidies, and strengthening tax administration, notably through the establishment of a large taxpayer unit. The envisaged creation of a Sovereign Wealth Fund to save part of the additional revenue from the expanded Panama Canal would be useful to contain spending pressures and create buffers.

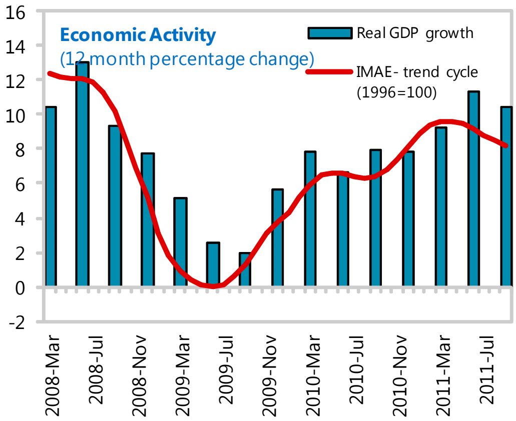
- *Financial sector* oversight should be brought in line with best international practices, and all non-bank segments should be upgraded, in line with FSAP recommendations. Enabling legislation to allow the new council of supervisors to operate as an effective supervisor of the whole system is urgently needed. Although banking supervision is strong and effective overall, risk-based and consolidated supervision should be further enhanced. Potential reputational risks highlight the need to continue with efforts to strengthen oversight of non-bank financial institutions. Ongoing initiatives to develop capital markets, notably through the market-makers initiative, are welcome.

- *Sustaining growth* over the medium term requires managing the public investment program carefully to avoid supply bottlenecks and obtain the best value for money from new infrastructure. Once the public investment program and the Panama Canal expansion taper off, growth will have to be driven by productivity gains. In this regard, ongoing efforts to improve the quality of education and to remove skill mismatches through vocational and on-the-job training would be key.

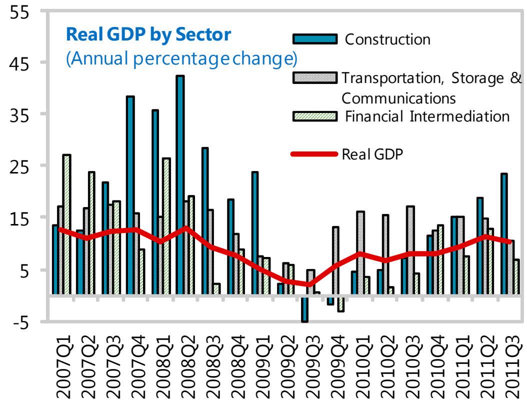
31. **Staff recommends that the next Article IV consultation takes place on the standard 12-month cycle**.

Figure 1. Panama: Real Sector Developments, 2007-11

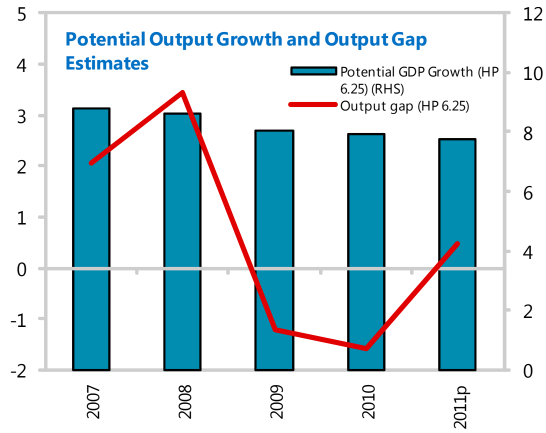
Economic activity rebounded strongly starting in 2009.



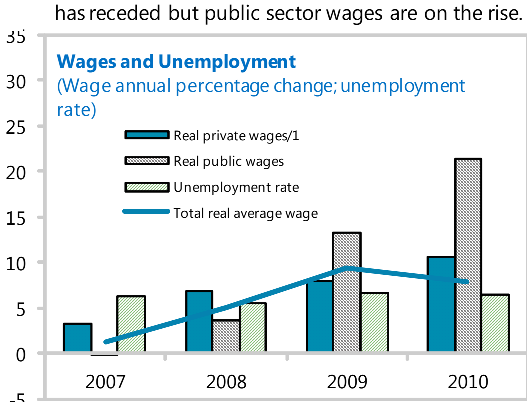
Construction and transportation remained the key growth drivers.



The output gap is likely to have closed in 2011.

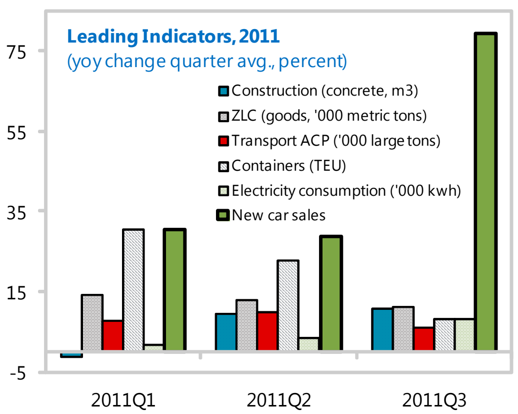


Unemployment remains low. Average wage growth has receded but public sector wages are on the rise.

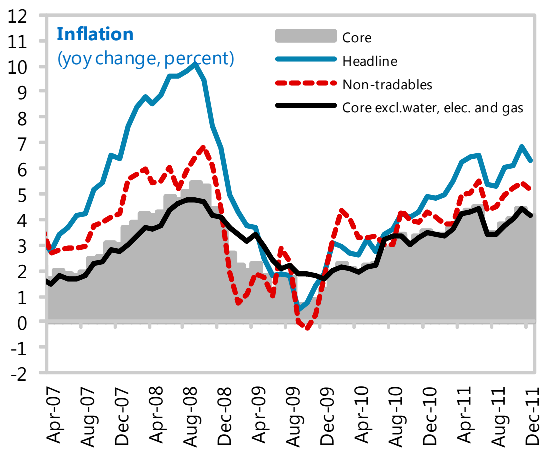


1/As submitted to Social Security Agency and are most likely underreported.

Activity slowed down somewhat in Q3, but output growth in 2011 will remain strong.

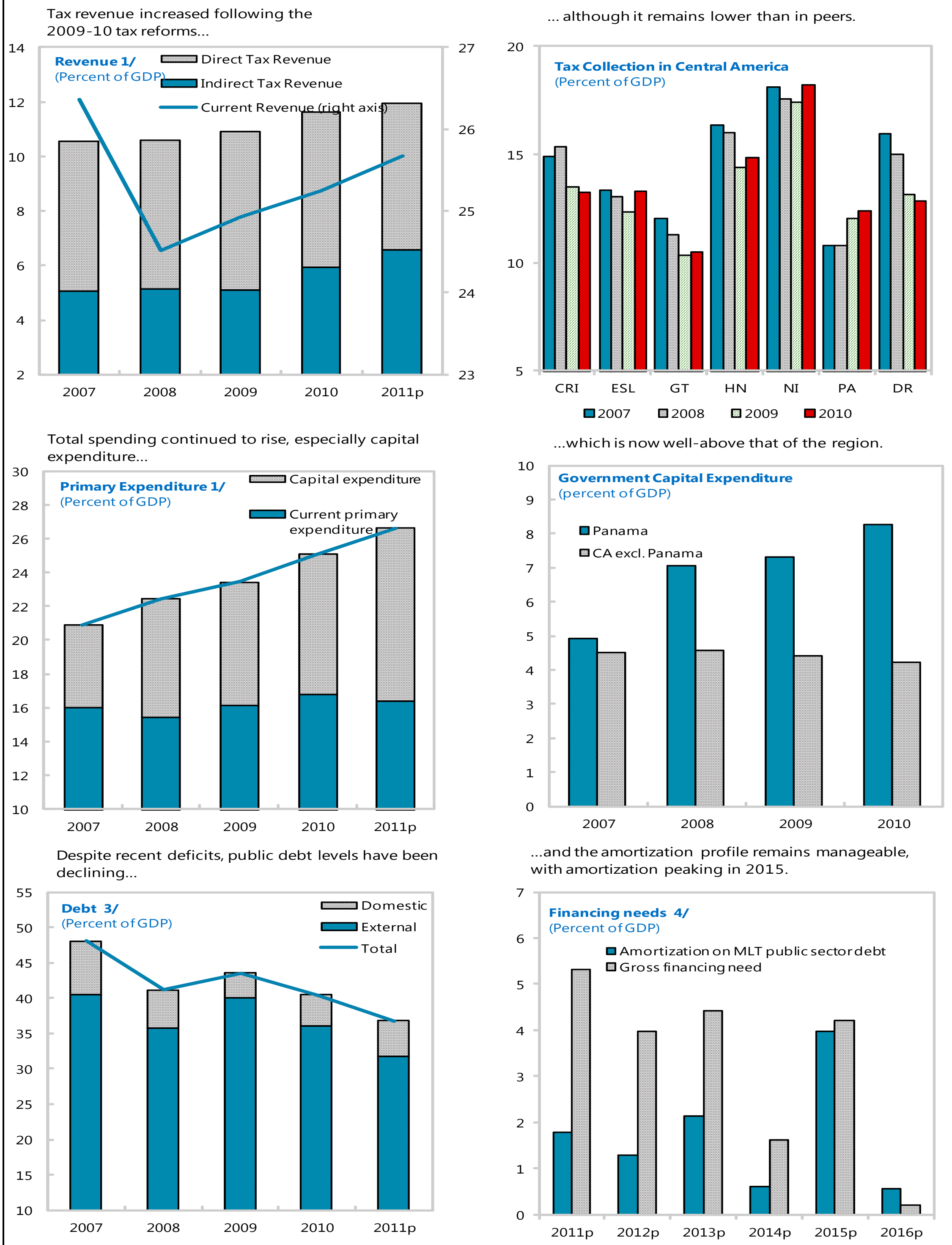


Headline and core inflation continue rising.



Source: National Authorities and IMF staff calculations.

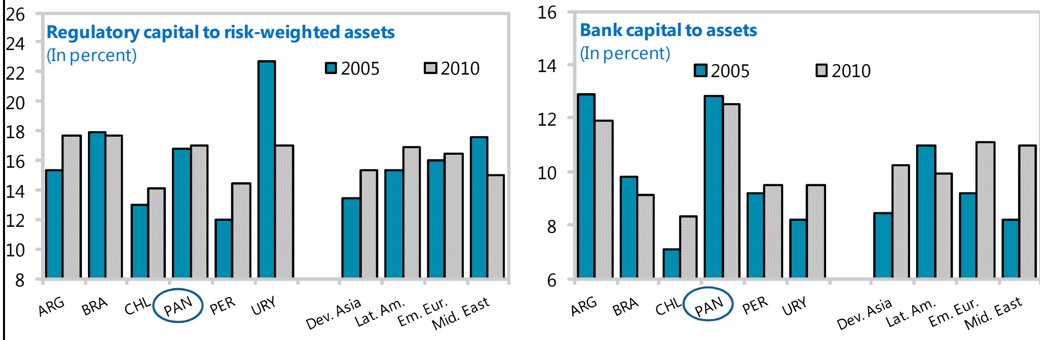
Figure 2. Panama: Fiscal Developments, 2007-11



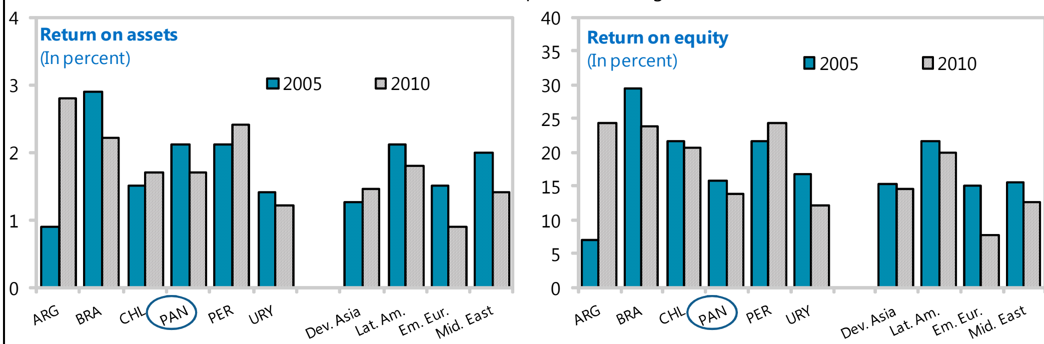
Sources: National Authorities; and IMF staff calculations.
1/ Data refers to the Central Government.
2/ Excludes Panama Canal Authority.
3/ Includes Panama Canal Authority debt starting 2010.
4/ NFPS deficit and amortization only.

Figure 3. Panama: Banking System Indicators in International Perspective1/

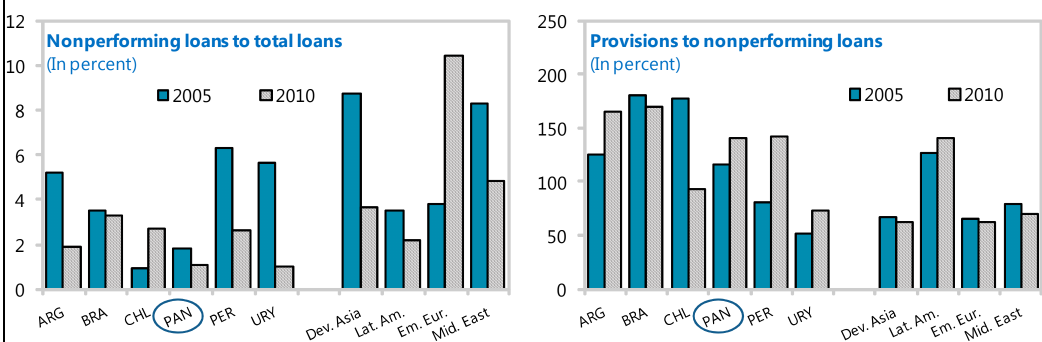
Capital levels look strong and broadly in line with regional levels.



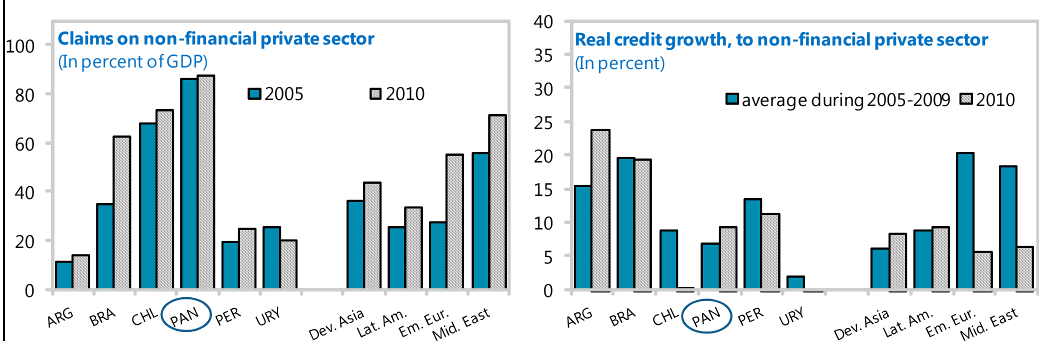
Profits are also at par with the region.



The NPL ratio is one of the lowest ; while provisions are in line with the region.



Private sector credit to GDP remains the highest in the region; and credit growth is moderate.

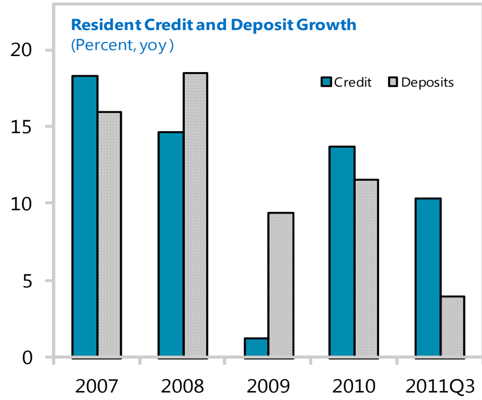


Sources: National authorities; and IMF staff calculations.

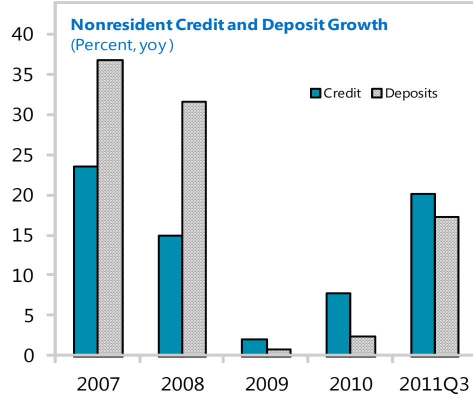
1/ Regional aggregates correspond to median values.

Figure 4. Panama: Financial Sector Developments, 2007-11

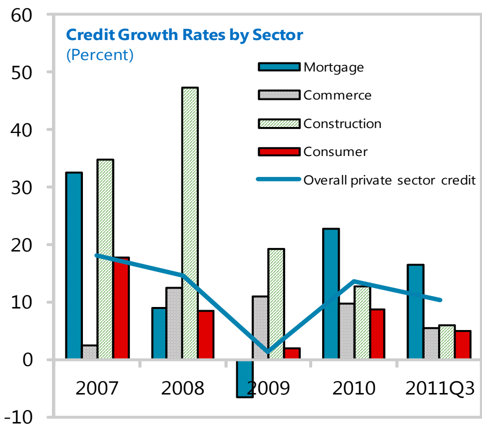
Following the crisis, credit to residents increased rapidly, while resident deposits remained resilient.



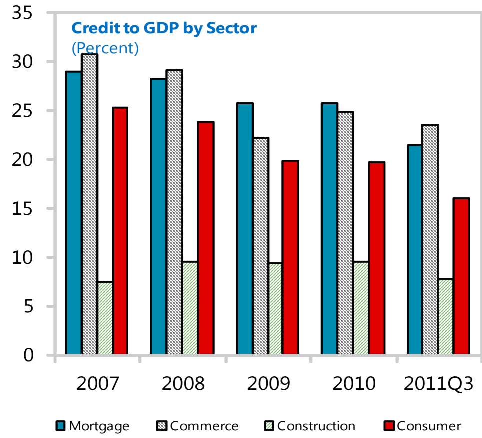
Nonresident credit and deposit growth slowed sharply in 2009 and are still below pre-crisis levels.



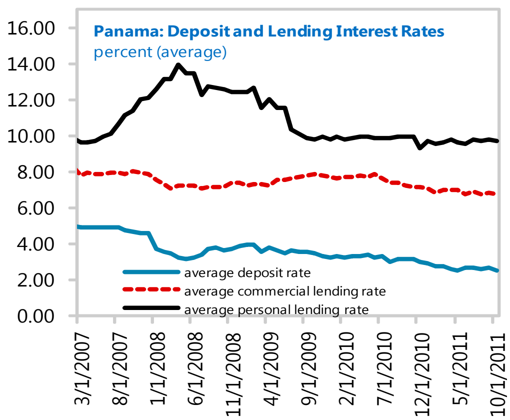
Mortgage lending rebounded in 2010...



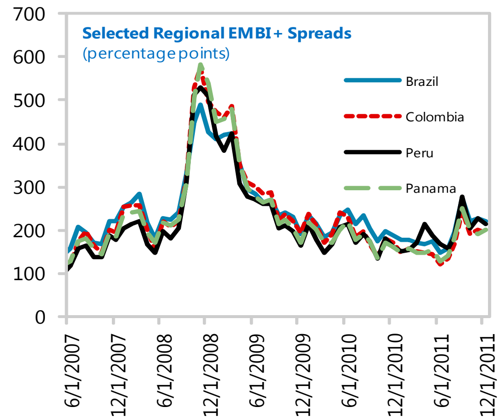
...and together with commerce represent the largest share of banks' loans portfolios.



Average interest rates and spreads remained stable despite strong competition and ample liquidity.



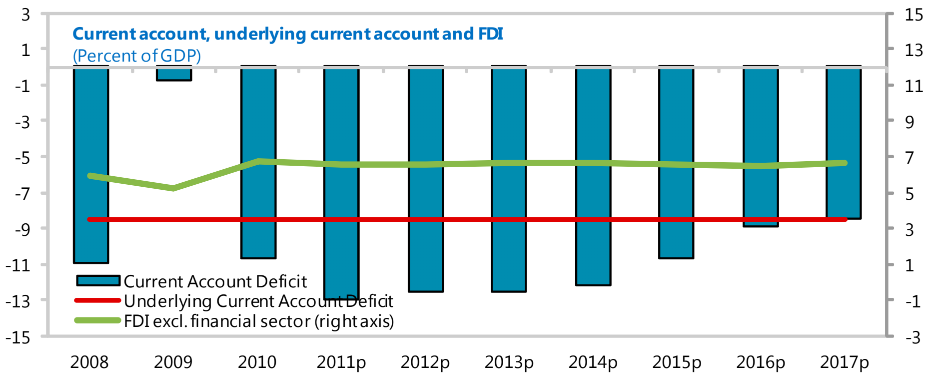
Spreads on sovereign debt fell to normal after a brief spike.



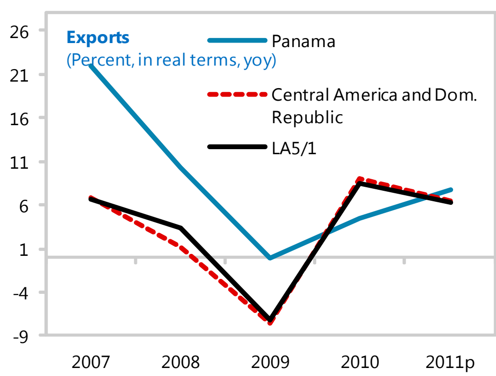
Source: National Authorities and IMF staff calculations.

Figure 5. Panama: External Sector Developments

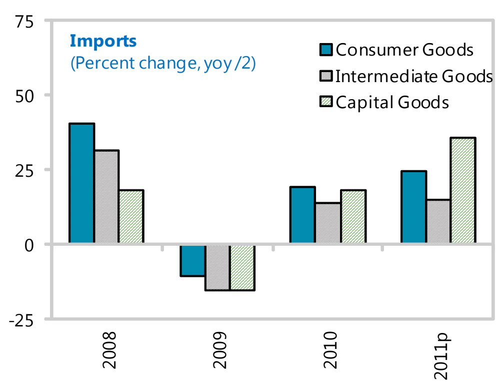
The external current account widened owing to imports related to the Panama Canal expansion and the public investment program, but it is largely financed by FDI and is expected to return gradually to its norm.



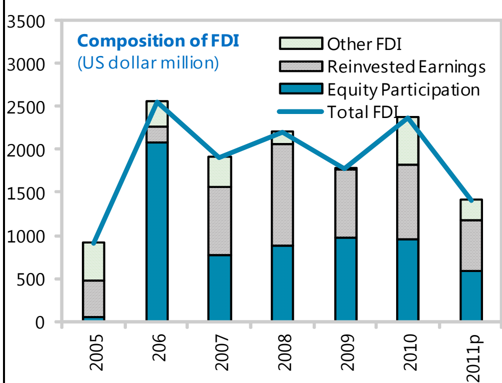
Export growth has rebounded...



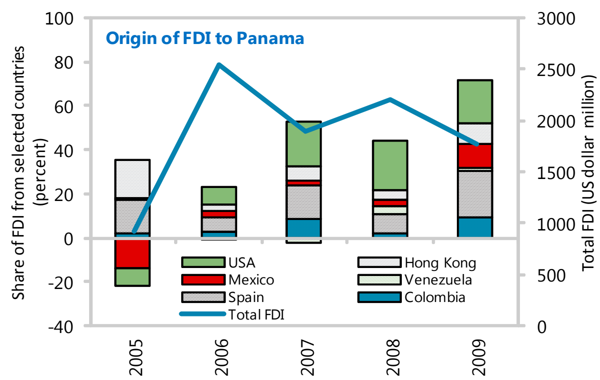
... and import growth has been strong, reflecting spending most recently on capital goods.



Equity participation and reinvested earnings comprise the bulk of FDI,

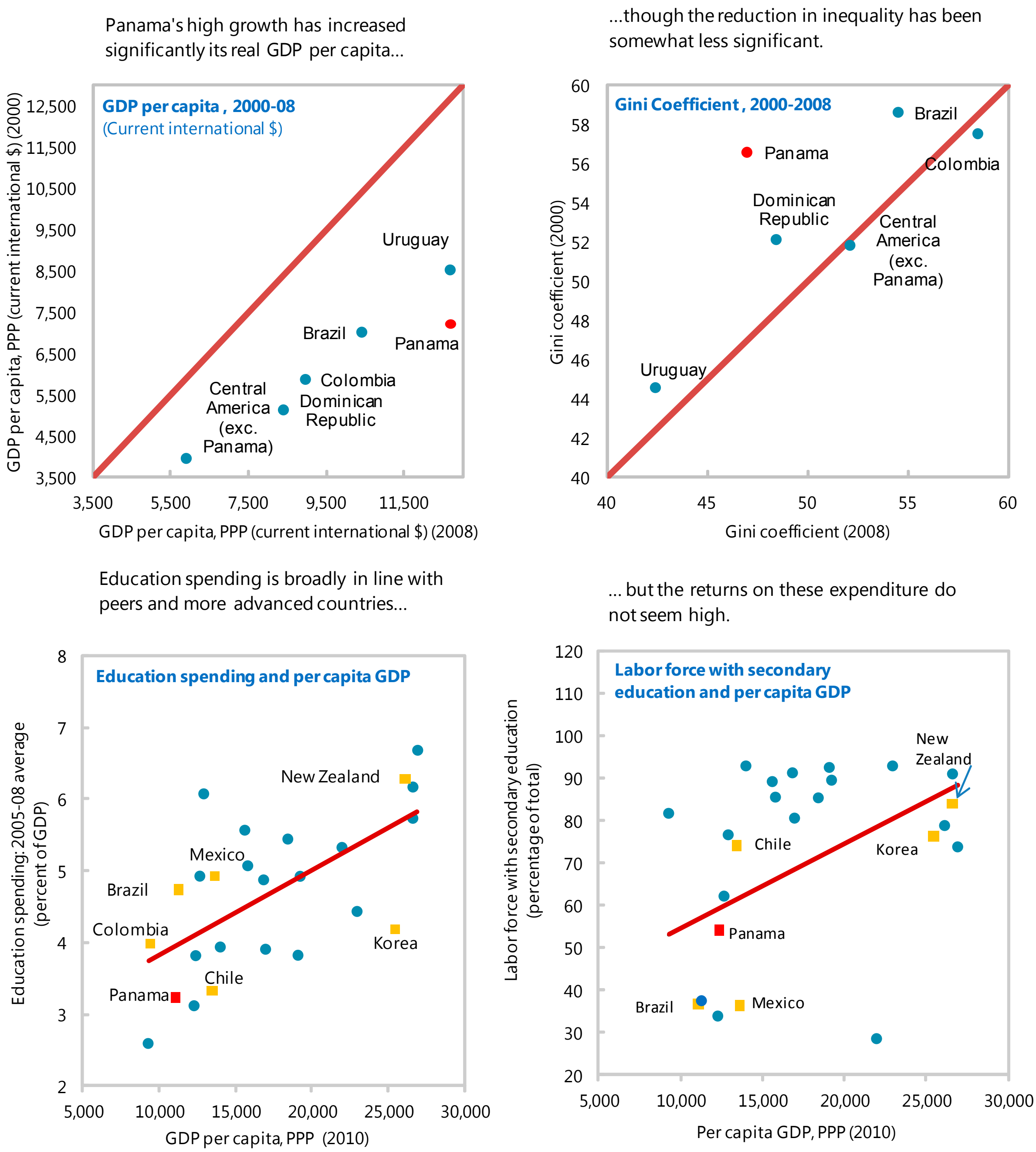


which comes mostly from the U.S., though shares of Mexico and Spain are rising.



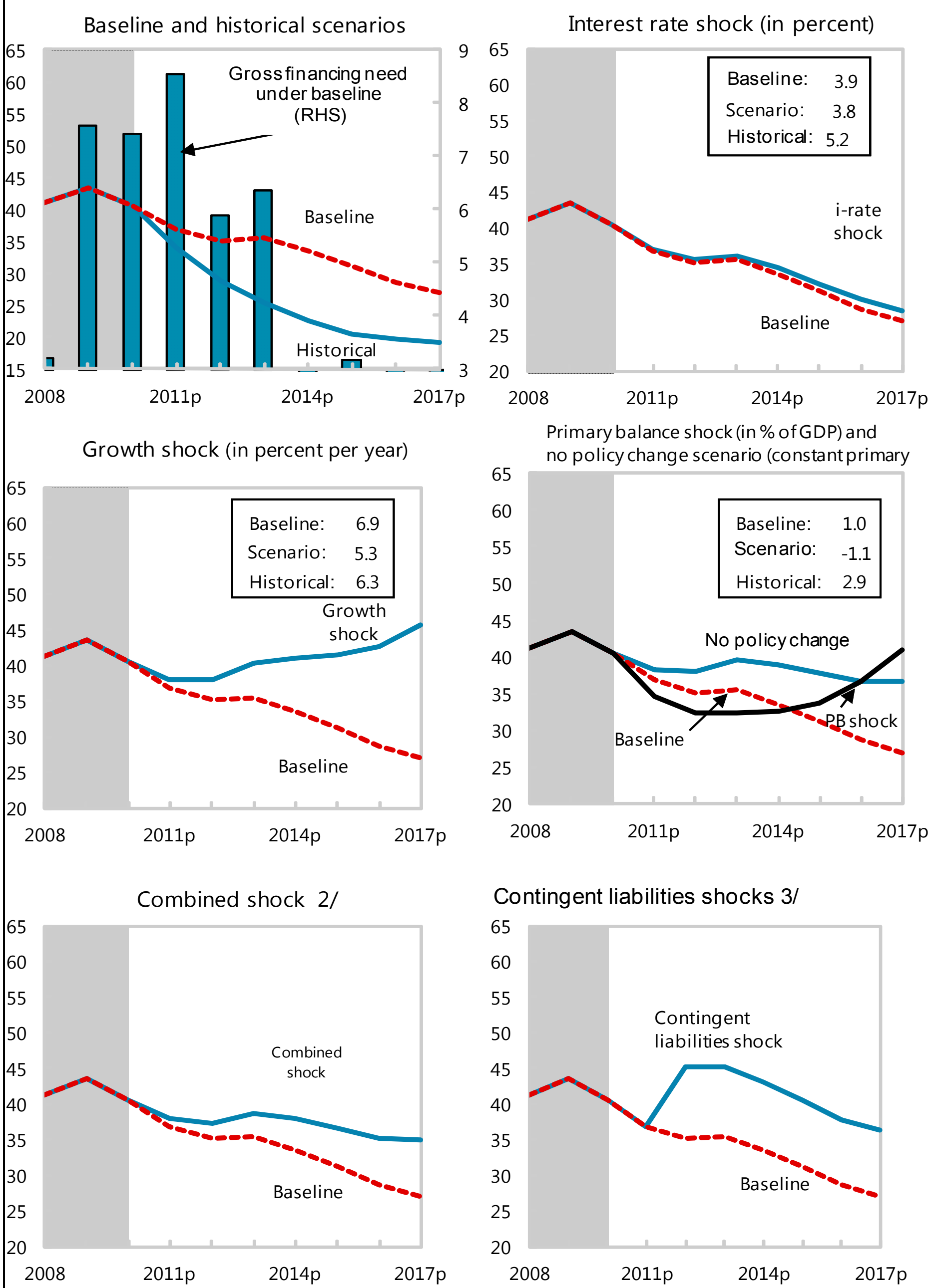
Source: National Authorities and IMF staff estimates and projections.
1/ LA5 refers to Brazil, Chile, Colombia, Mexico and Peru.
2/ The data for 2011 is the yoy growth rate in October.

Figure 6. Panama: Social and Development Indicators



Source: National Authorities and WDI.

Figure 7. Panama: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ 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 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, 2010)	7,820
Total unemployment	4.5	IMF Quota (SDR, million)	206.6

				Proj.	
	2008	2009	2010	2011	2012
			(Percent change)		
Production and prices					
Real GDP (1996 prices)	10.1	3.2	7.5	10.0	7.5
Consumer price index (average)	8.8	2.4	3.5	5.9	5.5
Consumer price index (end-of-year)	6.8	1.9	4.9	6.3	5.7
Domestic demand (at constant prices)					
Public consumption	2.6	4.1	12.2	12.2	7.0
Private consumption	-2.1	-2.8	24.4	7.0	9.4
Public investment 1/	58.3	17.2	34.4	39.3	4.5
Private investment	14.2	-13.4	-2.2	10.8	3.2
Financial sector					
Private sector credit	14.6	1.3	13.6	17.8	12.0
Broad money	18.5	9.4	11.6	8.9	8.7
Average deposit rate (1-year)	3.5	3.5	3.5	...	...
Average lending rate (1-year)	8.5	7.5	7.5	...	...
External trade 2/					
Merchandise exports	75.5	-37.1	12.7	13.2	4.8
Merchandise imports	33.7	-16.1	19.1	31.5	8.4
			(In percent of GDP)		
Saving-investment balance					
Gross domestic investment	27.6	25.6	26.0	29.0	28.0
Public sector	8.2	9.4	11.9	15.2	14.4
Private sector	19.4	16.2	14.1	13.8	13.6
Gross national saving	16.7	24.9	15.3	16.0	15.4
Public sector	9.7	8.6	7.7	8.7	9.4
Private sector	7.0	16.2	7.6	7.3	6.0
Public finances					
Revenue and grants	34.9	33.5	33.3	33.4	33.8
Expenditure	32.4	33.9	36.7	38.9	38.1
Current, including interest	24.1	24.5	24.8	23.7	23.7
Capital	8.2	9.4	11.9	15.2	14.4
Overall balance	2.5	-0.4	-3.4	-5.5	-4.3
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3	-2.0
External sector					
Current account	-10.9	-0.7	-10.7	-13.0	-12.6
Net exports from Colon Free Zone	0.0	8.0	1.8	1.8	1.7
Net oil imports	-1.0	0.1	0.3	0.9	1.2
Foreign direct investment	9.3	5.2	8.8	8.8	8.9
Total public debt					
Total debt 2/	41.1	43.5	40.5	36.8	35.2
External	35.7	40.1	36.0	31.8	29.2
Domestic	5.5	3.4	4.5	5.0	5.9
Memorandum items:					
GDP (in millions of US$)	23,002	24,163	26,590	31,532	34,946

Sources: Comptroller General; Superintendency of Banks; and Fund staff estimates.
1/ Includes Panama Canal Authority (ACP).
2/ Including ACP and net of Fiduciary Fund' holdings of non-government assets.

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

(In percent of GDP)

	2008	2009	2010	Proj. 2011	2012
Revenues	26.1	25.4	25.9	26.7	27.0
Current revenue	24.7	24.9	25.2	25.7	26.0
Tax revenue	10.6	10.9	11.6	11.9	12.1
Nontax revenue of central government	6.7	6.4	6.0	6.2	6.4
o/w: Panama Canal fees and dividends	3.0	3.2	3.1	2.7	2.7
Social security agency	5.8	5.7	6.2	6.1	6.0
Public enterprise operating balance	1.2	0.9	0.9	0.9	1.0
Other 2/	0.4	1.0	0.5	0.5	0.5
Capital revenue	1.1	0.3	0.6	1.0	1.0
Expenditure	25.7	26.4	27.8	29.0	29.0
Current primary expenditure	15.6	16.2	16.8	16.4	16.5
Central government	8.3	8.5	9.3	9.0	9.1
Rest of the general government	7.2	7.7	7.5	7.4	7.4
Social security agency	6.5	6.9	6.8	6.8	6.7
Decentralized agencies	0.7	0.8	0.7	0.7	0.7
Interest	3.1	2.9	2.7	2.4	2.3
Capital	7.0	7.3	8.3	10.2	10.2
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3	-2.0
Panama Canal Authority (ACP)					
Revenue	8.7	8.1	7.4	6.7	6.9
Current expenditure	2.4	2.2	2.2	2.1	2.0
Transfers to the government	3.0	3.2	3.1	2.7	2.7
Interest payments	0.0	0.0	0.0	0.1	0.2
Capital expenditure	1.2	2.1	3.6	5.0	4.1
Overall balance	2.1	0.5	-1.5	-3.2	-2.2
Overall balance, including ACP	2.5	-0.4	-3.4	-5.5	-4.2
Net financing, excluding ACP	-0.4	1.0	1.9	2.3	2.0
External	0.8	6.4	1.1	1.1	0.6
Domestic	-1.2	-5.4	0.8	1.2	1.4
Memorandum items:					
Savings (including ACP)	9.7	8.6	7.6	8.6	9.2
Primary balance (including ACP)	5.6	2.5	-0.6	-3.0	-1.7
Primary balance (excluding ACP)	3.5	1.9	0.8	0.1	0.3
Structural primary balance/3	2.7	2.2	1.2	0.0	0.2

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Official presentation excludes the operations of the ACP which reverted to Panama on December 31,1999.
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	Proj. 2011	2012
Revenues and grants	19.8	18.5	19.0	19.8	20.2
Current revenue	18.4	18.1	18.4	18.9	19.3
Taxes	10.6	10.9	11.6	11.9	12.1
Direct taxes	5.5	5.8	5.7	5.4	5.5
Income tax	4.9	5.2	5.0	4.7	4.8
Tax on wealth	0.5	0.6	0.7	0.7	0.7
Indirect taxes	5.1	5.1	5.9	6.6	6.7
Import tax	1.8	1.6	1.5	1.7	1.7
ITBMS	2.3	2.3	3.1	3.3	3.4
Petroleum products	0.4	0.5	0.4	0.4	0.4
Other tax on domestic transactions	0.7	0.7	1.0	1.1	1.1
Nontax revenue	7.8	7.2	6.8	7.0	7.2
Dividends	2.9	2.7	2.7	2.8	3.3
Of which: Panama Canal Authority	1.5	1.8	1.8	1.6	1.6
Panama Canal Authority: fees per ton 1/	1.5	1.4	1.3	1.1	1.1
Transfers from decentralized agencies	1.8	1.6	1.6	1.6	1.5
Other	1.5	1.4	1.2	1.4	1.3
Capital revenue	1.1	0.3	0.5	0.8	0.8
Grants	0.4	0.1	0.1	0.1	0.1
Total expenditure	19.5	19.9	21.5	22.5	22.3
Current	13.9	13.6	14.0	13.3	13.1
Wages and salaries	4.2	4.2	4.8	5.0	4.9
Goods and services	1.8	1.7	1.7	1.8	1.8
Pensions	1.9	1.6	1.2	1.2	1.1
Transfers to public and private entities	3.0	3.1	3.7	3.1	3.3
Interest	3.1	2.9	2.7	2.3	2.1
Domestic	0.4	0.4	0.1	0.1	0.2
External	2.7	2.6	2.5	2.1	1.9
Capital	5.6	6.3	7.4	9.2	9.2
Savings 2/	4.8	4.6	4.5	5.7	6.3
Overall balance	0.3	-1.4	-2.5	-2.7	-2.1
Financing (net)	-0.3	1.4	2.5	2.7	2.1
External	0.6	6.5	1.1	1.1	0.6
Domestic	-0.8	-5.1	1.4	1.6	1.5
Memorandum items:					
Primary balance	3.4	1.5	0.2	-0.4	-0.1
GDP (in millions of US$)	23,002	24,163	26,590	31,532	34,946

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

Table 4. Panama: Monetary Accounts 1/

	2007	2008	2009	2010	Proj. 2011	Proj. 2012
	(In millions of U.S. dollars at end-period)					
Net foreign assets	5,257	6,042	8,632	8,529	6,652	6,838
Short-term foreign assets, net	5,272	6,050	8,637	8,532	6,654	6,841
National Bank of Panama	2,028	2,695	3,406	2,945	2,245	2,265
Rest of banking system	3,244	3,355	5,231	5,586	4,409	4,575
Long-term foreign liabilities	14	8	5	2	2	2
National Bank of Panama	14	8	5	2	2	2
Net domestic assets	11,911	15,061	14,411	17,134	20,360	22,513
Public sector (net credit)	-2,435	-2,465	-3,265	-2,740	-2,830	-2,679
Central government (net credit)	-314	-456	-672	-702	167	718
Rest of the public sector (net credit)	-2,121	-2,009	-2,593	-2,038	-2,997	-3,397
Private sector credit	18,540	21,245	21,514	24,448	28,811	32,272
Private capital and surplus	-5,578	-6,419	-5,573	-6,438	-6,627	-7,201
Other assets (net)	1,383	2,700	1,734	1,863	1,006	120
Liabilities to private sector	17,167	20,335	22,240	24,813	27,011	29,351
Total deposits	17,100	20,274	22,073	24,699	26,888	29,217
Demand deposits	3,042	3,762	4,366	5,188	5,845	6,477
Time deposits	10,536	12,165	13,145	14,034	15,810	15,770
Savings deposits	3,522	4,347	4,562	5,477	5,233	6,970
Bonds	67	61	167	114	123	134
	(12-month change in relation to liabilities to the private sector at the beginning of the period)					
Net foreign assets	7.7	4.6	12.7	-0.5	-7.6	0.7
Net domestic assets	8.2	18.4	-3.2	12.2	13.0	8.0
Public sector credit (net)	-6.7	-0.2	-3.9	2.4	-0.4	0.6
Private sector credit	19.3	15.8	1.3	13.2	17.6	12.8
Private capital and surplus	11.2	4.9	-4.2	3.9	0.8	2.1
Other assets (net)	6.8	7.7	-4.8	0.6	-3.5	-3.3
Liabilities to the private sector	15.9	18.5	9.4	11.6	8.9	8.7
	(12-month percent change)					
Memorandum items:						
M2 2/	15.9	18.5	9.4	11.6	8.9	8.7
Private sector credit	18.2	14.6	1.3	13.6	17.8	12.0
	(In percent of GDP)					
Total deposits	86.4	88.1	91.4	92.9	85.3	83.6
Private sector credit	93.7	92.4	89.0	91.9	91.4	92.3

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and Fund staff estimates and projections.
1/ Domestic banking system only; comprises general license banks; does not include offshore banks; deposits from and credit to nonresidents 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		
	Dec.	Dec.	Dec.	Mar.	June	Sept.
Asset quality						
Nonperforming loans as percent of total loans						
Banking system	1.6	1.4	1.1	1.1	1.0	0.9
Domestic banks	1.7	1.3	1.0	1.3	1.0	1.1
Foreign banks	1.7	1.5	1.1	1.0	1.0	0.9
Ratio of provisions to nonperforming loans						
Banking system	104.8	120.0	139.6	131.9	140.2	141.4
Domestic banks	120.2	150.3	160.2	132.3	161.7	146.8
Foreign banks	93.5	99.6	124.1	131.5	123.2	136.3
Profitability						
Pretax return on average assets						
Banking system	2.2	1.4	1.7	2.1	2.5	2.6
Domestic banks	2.9	1.4	1.4	1.7	2.1	2.2
Foreign banks	2.7	1.4	1.9	2.3	2.8	3.0
Liquidity						
Ratio of liquid assets to total deposits						
Banking system	28.4	28.4	25.2	23.6	21.6	20.5
Domestic banks	25.9	27.6	27.4	25.6	23.6	22.0
Foreign banks	30.6	29.3	23.1	21.6	19.6	18.9
Ratio of liquid assets plus marketable securities to total deposits 2/						
Banking system	43.0	42.9	40.0	39.4	36.6	36.2
Domestic banks	39.0	39.9	38.3	37.1	36.6	35.9
Foreign banks	46.2	45.7	41.7	41.6	38.5	38.6
Capital adequacy ratios						
Ratio of capital to risk-weighted assets						
Banking system	14.8	16.4	17.5	16.5	16.1	15.6
Domestic banks	17.3	18.4	19.2	18.6	18.1	17.7
Foreign banks	13.0	15.3	14.7	14.5	14.2	13.6
Ownership						
Foreign banks' share of domestic banking system assets	57.5	53.9	53.1	53.5	53.0	53.2

Sources: Superintendency of Banks; and Fund 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	2012	2013	2014	2015	2016	2017
				Proj.						
	(In millions of U.S. dollars)									
Current account	**-2,513**	**-179**	**-2,848**	**-4,094**	**-4,385**	**-4,774**	**-5,060**	**-4,827**	**-4,343**	**-4,227**
Trade balance excluding Colón Free Zone	**-4,057**	**-4,123**	**-5,047**	**-7,080**	**-7,768**	**-8,452**	**-8,850**	**-9,192**	**-9,564**	**-9,739**
Exports, f.o.b.	3,426	2,154	2,428	2,749	2,880	3,056	3,300	3,623	3,903	4,225
Imports, f.o.b.	-7,482	-6,277	-7,474	-9,830	-10,649	-11,508	-12,150	-12,815	-13,467	-13,964
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**	**572**	**606**	**639**	**675**	**716**	**764**	**769**
Re-exports, f.o.b.	8,599	9,883	10,252	11,946	12,786	13,593	14,462	15,421	16,543	16,735
Imports, f.o.b.	-8,592	-7,941	-9,761	-11,375	-12,180	-12,954	-13,788	-14,706	-15,779	-15,965
Services, net	**2,511**	**2,978**	**3,074**	**3,812**	**4,258**	**4,464**	**4,676**	**5,219**	**6,077**	**6,529**
Travel, net	1,042	1,146	1,279	1,465	1,557	1,688	1,879	2,043	2,247	2,486
Transportation, net	1,215	1,576	1,451	1,938	2,248	2,279	2,256	2,590	3,201	3,391
Other services	254	256	344	409	454	497	540	586	630	651
Income, net	**-1,507**	**-1,449**	**-1,859**	**-1,980**	**-2,126**	**-2,128**	**-2,329**	**-2,403**	**-2,515**	**-2,709**
Private sector	-960	-844	-1,225	-1,321	-1,450	-1,573	-1,703	-1,839	-1,980	-2,005
Public sector	-547	-605	-634	-658	-676	-556	-625	-563	-535	-704
Of which : NFPS interest	-622	-620	-669	-675	-684	-564	-633	-572	-544	-713
Of which : related to Canal Expansion				-41	-84	-110	-114	-113	-115	-115
Current transfers, net	**532**	**472**	**491**	**582**	**646**	**705**	**768**	**833**	**896**	**923**
Capital and financial account	**2,407**	**332**	**2,615**	**3,394**	**4,405**	**4,794**	**5,110**	**4,897**	**4,443**	**4,327**
Financial account	**2,351**	**302**	**2,573**	**3,351**	**4,362**	**4,751**	**5,067**	**4,855**	**4,400**	**4,284**
Public sector	209	1,706	306	1,297	554	1,247	503	443	222	-84
Nonfinancial public sector	187	1,676	270	1,268	525	1,218	474	414	193	-113
Other net flows	22	30	36	36	36	36	36	36	36	36
Private sector, medium and long-term	1,077	-78	4,040	3,560	3,143	3,390	3,639	3,800	3,934	4,000
Direct investment	2,147	1,259	2,350	2,780	3,128	3,462	3,825	4,128	4,438	4,686
Portfolio investment	-555	-1,021	-1,170	-1,431	-1,300	-1,485	-1,703	-1,953	-2,235	-2,483
Loans	-515	-316	2,859	2,211	1,315	1,413	1,517	1,624	1,731	1,796
Short-term flows	1,065	-1,326	-1,773	-1,505	665	114	925	612	243	368
Errors and omissions	**778**	**558**	**-228**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**673**	**711**	**-460**	**-700**	**20**	**20**	**50**	**70**	**100**	**100**
Financing	**-673**	**-711**	**460**	**700**	**-20**	**-20**	**-50**	**-70**	**-100**	**-100**
Net foreign assets of the BNP	-667	-711	460	700	-20	-20	-50	-70	-100	-100
Memorandum items:	(In percent of GDP)									
Merchandise exports	14.9	8.9	9.1	8.7	8.2	8.0	7.9	8.0	8.0	8.5
Merchandise imports	32.5	26.1	28.1	31.2	30.5	30.2	29.2	28.4	27.8	27.9
Net exports from Colón Free Zone	0.0	8.1	1.8	1.8	1.7	1.7	1.6	1.6	1.6	1.5
Current account	-10.9	-0.7	-10.7	-13.0	-12.5	-12.5	-12.2	-10.7	-9.0	-8.5
Of which : related to Canal Expansion	-0.4	-0.4	-2.7	-3.9	-3.3	-3.3	-1.6	-0.8	-0.5	-0.5
Direct foreign investment	9.3	5.2	8.8	8.8	8.9	9.1	9.2	9.2	9.2	9.4
External public debt	35.7	40.1	36.0	31.8	29.2	29.1	27.1	25.2	23.1	21.6

Sources: Office of the Comptroller General; and Fund staff estimates and projections.

Table 7. Panama: Medium-Term Macroeconomic Framework

	2008	2009	2010	2011	2012	2013	Proj. 2014	2015	2016	2017
						(Percent change)				
Economic growth and prices										
Real GDP at market prices	10.1	3.2	7.5	10.0	7.5	7.0	6.3	6.2	5.5	5.4
CPI (period average)	8.8	2.4	3.5	5.9	5.5	5.0	4.5	4.0	4.0	4.0
CPI (end of period)	6.8	1.9	4.9	6.3	5.7	5.2	4.5	4.0	4.0	4.0
						(Percent of GDP)				
Savings and investment										
National savings	16.7	24.9	15.3	16.0	15.4	15.1	16.0	17.3	19.0	19.5
Public sector	9.7	8.6	7.7	8.7	9.4	9.5	9.3	10.0	11.6	12.2
Private sector	7.0	16.2	7.6	7.3	6.0	5.7	6.7	7.3	7.4	7.4
Gross domestic investment	27.6	25.6	26.0	29.0	28.0	27.7	28.2	28.0	27.9	28.0
Public sector	8.2	9.4	11.9	15.2	14.4	13.9	11.0	10.1	10.0	9.8
Of which: Canal Expansion	0.7	0.6	3.6	5.0	4.1	4.0	1.8	0.7	0.3	0.3
Private sector	19.4	16.2	14.1	13.8	13.6	13.8	17.2	17.8	18.0	18.2
External savings	-10.9	-0.7	-10.7	-13.0	-12.6	-12.5	-12.2	-10.7	-9.0	-8.5
Nonfinancial public sector, excluding ACP										
Revenue	26.1	25.4	25.9	26.7	27.0	26.7	26.4	27.0	27.8	28.1
Revenue, excluding ACP transfers	23.1	22.1	22.8	23.0	23.2	23.2	22.7	22.9	22.7	22.6
Expenditure	25.7	26.4	27.8	29.0	29.0	28.3	27.4	27.3	27.4	27.2
Primary balance	3.5	1.9	0.8	0.1	0.3	0.6	1.0	1.6	2.1	2.5
Overall balance	0.4	-1.0	-1.9	-2.3	-2.0	-1.5	-1.0	-0.2	0.4	0.9
Net external financing	0.8	6.4	1.1	1.1	0.6	0.6	0.4	0.2	-0.3	-0.9
Net domestic financing	-1.2	-5.4	0.8	1.2	1.4	0.9	0.6	0.0	-0.1	0.0
Panama Canal Authority (ACP)										
Revenue	8.7	8.1	7.4	6.7	6.9	6.5	6.2	6.1	7.0	6.8
Current expenditure	2.4	2.2	2.2	2.1	2.0	1.8	1.9	1.9	1.9	1.8
Transfers to the government	3.0	3.2	3.1	2.7	2.7	2.5	2.7	3.1	4.0	4.5
Interest payments	0.0	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.2	0.2
Capital expenditure	1.2	2.1	3.6	5.0	4.1	4.0	1.8	0.7	0.3	0.3
Overall balance	2.1	0.5	-1.5	-3.2	-2.2	-2.2	-0.3	0.1	0.5	-0.1
Nonfinancial public sector, including ACP										
Overall balance	2.5	-0.4	-3.4	-5.5	-4.3	-3.7	-1.3	-0.1	0.8	0.8
Total public debt 1/	41.1	43.5	40.5	36.8	35.2	35.5	33.6	31.2	28.7	27.0
o/w: ACP	0.0	1.4	3.5	3.0	4.6	4.2	3.8	3.5	3.3	3.1
External										
Exports, f.o.b., excluding Colón Free Zone	14.9	8.9	9.1	8.7	8.2	8.0	7.9	8.0	8.0	8.5
Imports, f.o.b., excluding Colón Free Zone	-32.5	-26.0	-28.1	-31.2	-30.5	-30.2	-29.2	-28.4	-27.8	-27.9
Net exports of Colón Free Zone	0.0	8.0	1.8	1.8	1.7	1.7	1.6	1.6	1.6	1.5
Current account balance	-10.9	-0.7	-10.7	-13.0	-12.6	-12.5	-12.2	-10.7	-9.0	-8.5
Foreign Direct Investment	9.3	5.2	8.8	8.8	8.9	9.1	9.2	9.2	9.2	9.4
						(In millions of U.S. dollars)				
Memorandum items:										
Nominal GDP	23,002	24,163	26,590	31,532	34,946	38,137	41,564	45,080	48,497	49,990
External debt (public, percent of total non-bank external debt)	66.1	75.8	71.5	67.2	61.6	63.6	59.3	57.4	54.7	52.8
External Debt (excluding banks, percent of GDP)	54.0	52.9	50.3	47.3	47.5	45.8	45.7	43.9	42.3	40.9
External Debt (including banks, percent of GDP) 2/	195.1	166.3	168.7	157.4	166.9	166.5	167.2	166.7	166.9	169.1

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Including ACP and net of Feduciary Fund' holdings of non-government assets.

2/ Includes offshore banks.

Table 8. Panama: Debt of the Nonfinancial Public Sector

	2008	2009	2010	Proj. 2011	Proj. 2012
	(In millions of U.S. dollars)				
External debt	**8,203**	**9,687**	**9,571**	**10,015**	**10,216**
Multilaterals	1,350	1,646	1,825	1,971	2,252
IBRD	271	435	420	399	436
IDB	948	1,073	1,284	1,310	1,409
Others	130	138	121	262	407
Bilateral and guaranteed suppliers	210	223	325	367	369
Commercial banks	170	219	217	216	216
Global bonds/1	6,473	7,599	6,863	6,530	6,448
ACP 2/	0	0	341	931	931
Domestic debt	**1,257**	**821**	**1,190**	**1,574**	**2,067**
Private creditors	828	519	894	1,278	1,771
Public financial institutions	429	302	296	296	296
Total Public debt	**9,460**	**10,508**	**10,762**	**11,589**	**12,283**
	(In percent of GDP)				
Total	**41.1**	**43.5**	**40.5**	**36.8**	**35.1**
External	35.7	40.1	36.0	31.8	29.2
Domestic	5.5	3.4	4.5	5.0	5.9
Memorandum items:					
Held by Fiduciary 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	2.5	2.2
GDP (in millions of U.S. dollars)	23,002	24,163	26,590	31,532	34,946

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Net of assets held by the Fiduciary Fund, excluding holdings of government securities.

2/ Disbursements from multilateral development banks and JBIC for the Panama Canal expansion.

Table 9. Panama: Vulnerability Indicators

	2008	2009	2010	Proj. 2011
Financial indicators				
Broad money (12-month percent change)	18.5	9.4	11.6	8.9
Private sector credit (12-month percent change)	14.6	1.3	13.6	17.8
Deposit rate (6-month; in percent) 1/	3.5	3.5	3.5	...
External indicators				
Merchandise exports (12-month percent change)	75.5	-37.1	12.7	13.2
Merchandise imports (12-month percent change)	33.7	-16.1	19.1	31.5
Current account balance (in percent of GDP)	-10.9	-0.7	-10.7	-13.0
Capital and financial account balance	10.5	1.4	9.8	10.8
Of which: direct investment	9.3	5.2	8.8	8.8
Public sector external debt	35.7	40.1	36.0	31.8
In percent of exports of goods and services 2/	95.1	104.4	110.8	96.9
External interest payments (in percent of Exports of goods and services) 2/	6.4	6.0	7.8	6.5
External amortization payments (in percent of Exports of goods and services) 2/	10.7	2.3	2.0	4.6
REER, percent change (depreciation -) 3/	-1.3	2.0	-2.1	...
Gross international reserves at end of period				
In millions of U.S. dollars 4/	2,710	3,424	2,975	2,275
In months of imports of goods and services	3.2	4.8	3.3	1.9
In percent of broad money	13.3	15.4	12.0	8.4
In percent of short-term external debt 5/	1,285	1,992	620	600
	(In millions of U.S. dollars)			
Memorandum items:				
Nominal GDP	23,002	24,163	26,590	31,532
Exports of goods and services 2/	8,629	9,275	8,641	10,331

Sources: Ministry of Economy and Finance; and Fund staff estimates and projections.

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/ Average.

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

5/ Short-term public external debt includes amortization in the following year. Excludes global bonds debt exchange operations.

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

	2008	2009	2010	Proj. 2011
	(In percent of GDP)			
Net international investment position	**-79.5**	**-66.3**	**-64.2**	**-59.3**
Assets	**200.5**	**176.9**	**179.1**	**169.0**
Portfolio investment abroad	38.2	35.1	35.1	33.6
of which: debt securities	27.7	27.7	27.7	27.7
Other investment	143.1	123.5	128.8	120.6
Trade credits	15.3	13.5	12.6	12.6
Loans (short term, to banks)	81.1	65.8	59.2	61.6
Currency and deposits	38.9	34.2	38.5	35.6
Other assets	7.9	10.1	14.3	10.8
Reserve assets	19.1	18.2	19.2	14.9
Liabilities	**280.0**	**243.2**	**243.3**	**228.3**
Direct investment inward	84.9	76.9	74.6	70.9
Portfolio investment	34.1	33.4	30.4	26.6
of which debt securities	34.1	33.4	30.4	26.6
Financial derivatives	0.0	0.0	0.0	0.0
Other investment	161.0	132.9	138.4	130.8
Trade credits	5.5	4.4	4.6	4.3
Loans	41.1	32.5	48.9	55.4
Monetary authorities	0.4	0.3	0.3	0.3
General government	8.4	8.2	8.5	7.1
Banks	27.6	19.5	35.3	41.5
Long-term	11.2	7.5	16.1	20.9
Short-term	16.5	12.0	19.2	20.6
Other sectors	4.7	4.5	4.8	6.5
Currency and deposits	109.7	91.3	80.4	66.2
Other liabilities	4.7	4.6	4.5	5.0

Sources: Panamanian authorities, other reporting agencies, and Fund staff calculations.

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

(In percent of GDP)

				Proj.						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	26.1	25.4	25.9	26.7	27.0	26.7	26.4	27.0	27.8	28.1
Taxes	10.6	10.9	11.6	11.9	12.1	12.3	12.4	12.7	12.7	12.7
Social contributions	5.8	5.7	6.2	6.1	6.0	5.8	5.6	5.4	5.2	5.1
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	8.1	8.6	8.8	8.6	8.4	8.9	9.7	10.3
Expenditure	25.7	26.4	27.8	29.0	29.0	28.3	27.4	27.3	27.4	27.2
Expense	15.6	16.2	16.8	16.4	16.5	16.3	16.1	16.0	16.0	16.1
Compensation of employees	6.1	6.2	6.5	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	3.4	3.3	3.3	3.2	3.2	3.2	3.3
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	2.1	2.0	1.8	1.7	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	4.9	4.3	4.4	4.4	4.3	4.3	4.4	4.4
Other expense	1.7	2.2	2.6	1.9	1.9	1.9	1.9	1.7	1.7	1.7
Net acquisitions of financial assets	7.0	7.3	8.3	10.2	10.2	9.9	9.2	9.4	9.7	9.5
Acquisitions of nonfinancial assets	7.0	7.3	8.3	10.2	10.2	9.9	9.2	9.4	9.7	9.5
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	9.1	10.3	10.5	10.4	10.3	11.1	11.7	12.0
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	-2.0	-1.5	-1.0	-0.2	0.4	0.9
Statistical Discrepancy	0.0	0.2	0.0	-3.4						
Transactions in financial assets and liabilities	-0.4	1.2	1.9	-1.1	...	...	...	...	...	...
Net acquisition of financial assets	-0.1	-1.2	-0.2	-2.2	...	...	...	...	...	...
Currency and deposits (foreign)	0.0	-0.1	-0.1	0.0	...	...	...	...	...	...
Debt securities (domestic)	-0.2	-1.1	-0.1	-2.2	...	...	...	...	...	...
Net incurrence of liabilities	-0.3	2.4	2.1	1.1	...	...	...	...	...	...
Debt securities (foreign)	0.0	5.5	0.0	0.1	...	...	...	...	...	...
Loans (domestic)	-0.9	-4.0	1.0	0.0	...	...	...	...	...	...
Loans (foreign)	0.6	0.9	1.1	1.1	...	...	...	...	...	...

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

1/ Excludes Panama Canal Authority.

Table 12. Panama: Public Sector Debt Sustainability Framework, 2008-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Proj.							Debt-
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2017	stabilizing primary balance 9/
1 **Baseline: Public sector debt 1/**	41.1	43.5	40.5			**36.8**	**35.2**	**35.5**	**33.6**	**31.2**	**28.7**	**27.0**	**0.8**
o/w foreign-currency denominated	35.7	40.1	36.0			31.8	29.2	29.1	27.1	25.2	23.1	21.6	
2 Change in public sector debt	-6.9	2.4	-3.0			-3.7	-1.6	0.3	-1.9	-2.4	-2.5	-1.7	
3 Identified debt-creating flows (4+7+12)	-9.2	-1.5	-0.3			-0.8	0.4	0.5	-2.2	-3.4	-4.8	-4.2	
4 Primary deficit	-5.6	-2.5	0.9			3.2	1.7	1.4	-1.2	-2.7	-4.3	-5.0	
5 Revenue and grants	29.4	28.0	27.8			28.5	29.2	28.8	28.4	28.8	30.3	30.9	
6 Primary (noninterest) expenditure	23.8	25.6	28.7			31.6	30.8	30.2	27.2	26.1	26.0	25.9	
7 Automatic debt dynamics 2/	-3.6	0.9	-1.3			-3.9	-1.3	-0.9	-0.9	-0.8	-0.5	0.8	
8 Contribution from interest rate/growth differential 3/	-3.6	0.9	-1.3			-3.9	-1.3	-0.9	-0.9	-0.8	-0.5	0.8	
9 Of which contribution from real interest rate	0.6	2.2	1.7			-0.5	1.2	1.4	1.1	1.1	1.1	2.3	
10 Of which contribution from real GDP growth	-4.2	-1.3	-3.0			-3.4	-2.5	-2.3	-2.1	-1.9	-1.6	-1.5	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0			...	...	...	...	...	...	...	
12 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	
13 Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 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	
15 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	
16 Residual, including asset changes (2-3) 5/	2.3	3.9	-2.7			-3.0	-2.0	-0.2	0.2	1.0	2.3	2.5	
Public sector debt-to-revenue ratio 1/	139.8	155.0	145.8			129.1	120.6	123.2	118.2	108.3	94.6	87.3	
Gross financing need 6/	3.2	7.6	7.4			8.6	5.9	6.4	1.4	3.2	-2.1	-2.8	
in billions of U.S. dollars	734	1,828	1,973			2,699	2,068	2,423	572	1,423	-995	-1,394	
Scenario with key variables at their historical averages 7/						**34.1**	**34.1**	**28.9**	**25.5**	**22.5**	**20.4**	**19.7**	**-0.2**
Scenario with no policy change (constant primary balance) in 2011-2016						**34.5**	**32.3**	**32.2**	**32.6**	**33.8**	**36.5**	**40.9**	**1.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline				10-Year Historical Average	10-Year Standard Deviation								
Real GDP growth (in percent)	10.1	3.2	7.5	6.3	3.7	10.0	7.5	7.0	6.3	6.2	5.5	5.4	
Average nominal interest rate on public debt (in percent) 8/	7.6	7.5	6.9	7.4	0.4	7.1	7.0	6.5	6.2	6.0	5.9	6.0	
Average real interest rate (nominal rate minus change in GDP deflator, in	2.0	5.7	4.5	5.2	1.3	-0.7	3.9	4.5	3.7	3.8	3.9	8.2	
Nominal appreciation (increase in US dollar value of local currency, in per	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.5	1.8	2.4	2.2	1.3	7.8	3.1	2.0	2.5	2.2	2.0	-2.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	21.6	10.9	20.6	9.3	7.2	21.3	4.8	4.9	-4.4	2.0	5.2	4.9	
Primary deficit	-5.6	-2.5	0.9	-2.9	2.8	3.2	1.7	1.4	-1.2	-2.7	-4.3	-5.0	

1/ Nonfinancial public sector including Panama Canal Authority.
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. Negative sign implies accumulation of assets.
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.

ANNEX I. REAL ESTATE MARKET DEVELOPMENTS AND MACROPRUDENTIAL POLICY

1. **Panama's real estate market has been highly dynamic in recent years, in line with strong economic growth and low unemployment.**[1] In spite of very rapid construction growth in the years prior to the global financial crisis, the sector achieved a soft landing during the economic slowdown of 2008–09 (Annex I, Figure 1). Investment in luxury residential properties was sustained by safe-haven inflows from the region, which substituted in part for lower demand from advanced economies. Although the share of construction and mortgage lending in bank portfolios rose to 28.5 percent by end-2008, banks managed their exposures to the construction sector quite conservatively, mainly through self-imposed lending limits. While 2009 saw a sharp slowdown in housing activity and overall credit growth, starting in 2010 construction activity rebounded strongly. New constructions shifted to lower-value housing for the domestic market, and, increasingly, to commercial and industrial real estate propelled by Panama's ambitious public investment program (Annex II, Figure 1).

2. **Although there is no clear evidence of a property market bubble (partly due to data gaps), market participants indicate that prices of prime residential and industrial real estate are rising rapidly**. By contrast, signs of excess supply in the commercial segment are emerging, with prices of office space declining by about 10 percent during 2010-11 and the share of pre-sold commercial units to be finished in 2012 running at a low 50 percent. There is also anecdotal evidence that developers have started to rent unsold units to meet the demand from middle and high-level expatriate staff of multinational companies. Going forward, softer economic activity and lower safe-haven investments may reduce demand and increase the inventories of finished units.

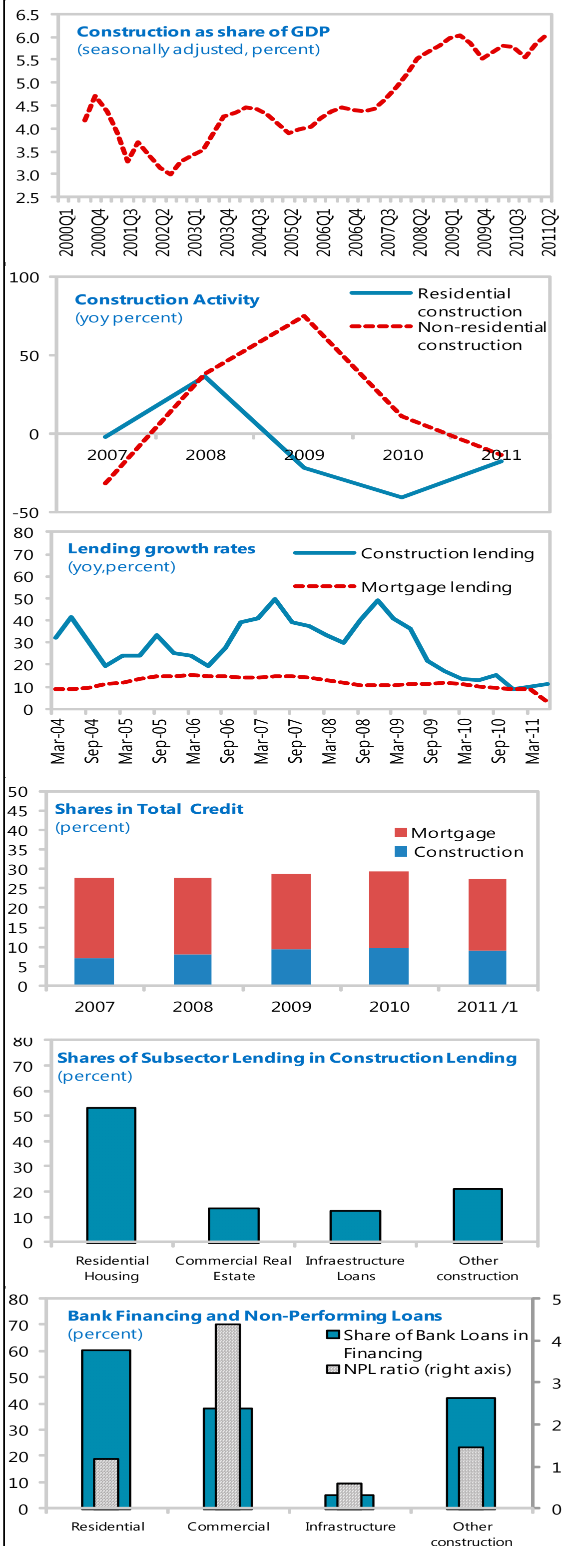
3. **In the absence of monetary policy tools, macroprudential policy can play an important role in managing demand and safeguarding sound credit expansion**. As banking practices become more competitive in an environment of low interest rates, macroprudential policy can help prevent or reduce the severity of asset price bubbles by limiting the leverage of borrowers relative to market values or income. Commonly-used instruments include limits on the loan-to-value ratio as well as on the relation between debt or debt service to household income. Other economies with hard pegs and a macro-critical housing sector (e.g. Hong Kong SAR and Singapore) are actively and successfully using those types of instruments to influence market and price

[1] Prepared by T. Wezel.

developments, sometimes adjusting limits as market dynamics change.[2]

4. **Panama's macroprudential policy framework is at an incipient stage.** However, the current juncture consisting of a dynamic domestic economy, low U.S. interest rates, and a rapidly deteriorating global outlook, should provide an impetus for developing additional demand management tools. Self-imposed restrictions by banks on clients' leverage and general exposure limits cannot be relied upon to deliver desirable aggregate outcomes. Moreover, property market developments are monitored through periodic surveys of construction activity, but information on market prices and other property market indicators is not collected. Similarly, data on household or corporate indebtedness is not compiled for prudential purposes. A key FSAP recommendation is therefore to step up data collection to allow the calculation of price indices and other market indicators on an ongoing basis. Information on the credit burden of households should also be made available. Beyond pure market surveillance, the authorities should be ready to enforce limits on loan to value or debt (service) to income ratios, should developments in certain market segments warrant such actions. More generally, the use of such countercyclical tools should be embedded in an institutional framework for macroprudential policy.

Annex I Figure 1. Panama: Real Estate Sector Developments



1/ Data for Q1 and Q2 2011.

Source: Superindendency of Banks, and IMF staff calulations.

2 Wong, E., T. Fong, K. Li and H. Choi, "Loan-to-Value Ratio as a Macro-Prudential Tool – Hong Kong's Experience and Cross-Country Evidence", Hong Kong Monetary Authority Working Paper 01/2011.

ANNEX II. EXTERNAL STABILITY AND COMPETITIVENESS

1. **This annex analyzes Panama's external stability and competitiveness using several methodologies to assess the level of the real effective exchange rate (REER) and non-price survey-based indicators**.[1] Despite the large deficits as a share of GDP, the analysis suggests that Panama's current account developments are consistent with external stability, and that there are no major external vulnerabilities. Results from three quantitative methodologies suggest that, as of end-2010, the real effective exchange rate was broadly in line with fundamentals. Survey data analysis indicates that Panama's competitiveness is dampened by structural factors related to institutions, human capital development and skills' allocation through the labor market (Annex II, Figure 1).

External Stability

2. **Panama's external current account (CA) is projected to post deficits in excess of 10 percent of GDP through 2014 before returning to its long-term norm of 5–7 percent by 2016–17**. The external CA moved from near balance in 2009 to a projected deficit of 13 percent of GDP in 2011, primarily owing to a surge in capital goods imports related to the canal expansion and the public investment program. Although Foreign Direct Investment (FDI) inflows are expected to continue financing the bulk of the external current account deficits in the coming years, questions about the sustainability of those deficits are pertinent.

3. **The composition of imports and FDI do not suggest that Panama's external accounts are on an unsustainable path, but downside risks exist.** Imports growth in 2011 has been mostly driven by capital goods related to the Panama Canal expansion and public investment projects. Although FDI remains strong, Panama could be vulnerable to a sharp deterioration of economic conditions in countries which are the main sources of inward FDI such as the U.S. and Spain (Figure 5), particularly as a large share of FDI consists of reinvested earnings.

4. **An analysis of the composition of external assets and liabilities does not reveal major vulnerabilities, though private external debt liabilities are relatively high**. The estimates of Panama's International Investment Position suggest that private external debt liabilities have been rising over time, reaching 127 percent of GDP at end-2010. However, most of these represent increased loan liabilities of offshore banks rather than external debt exposures of on-shore Panamanian households or companies.

REER Assessment

5. **Panama's Nominal Effective Exchange Rate (NEER) and the CPI-based Real Effective Exchange Rate (REER) are much lower than their end-2008 peak.** However, in 2011, reflecting the uncertain

[1] Prepared by P. Muthoora.

global external environment, the NEER appreciated in line with movements in the dollar, while the REER rose also owing to high domestic inflation (Annex II, Figure 1). Panama's inflation is projected to remain somewhat above that of major trading partners, particularly the U.S, in the near future, which could dent competitiveness.

6. **Results from the exchange rate assessment as of end-2010, using three standard methodologies, are somewhat ambiguous but do not suggest significant REER misalignment** (Table 1). While the macroeconomic balance approach and the external sustainability approach suggest overvaluation of 8.1 and 7.8 percent respectively, the equilibrium Real Exchange Rate (RER) method suggests an undervaluation of about -10.5 percent. As is well known, these estimates are very sensitive to key parameter assumptions (such as the elasticity of the current account balance to the REER) and to the estimated current account norm.

7. **The macroeconomic balance approach relies on an estimate of a current account norm, based on fundamental determinants of the current account balance.** The determinants used in the calculations are the fiscal balance, the old-age dependency ratio, population growth, the oil balance, relative GDP per capita growth and output growth. Using coefficients from the pooled estimation in Lee et al. (2008), the current account norm is estimated at about -4.7 percent of GDP. Given an estimated elasticity of the current account balance to the REER of 0.25,[2] the REER depreciation required to close the gap between the norm and the underlying current account balance in 2016 is estimated to be 8.1 percent.[3]

8. **The external sustainability approach estimates the current account to GDP ratio needed to stabilize the net foreign asset (NFA) position of the country**.[4] In this case, it is assumed that Panama's NFA position in 2007, -87 percent of GDP, is close to its long-term equilibrium level.[5] The approach then calculates the corresponding NFA-stabilizing current account balance, estimated here at -6.6 percent of GDP. Using the elasticity estimate of 0.25, the results suggest an exchange rate misalignment of 7.8 percent.

9. **Under the equilibrium exchange rate approach the degree of misalignment is calculated as the deviation of the actual REER from its estimated value**. To obtain the equilibrium real exchange rate, the dynamic OLS coefficient estimates are applied to Panama

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[2] The elasticity of 0.25 is the current account balance elasticity obtained for Panama in Tokarick (Tokarick, 2010, "A method for Calculating Export Supply and Import Demand Elasticities," IMF Working Paper 10/180).

[3] This coincides with the end of the WEO projection period for the calculation of the underlying current account balance.

[4] The NFA position is obtained from Lane and Milesi-Ferretti (2009). This measure of the NFA is based on adjusted FDI and reserve assets figures and differs from the authorities' estimates.

[5] The choice of 2007 as the reference year allows to focus on a level of NFA that is not affected by the expansion of the Panama canal or the 2008-09 slowdown.

data.[6] The fundamentals included are the terms of trade, the public consumption to GDP, and investment-to-GDP ratios, trade openness, and the relative real GDP per capita to proxy for the productivity differential between Panama and its major trading partners. Estimates suggest that as of end-2010 Panama's REER was some 10.5 percent below equilibrium.

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

	CA Norm	NFA to GDP	NFA-stabilising CA	Underlying CA	Gap	Elasticity	Misalignment
MB	-4.7			-6.7	-2.0	-0.25	8.1
ES		-87.1	-6.5	-8.5	-1.9	-0.25	7.8
EER							-10.5

Survey-Based Indicators of Competitiveness

10. **Panama's ranking in various competitiveness surveys has improved in recent years.** Overall, competitiveness surveys (based either on perceptions or objective measures) highlight several areas of strength, including financial development, infrastructure, macroeconomic and political stability, and openness to trade. At the same time, results indicate that Panama's main weaknesses relate to institutions, health and education, and labor markets.[7]

11. **In the latest DB assessment (DB 2012),[8] Panama ranked 61st out of 183 economies.** This represents a marginal improvement relative to the 2011 assessment when Panama was placed 63rd. Panama scores well on trading across borders, but is at a disadvantage against all comparator countries (Latin America and Caribbean average) with regards to registering property, protecting investors, paying taxes, and enforcing contracts.

12. **According to the GCI, Panama ranks 49 out of 142 countries in 2011–12 (up from 53 in 2010–11**). Table 2 provides a comparison of the rankings of Panama with Singapore (ranked second) and the five largest Latin American economies. Panama's rankings on individual pillars suggest that its relative strengths are its financial development, infrastructure, technological readiness, macroeconomic environment and business sophistication. At the same time, according to the survey, Panama's key weaknesses lie in human capital development and labor markets. It scores poorly with regards to the delivery of health care and primary education, provision of on-the-job training and the allocation of labor resources.

13. **The 2010 World Governance Indicators show that Panama lags behind Singapore on all indicators**

[6] Lee et al, 2008, "Exchange Rate Assessments: CGER Methodologies," International Monetary Fund, Occasional Paper 261.

[7] The surveys reviewed are the World Bank Doing Business (DB) Indicators; the World Economic Forum's Global Competitiveness Index (GCI) and the Worldwide Governance indicators.

[8] The data for all indicators of the Doing Business Assessment 2012 are for end-June 2011, except for data on paying taxes which are for January-December 2010. The methodology was modified for three of the indicators (Getting credit, Dealing with Construction Permits and Paying taxes) in the 2012 DB assessment. Consequently, Panama's 2011 ranking was revised from 72nd to 63rd. Comparisons over time with the new methodology are only possible for the updated 2011 and the 2012 rankings.

except voice and accountability. The World Governance Indicators, developed by Kaufmann et al. (2010) provide additional dimensions with which to assess the external competitiveness of economies. They assign scores to countries on 6 indicators of governance, notably: control of corruption; government effectiveness; political stability and absence of violence/terrorism; regulatory quality; rule of law and voice and accountability. Each dimension is assigned a score from -2.5 to 2.5 (indicating better governance). Based on the 2010 scores, shown in Figure 2, it would appear that Panama falls behind Singapore on all indicators except voice and accountability. However, except for Chile, Panama fares better than the large emerging markets of Latin America on most indicators of governance.

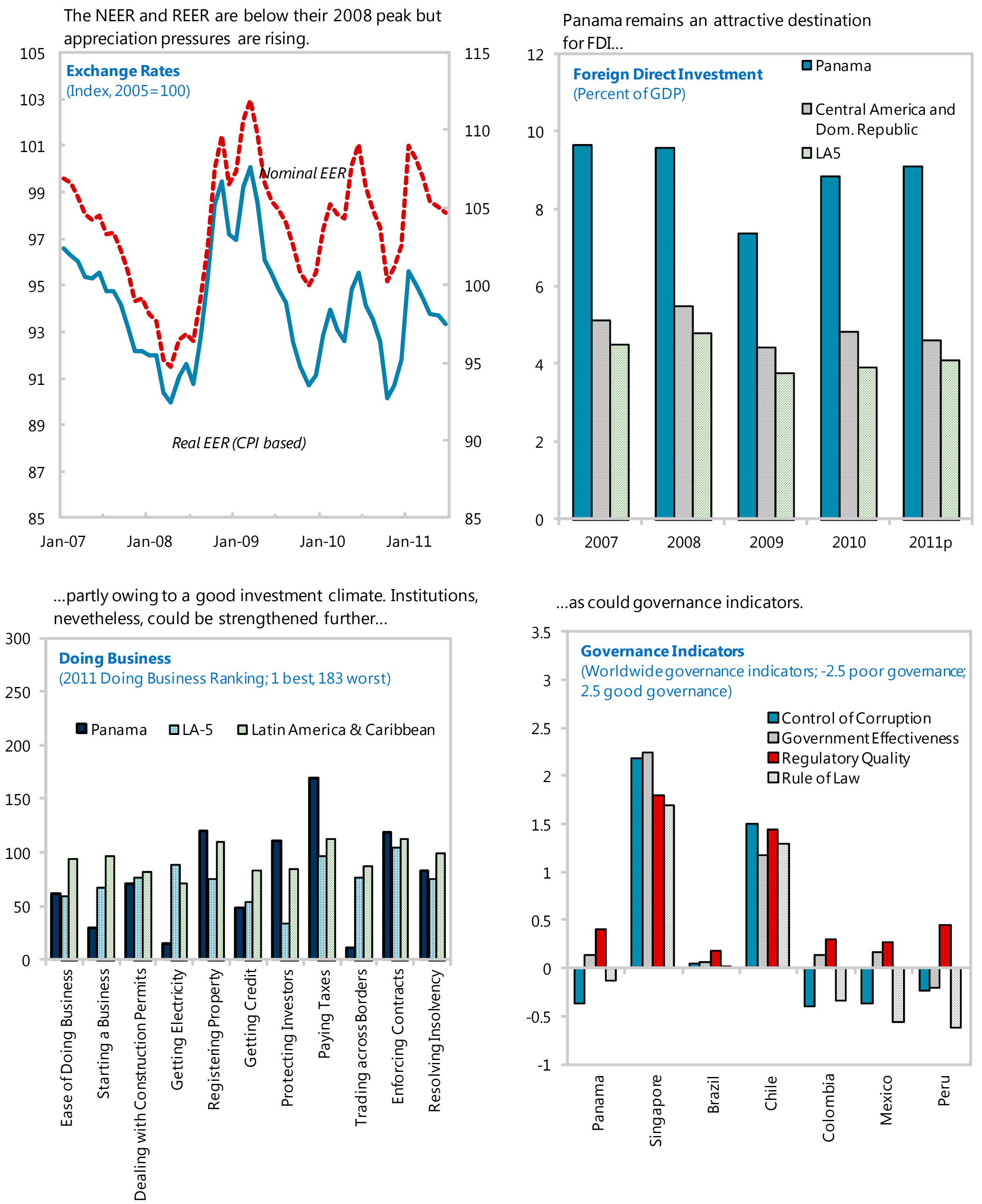
14. **The authorities have identified several key areas to promote Panama's competitiveness, and ongoing efforts and initiatives aim at reducing bottlenecks**. A special secretariat has been established to coordinate the development strategy of logistics-related activities and remove remaining bottlenecks to further expansion. A new initiative by the Ministry of Education seeks to involve private sector enterprises in providing training to students to better align supply and demand for skills. Strengthening security; reinforcing institutions (especially the judiciary); and the introduction of a bankruptcy law are other elements of the government's competitiveness strategy.

Table 2. Global Competitiveness Rankings: Panama, Singapore and LA5 Countries

		Panama	Singapore	LA5	Brazil	Chile	Colombia	Mexico	Peru
	Overall GCI Ranking	49	2	55	53	31	68	58	67
	Ranking on Pillars:								
1	Institutions	75	1	80	77	26	100	103	95
2	Infrastructure	38	3	69	64	41	85	66	88
3	Macroeconomic Environment	41	9	52	115	14	42	39	52
4	Health and Primary Education	79	3	80	87	71	78	69	97
5	Higher Education and Training	78	4	62	57	43	60	72	77
6	Good Market Efficiency	46	1	74	113	25	99	84	50
7	Labor Market Efficiency	115	2	73	83	39	88	114	43
8	Financial Market Development	27	1	52	43	37	68	72	38
9	Technological Readiness	40	10	61	54	45	75	63	69
10	Market Size	85	37	29	10	46	32	12	43
11	Business Sophistication	46	15	55	31	39	61	56	89
12	Innovation	72	8	65	44	46	57	63	113

Source: World Economic Forum Global Competitiveness Report 2011-2012.

Annex II Figure 1. Panama: Competitiveness Indicators



Source: National Authorities, World Economic Outlook, World Bank Doing Business data, Worldwide Governance Indicators and IMF staff calculations.
1/ LA5 refers to Brazil, Chile, Colombia, Mexico and Peru.

INTERNATIONAL MONETARY FUND

PANAMA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 24, 2012

Prepared By: The Western Hemisphere Department

CONTENTS

ANNEX 1. FUND RELATIONS

(As of November 30, 2011)

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	170.90	86.75

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	0.05	0.05	0.05	0.05
Total	0.05	0.05	0.05	0.05

[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

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 2010 Article IV consultation was concluded on July 12, 2010. Panama is on the standard 12-month consultation cycle. 2011 Consultation was delayed to align with the Financial Sector Assessment Program (FSAP) process.

XIII. FSAP: FSAP concluded in September 2011. It confirmed the banking sector's strength and resilience to potential shocks, noting nonetheless that there 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 areas 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 GFSM2001 manual. In the *financial area*, TA concentrated mostly on improving data compilation on a regional level, and of non-financial groups.

XV. Resident Representative: None.

ANNEX 2. RELATIONS WITH THE WORLD BANK-UNDER JMAP

Title	Products	Provisional Timing of Missions	Expected Delivery Date
Bank Work Program	First Programmatic Management and Efficiency of Expenditures DPL	November 2011	April 2012 December 2011
	Implementation of Panama Maritime Strategy	October 2011	September 2016
	Enhanced Public Sector Efficiency Technical Assistance Loan	November 2011	
	Metro Water and Sanitation Improvement Project	October 2011	September 2015
	Health Equity and Performance Improvement Project	December 2011	June 2013
	Social Protection Project	November 2011	June 2012
	Water Supply and Sanitation in Low-Income Communities	October 2011	May- 2012
	Rural Productivity Project	November 2011	January 2013
	Rural Productivity Project (GEF)	October 2011	June 2013

ANNEX 3. RELATIONS WITH INTERAMERICAN DEVELOPMENT BANK

(As of December 2011)

1. In 2011, the IDB disbursed US$181.47 millions, of which, US$100 million correspond to budget support from the "Program of Reducing Vulnerability to Natural Disasters and Climate Change". The Bank also approved US$220 million for four different sectors: an emergency loan for the flooding (US$20 million), health sector (US$ 50million), fiscal management (US$ 50million), and natural disasters and climate changes (US$100 million).

Panama: Relations with the Inter-American Development Bank

(As of December 31, 2011, in millions of U.S. dollars)

A. Operations

Sector	Approved	Disbursed	Undisbursed Amounts
Sanitation	234.0	82.2	151.8
Education	88.1	58.1	30.0
Urban Dev. And Housing	30.0	6.5	23.5
Energy	42.5	15.7	26.8
State Modernization	100.4	27.0	73.5
Science and Technology	19.7	8.8	10.9
Integration and trade	4.7	4.1	0.6
Social Investment	20.2	9.3	10.8
Capital and financial	56.3	16.1	40.2
Transportation	140.0	53.3	86.7
Environmental and rural Dev.	68.1	44.6	23.6
Health	50.0	0.0	50.0
Disaster Prevention	120.0	113.9	6.1
Total	974.1	439.5	534.6

Source: IDB.

B. Loan Transactions

	2007	2008	2009	2010	2011 p
Disbursements	74.9	126.8	216.8	302.2	190.4
Repayments	81	89.4	91.4	92.9	107.7
Net Lending	-6.1	37.4	125.4	209.3	82.7
Interests and Charges	44.1	45.9	45.4	49.7	51.9
Subscriptions and Contributions	1.6	0	3	0.7	0
Net Transfer	-51.8	-8.5	77	158.9	30.8

Source: IBD.

ANNEX 4. STATISTICAL ISSUES

1. Progress has been achieved in improving the accuracy, timeliness, and publication of economic statistics. Data provided to the Fund are generally adequate for surveillance. However, there is a need to address methodological weaknesses in foreign trade calculations and to improve the consistency between the national accounts and the external sector accounts. Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000. However, the metadata and plans for improving the statistical system that are posted on the Dissemination Standards Bulletin Board (DSBB) need updating. Following an SDDS assessment mission conducted by the Statistics Department in April 2011, the authorities agreed on a work program aimed at meeting the requirements for Panama's subscription to the SDDS. The work program envisages that Panama could become an SDDS participant by 2013,

Real Sector

2. National accounts data are released with a lag of approximately three months. The index of monthly economic activity is released with a lag of up to two months. 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 in early 2012.

3. A population census was conducted in May 2010 and results were published in 2011.

4. 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.

5. A new Household Income and Expenditure Survey was conducted during 2007–08, and the National Institute of Statistics and Census the base, basket, and weights of the CPI.

Government Finances

6. The Ministry of Finance compiles budget execution data for the central government and data on nonfinancial public sector operations (central government, public enterprises, and agencies) on a cash basis. Monthly and quarterly data have been reported up to November 2011 for the budgetary central government operations (www.mef.gob.pa).

7. 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 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. It would also be necessary to timely compile and disseminate information on these entities. The authorities are receiving technical assistance from Statistics Department (STA)/Central America Technical Assistance Center (CAPTAC) to implement the government Finance Statistics Manual 2001 (GFSM 2001) and 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 the public accounting and adopting accrual accounting under International Public Sector Accounting Standards (IPSAS). In 2011, FAD assessed Panama's progress in implementing Single Treasury Account and improving government accountability and internal audit. While the authorities took important steps in improving these areas, further work would be needed to achieve compliance with international best practices.

Monetary Accounts

8. Panama has been publishing financial sector data based on the new standardized report forms (SRFs) for monetary statistics in the International Financial Standards Supplement since March 2007 and participates in a regional project for harmonizing monetary and financial statistics in Central America and the Dominican Republic, supported by CAPTAC. The aim is to facilitate cross-country comparison and regional analysis. Provision of monthly data by the two public financial institutions, the National Bank of Panama and the Savings Bank (Caja de Ahorros), is regular and prompt. Monthly data on the operations of the domestic and international commercial and savings banks is prepared by the Superintendency of Banks, and posted on its website (www.superbancos.gob.pa) and reported to STA with a lag of one to two months. The state-owned development banks, the Agricultural Development Bank, and the Mortgage Bank are not regulated by the Superintendency of Banks and no data are reported to the Fund.

Balance of Payments

9. Weaknesses in foreign trade flows calculations, particularly in 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 is available with a delay of about one quarter, and is 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. Quarterly International Investment Position (IIP) data have been compiled since 2002, and annual data are available since 1998.

Panama: Table of Common Indicators Required for Surveillance

(As of November 30, 2011)

	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]	Memo Items: Data Quality–Accuracy and Reliability[8]
Exchange Rates	Fixed	NA	NA	NA	NA		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/2011	11/2011	M	M	A		
Reserve/Base Money	NA	NA	NA	NA	NA	NA, O, NA, LO	LO, O, O, O, NA
Broad Money	10/2011	11/2011	M	M	M		
National Bank of Panama Balance Sheet	10/2011	11/2011	M	M	A		
Consolidated Balance Sheet of the Banking System	10/2011	11/2011	M	M	M		
Interest Rates[2]	10/2010	11/2011	M	M	M		
Consumer Price Index	11/2010	12/2011	M	M	M	O, LNO, LO, LO	LO. LO. LO. O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	9/2011	11/2011	Q	Q	Q	LO, LNO, LO, O	O, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	9/2011	11/2011	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/2011	11/2011	M	M	M		
External Current Account Balance	9/2011	12/2011	Q	Q	Q	LO, LO, O, LO	LO, O LO, LO, LNO
Exports and Imports of Goods and Services	9/2011	12/2011	M	M	M		
GDP/GNP	Q2/2011	6/2011	Q	Q	Q	O, O, O, LO	LO, LO, LNO, LO, LNO
Gross External Debt	10/2011	11/2011	M	M	M		
International Investment Position [9]	2010	6/2011	A	A	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] 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 row, 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), largely 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
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/26
FOR IMMEDIATE RELEASE
March 16, 2012

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

IMF Executive Board Concludes 2011 Article IV Consultation with Panama

On February 22, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.[1]

Background

Panama's economy rebounded quickly following the 2008–09 global crisis. Supported by strong fundamentals, political stability, and prudent fiscal management, real GDP growth rates have been among the highest in the region. Macroeconomic stability and policies to foster greater social inclusion have reduced unemployment to historic lows and improved poverty indicators.

Following the 2009 slowdown, output grew by 7½ percent in 2010, and may grow by 10 percent for the year in 2011. Construction, commerce and transportation have been the most dynamic sectors, while canal traffic has been buoyed by strong demand from emerging Asia and South America. High international commodity prices, combined with Value Added Tax (VAT) and minimum wage increases, have pushed inflation above historical averages, with inflation in 2011 projected to be above 6 percent. The fiscal stance remained moderately expansionary in 2010–11, adding to domestic demand pressures. The widening of the external current account deficit has continued to be driven by strong capital goods imports, related to the canal

[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.

expansion, but Foreign Direct Investment flows have also increased. Bank credit to the private sector in 2010–11 grew at rates slightly above nominal GDP. A first-time Financial Sector Assessment Program (FSAP) conducted in September 2011 confirmed that the financial system is sound, and that it would remain adequately capitalized even under challenging external conditions.

Panama's macroeconomic outlook is favorable, with broadly balanced risks. The Panama Canal expansion and the large public investment program are expected to sustain domestic demand. Risks of overheating stemming from the strong domestic demand, tight labor markets and inflation are expected to be offset by the easing uncertainties in world commodity markets. Key medium-term challenges are to strengthen the fiscal framework, upgrade financial sector supervision and infrastructure, and improve the quality of education and training to enhance competitiveness and ensure sustained broad-based growth.

Executive Board Assessment

Executive Directors commended Panama's remarkable resilience to external turbulence, on the back of strong economic fundamentals and prudent policies. Robust economic growth and steady fiscal consolidation have contributed to lowering the public debt ratio. The growth outlook for 2012 is favorable, underpinned by large scale public investments, and overall vulnerabilities are low. The priorities going forward are to build policy buffers, further increase financial sector resilience, and foster sustained and more inclusive growth.

Directors considered that the envisaged neutral fiscal stance in 2012–13 is broadly appropriate, although many saw merit in a somewhat tighter fiscal stance to rebuild buffers more rapidly and help contain possible overheating pressures. With the implementation of the public investment program, Directors underscored the importance of continuing to strengthen the fiscal framework to enhance spending efficiency and improve public finance and liability management. Directors welcomed the authorities' efforts to strengthen revenue collection to provide room for social spending and to enhance the effectiveness of such spending by better targeting subsidies. They supported the plan to create a Sovereign Wealth Fund to save additional revenue from the expanded Panama Canal, noting that the Social and Fiscal Responsibility Law will need to be modified to anchor surpluses.

Directors welcomed the resilience of Panama's financial system, while supporting continued efforts to strengthen crisis prevention and the institutional and policy framework. They generally saw merit in the authorities' plans to establish a fund to respond to temporary liquidity shortages in the financial system while aiming to avoid moral hazard. They also saw scope for macroprudential tools in managing rapid credit growth in the absence of monetary policy.

Directors commended Panama's success in establishing a strong banking center, which has become an important regional hub. To compete globally and in a broader range of investment and wealth management services, Panama will need to upgrade its financial sector supervision and infrastructure. Risk based and consolidated banking supervision and oversight of non bank segments will need to be enhanced. Directors welcomed the authorities' commitment to complete an AML/CFT assessment by end 2012.

Directors noted that Panama's competitiveness has improved in recent years. The recently approved Free Trade Agreement with the United States is expected to boost further Panama's status as a regional logistics hub. To continue to attract investment and promote employment, Panama will need to further improve the business environment and the labor market. Directors also stressed the importance of enhancing human capital and improving access to basic services to foster inclusive growth.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Panama: Selected Economic Indicators

	2008	2009	2010	Proj. 2011
	(Annual percent change)			
Real economy				
Nominal GDP	16.2	5.0	10.0	18.6
Real GDP (1996 prices)	10.1	3.2	7.5	10.0
Consumer price index (average)	8.8	2.4	3.5	5.9
Consumer price index (end-of-year)	6.8	1.9	4.9	6.3
Money and credit				
Private sector credit	14.6	1.3	13.6	17.8
Broad money	18.5	9.4	11.6	8.9
Average deposit rate (1-year)	3.5	3.5	3.5	...
Average lending rate (1-year)	8.5	7.5	7.5	...
	(Percent of GDP)			
Saving and investment				
Gross domestic investment [1]	27.6	25.6	26.0	29.0
Gross national saving	16.7	24.9	15.3	16.0
Nonfinancial public sector				
Revenue and grants	34.9	33.5	33.3	33.4
Expenditure	32.4	33.9	36.7	38.9
Current, including interest	24.1	24.5	24.8	23.7
Capital	8.2	9.4	11.9	15.2
Overall balance	2.5	-0.4	-3.4	-5.5
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3
External sector				
Current account	-10.9	-0.7	-10.7	-13.0
Capital and financial account	10.5	1.4	9.8	10.8
Real effective exchange rate (depreciation -)	-1.3	2.0	-2.1	…
External public debt [2]	35.7	40.1	36.0	31.8
Memorandum items:				
GDP (in millions of US$)	23,002	24,163	26,590	31,532

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 Nogueira Batista, Exective Director for Panama and Mr. Alfred Maciá, Advisor to the Executive Director February 22, 2012

1. Our authorities welcome the constructive dialogue with staff in preparation of the Article IV consultation and the FSAP. They also value the Fund's technical assistance in the drafting of the sovereign wealth fund and the public-private partnership legislation. Both drafts of legislation should reach Congress by mid-2012.

2. Panama's government remains engaged in mobilizing resources for its 5-year (2010–2014) public investment strategy, key social programs for the most vulnerable, and the conclusion of the Panama Canal expansion on target in 2014. Economic activity surged by about 10.5 percent in 2011 compared to 7.5 percent in 2010. This rapid GDP growth reflects the ongoing Canal expansion, other public investment programs, as well as strong foreign direct investment (FDI). Output growth is projected to remain close to 7 percent in 2012. The authorities expect that high growth will continue in the medium term despite global uncertainties.

3. Panama's investment performance has been outstanding. Data reported by IMF staff indicate that public investment (including investment by the Panama Canal Authority) increased by almost 40 percent at constant prices last year, after having expanded by 34 percent in 2010. Private investment contracted in 2009 and 2010, but recovered markedly in 2011. As a result, the gross domestic rate of investment has reached 29 percent, one of the highest in the region.

4. Economic growth has remained broad-based. Commerce, transportation, construction, communications, storage and mining have been the most dynamic sectors. Labor markets have also improved. Open unemployment in 2011 fell to 2.9 percent compared to 4.7 percent in 2010, and 5.2 percent in 2009. Youth unemployment remains a concern, affecting mainly women.

5. Average CPI inflation reached 5.9 percent compared to 3.5 percent in 2010. Strong domestic demand, higher international prices in food, energy, and raw materials explain most of the increase in inflation. CPI inflation is expected to moderate to about 5 percent in 2012. The current account deficit is projected to exceed 12 percent of GDP in 2011 compared to 10.7 percent in 2010. Capital goods imports driven by the large public works will continue to exert pressure on the balance of payment on current account. However, most of the current account imbalance is covered by FDI. In the last two years, FDI has averaged nearly 9 percent of GDP, as reported by staff.

6. In 2011, the fiscal stance came under pressure. Panama faced massive flooding nation-wide at end-2010 with damaging effects to agriculture and infrastructure costing over US$150 million. A national emergency was declared, condition that allowed, under the Social and Fiscal Responsibility Law (SFRL), the fiscal deficit ceiling to be increased to 3 percent GDP in 2011. This freed resources to tackle flood-related public works. Nevertheless, the final result is likely to have remained well below the revised SFRL

ceiling.

7. Revenues of the non financial public sector (NFPS) strengthened in 2011. Total revenues increased by 13 percent relatively to 2010. Tax revenues increased 11.5 percent reflecting the full impact of previous tax reforms and the VAT increase of 2 percent in mid-2010. This revenue performance and prudent spending created the fiscal space for the public investment program and poverty-related programs.

8. As indicated, public and private investment gained momentum in 2011. The rate of project implementation exceeded 85 percent from 77 percent in 2009. Work on the new Metro system began in 2011, and the Canal expansion is at its peak. The inner city highway system and the construction of new airports and hospitals will accelerate in 2012. FDI has flowed mainly into the expansion of ports, tourism, electricity transmission and energy infrastructure.

9. Panama was excluded from the OECD grey list as of last July 2011 after signing 11 double-taxation agreements (DTAs) and a tax information and exchange agreement (TIEA) with the United States. Last October 2011, in Paris, our authorities personally delivered to OECD's Global Forum a report on the new laws to regulate the exchange of information for tax purposes. In December 2011, France's National Assembly approved the DTA with Panama. The country will continue strengthening its legal framework on tax information exchange and intends to sign DTA agreements with other nations.

10. On a separate note, in mid-2011, Fitch Ratings raised Panama credit rating to BBB from BBB-. This was followed by Moody's and Standard & Poor's placing the country in "positive watch" for a possible upgrade in 2012. Also, last October, the United States Congress ratified the Free Trade Agreement with Panama. These developments should enhance the prospects for even larger FDI flows into Panama.

11. Our authorities welcomed the completion of the FSAP. The assessment reaffirms the banking sector's strong liquidity, profitability, and high capitalization. Credit risks are low. Interbank contagion and cross-border risks to onshore banks are considered limited though close monitoring is warranted. The authorities are giving priority to actions that strengthen risk-based and consolidated cross-border supervision as well as non-bank supervision. The Superintendence of Banks is also committed to strengthening bank resolution and monitoring of systemic risks. The authorities concur that the pending AML/CFT assessment should be implemented this year by IMF staff.

12. Lastly, President Martinelli's administration continues to assign priority to targeted-income support programs. These programs aim at reducing poverty and improving income distribution. In its latest survey, the Economic Commission for Latin America and the Caribbean reports that poverty levels in Panama have fallen from 33.4 percent of total population in 2009 to 29.8 percent in 2010. Panama ranks 58 among 187 countries in the United Nations Human Development index. The country ranks 1st in Central America and 9th in Latin America. The government of Panama is determined to continue to expand targeted-income support programs, and to intensify technical training to improve competitiveness and help lift untrained adults out of poverty.