



PANAMA

August 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PANAMA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Panama, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 10, 2015 consideration of the staff report that concluded the Article IV consultation with Panama.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 10, 2015, following discussions that ended on March 12, 2015, with the officials of Panama on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 19, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Panama.

The documents listed below have been or will be separately released.

Selected Issues

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IMF Executive Board Concludes 2015 Article IV Consultation with Panama

On June 10, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Panama.

Panama's economic performance is expected to remain strong. Real GDP slowed to 6.2 percent in 2014, reflecting a slower pace of public investment, continued weakness in Colon Free Zone activity, and delays in the Canal expansion. Growth is expected to remain stable in 2015. Lower oil prices and the U.S. recovery will be positive forces but these will be offset by U.S. dollar appreciation and some lags in new public investment. Over the medium term, the expanded Canal and the new copper mine should help maintain growth at 6-7 percent. Inflation moderated to 2.6 percent in 2014 as a result of lower oil prices and price controls on certain food items. Inflation is expected at around 1 percent in 2015, taking into consideration the January increase in electricity tariffs, and assuming a slow upward trajectory for oil prices and the elimination of price controls in July.

The 2014 fiscal deficit reached 4.3 percent of 1996-base GDP. Revenues increased by 1.1 percent while current primary expenditures grew by 13 percent. Going forward, the fiscal framework envisaged in the Social and Fiscal Responsibility Law (SFRL) aims at removing the effects on government spending of cyclical fluctuations in Canal contributions. Accordingly, the overall fiscal deficit can exceed the SFRL deficit ceilings up to the amount that budget contributions from the Canal are below 3.5 percent of GDP (if above, the difference would instead be credited to the Sovereign Wealth Fund). In line with the framework, the 2015 fiscal deficit is expected at 3.8 percent of 1996-base GDP in order to accommodate past commitments on capital expenditures as well as a projected weak revenue performance. Total gross debt of the public sector (including the Canal Authority debt) increased to about 46 percent of GDP in 2014, reversing the declining trend seen since 2005. Nonetheless, public debt is projected as sustainable. Under the planned policies, total gross public debt is projected to decline by about 5 percentage points of GDP by 2019. However, additional liabilities encompass unfunded

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.

pension liabilities, other outstanding public liabilities, and the contingent liabilities linked to public companies.

The current account deficit remained elevated in 2014, at 12 percent of GDP, owing in part to strong investment-related imports, but should moderate over time as investment projects wind down and exports increase. This deficit is expected to continue to be financed by buoyant foreign direct investment inflows (including in the mining, logistics and energy sectors).

The authorities and the Financial Action Task Force (FATF) agreed on a plan to address the deficiencies related to Panama's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, to bring the framework in line with the international standard. The authorities have made substantial progress, including the passing of new AML/CFT legislation.

Near-term risks mostly relate to a weaker global economy or to possible delays in enhancing financial transparency. Slower-than-expected global growth and weaker trade represent downside risks. An abrupt surge in global financial market volatility or an upward shift in U.S. interest rates would feed quickly into the local financial system, with spillover effects on the local economy. However, strong fundamentals and the room to implement a countercyclical fiscal response would mitigate the impact of such external shocks. The potential negative impact from delays in concluding the measures to tackle financial transparency shortcomings could be significant. Conducting international transactions has become somewhat more difficult due to concerns over transparency and weaknesses of the AML/CFT framework, including through increased due diligence by correspondent banks. Delaying reforms to financial integrity and transparency could have negative implications for the economy through higher costs of trade settlements, difficulty in obtaining cross-border borrowing and potential decline in FDIs.

Executive Board Assessment²

Executive Directors commended Panama's robust macroeconomic performance and continued solid economic growth. Noting Panama's exposure to external shocks in global growth, trade, and financial markets, Directors stressed the importance of enhancing the fiscal framework and fostering resilience through strengthened fiscal buffers, while maintaining financial stability and sustaining strong and inclusive growth.

Directors encouraged the authorities to strengthen the fiscal framework for the medium term. They advised revising the threshold for canal contributions in line with average expected contributions, while adopting a more comprehensive definition of net debt in the Social and Fiscal Responsibility Law (SFRL). Directors also recommended continued efforts to enhance revenue mobilization through capacity building and administrative reforms. They welcomed the

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

progress in reducing electricity subsidies, and encouraged further efforts to improve the targeting of subsidies and streamline current spending.

Directors underscored the importance of reforming the pension system to address large unfunded liabilities, while curbing other contingent liabilities. They looked forward to full implementation of the Single Treasury Account and progress on other initiatives to improve public financial management.

Directors commended the authorities for the progress in enhancing the financial integrity and transparency frameworks, including the recent passage of AML/CFT legislation and ongoing implementation of the action plan agreed with the Financial Action Task Force (FATF). They called for expeditious resolution of the remaining deficiencies to bring the financial integrity and transparency frameworks fully in line with the international standard.

Directors noted that Panama's banking system remains stable, well capitalized and highly liquid, but advised continued efforts to strengthen bank supervision and risk monitoring. They encouraged swift implementation of the remaining 2011 FSAP recommendations, and called for further progress on a well-designed liquidity facility for banks. Directors also recommended better monitoring of financial risks and macrofinancial linkages, and further development of the macroprudential policy framework.

Directors agreed that improvements in productivity and human capital are key to sustainable, equitable, and inclusive growth. This will require efforts to further enhance the quality of public education and healthcare, upgrade skills, stimulate youth employment and female labor force participation, and strengthen institutions. They also recommended that the authorities take advantage of the current benign inflation environment to phase out price controls.

Directors encouraged the authorities to improve the quality and coverage of statistics, which would help close gaps in data that are relevant for conducting sound macroeconomic policy and risk assessment.

Panama: Selected Economic Indicators

						Proj	
	2011	2012	2013	2014	2015	2016	
	(Annual percent change)						
Real economy							
Nominal GDP	15.8	14.7	12.4	8.4	8.4	8.6	
Real GDP (1996 prices)	10.9	10.8	8.4	6.2	6.1	6.4	
Consumer price index (average)	5.9	5.7	4.0	2.6	0.9	2.0	
Consumer price index (end-of-year)	6.3	4.6	3.7	1.0	2.4	2.0	
Money and credit							
Private sector credit	16.8	14.1	12.1	9.1	7.9	7.1	
Broad money	9.3	10.3	8.6	8.1	8.2	8.6	
Average deposit rate (1-year)	2.7	2.7	2.7	2.7	...	...
Average lending rate (1-year)	6.9	7.2	7.2	6.9	...	...
	(Percent of GDP)						
Saving and investment							
Gross domestic investment	27.2	28.6	30.0	29.8	29.3	28.1	
Gross national saving	11.3	18.8	17.8	17.8	18.9	18.1	
Nonfinancial public sector 2/							
Revenue and grants	29.0	29.0	28.2	26.1	25.8	25.6	
Expenditure	33.4	32.2	32.7	32.7	31.7	30.0	
Current, including interest	20.6	20.1	19.2	19.8	21.0	21.0	
Capital	12.8	12.1	13.5	12.9	10.7	9.0	
Overall balance	-4.4	-3.2	-4.6	-6.6	-5.9	-4.4	
Overall balance, excluding ACP	-2.1	-1.5	-2.5	-4.3	-3.8	-3.7	
External sector							
Current account	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0	
Foreign direct investment	9.4	9.1	10.8	9.9	10.0	9.8	
Real effective exchange rate (depreciation -)	1.7	3.9	4.5	-2.0			
External public debt 3/	37.7	32.9	33.1	36.7	36.5	34.0	
Memorandum items:							
GDP (in millions of US\$, current price, 1996-base)	31,320	35,938	40,393	43,784	47,478	51,579	

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

1/ Complete 2007-base national accounts data are not available and staff GDP ratios and projections are still based on GDP with base year of 1996. GDP figures have been revised upward. The revision encompasses changing the base year from 1996 to 2007 as well as enhancing the computation methodology due to the implementation of key recommendation of the new 2008 System of National Accounts (2008 SNA). The upward revision to nominal GDP is between 5.6 to 8.2 percent, depending on the year.

2/ Includes Panama Canal Authority (ACP).

3/ Including external debts of ACP.



PANAMA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

May 19, 2015

KEY ISSUES

Backdrop and Outlook. Panama's economic growth is slowing towards its medium-term potential and is expected to remain in the 6–7 percent range over the next 5 years. Inflation has been declining due to lower oil prices and price controls imposed on some food items in July 2014. The external current account deficit remains elevated, with foreign direct investment as the main source of financing, but should moderate over time as investment winds down and the corresponding projects start generating exports.

Risks. A globally integrated economy brings substantial benefits to Panama, but also makes it vulnerable to external shocks to global growth, trade, and financial markets. However, strong fundamentals and the room to implement a countercyclical fiscal response would mitigate the impact of such external shocks. Delayed reforms to financial transparency are an important risk that could restrict access to global capital and the international payments system.

Policy advice. It is essential to finalize the strengthening of the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework in order to comply with the international standard. The fiscal framework needs to be strengthened to serve as a solid medium-term anchor. In particular, fiscal buffers should be enhanced to cope with risks and expected or potential liabilities. In parallel, the pension system needs to be reformed, notably to address the large unfunded pension liabilities. Financial sector reforms should be geared towards implementing fully the remaining recommendations of the 2011 Financial Sector Assessment Program (FSAP), including establishing a facility for the provision of temporary liquidity to banks, improving the monitoring of external and systemic risks, upgrading the legislation on non-bank financial intermediaries, and developing further the macroprudential policy framework along with key instruments. Further investment in training, education, and healthcare will raise labor productivity and promote sustained and more inclusive growth.

Approved By
**Nigel Chalk and
 Masato Miyazaki**

Discussions took place in Panama City during March 3–12, 2015. The staff team comprised Messrs. Ricci (head), Hadzi-Vaskov, and Cerdeiro, Mme. Yang (all WHD), Mr. Wezel (MCM), and Mr. Dawe (LEG). Mr. Macia (OED) also participated in the meetings. The team met with Minister of Economy and Finance De La Guardia, Minister of Labor Carles Rudy, Minister of Social Development Vásquez Velásquez, other senior public officials, and private sector representatives.

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BACKDROP AND ECONOMIC OUTLOOK

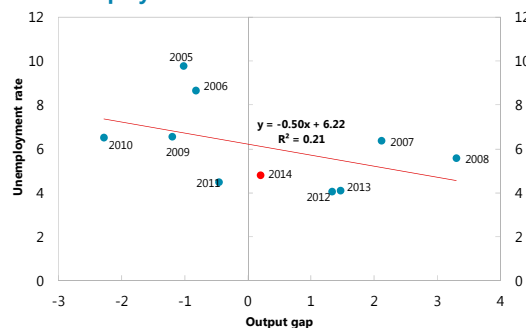
1. The presidential election took place in May 2014. President Juan Carlos Varela, the head of the Partido Panameñista, took office in July 2014. The new government is continuing a pro-growth economic policy agenda, with a deeper emphasis on social issues as well as transparency and equity. The lack of a government majority in the National Assembly could, however, complicate policy efforts. The country is undergoing an important anti-corruption campaign. This has led to a greater scrutiny in awarding construction permits and public contracts, which in turn is likely to slow down investment.

2. Panama’s economic growth continues to slow towards its medium-term potential. Real GDP growth slowed down to 6.2 percent after reaching 8.4 percent in 2013 (Table 1)¹. This mainly reflects a slowing in the pace of public investment from the high levels of recent years, continued weakness in Colon Free Zone activity (in part linked to difficulties in trade relations with Venezuela and Colombia), and delays in the Canal expansion. Unemployment has risen modestly, reflecting the economic slowdown, but still remains low by historical standards.

3. Growth is expected to remain stable in 2015. Lower oil prices and the U.S. recovery will be positive forces, but will be offset by U.S. dollar appreciation and some lags in new public investment. Once operational, the expanded Canal (in 2016) and the new copper mine (Minera Panama, in 2018) are expected to help maintain growth at 6–7 percent over the next five years.

4. Inflation has been declining. As promised during the electoral campaign, the government imposed price controls on 22 food items in

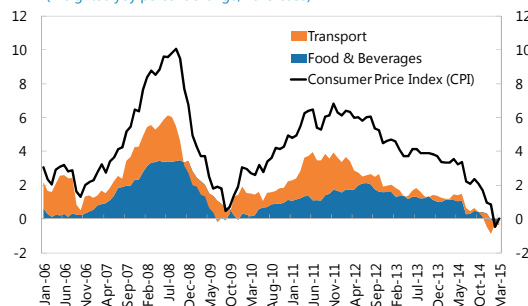
Unemployment is in line with Okun's Law



Sources: Panama National Authorities; and World Economic Outlook (WEO).

CPI Contribution

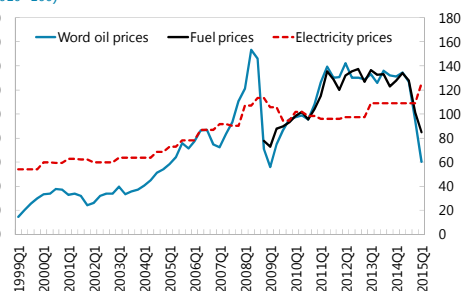
(Weighted yoy percent change, 2013 base)



Sources: Panama National Authorities, and IMF staff estimates.

World Oil Prices and Energy Prices in Panama

(2010=100)



Sources: National Authorities; and IMF staff estimates.

¹ Ratios to GDP in our Tables are based on the 1996-base GDP (unless otherwise indicated), as the full set of 2007-base national account statistics is not yet available.

July 2014, initially for 6 months, and subsequently until June 2015. As a result of these price controls, coupled with lower oil prices, headline inflation decelerated from 3.4 percent (yoy) in June 2014 to -0.4 percent in February 2015. The government has taken advantage of lower oil prices to reduce energy subsidies. Inflation is projected at around 1 percent in 2015, taking into consideration the January increase in electricity tariffs, a slow upward trajectory for oil prices, and the elimination of price controls in July.

5. The 2014 fiscal deficit required a modification of the Social and Fiscal Responsibility Law (SFRL) ceiling.

The fiscal deficit reached 4.1 percent of 2007-base GDP (4.3 percent of 1996-base GDP, see Table 2), within the revised ceiling approved by the National Assembly, but 1.4 percent of GDP beyond the limits in the original law. Noninterest current expenditures increased by 13 percent in 2014, reflecting increased spending by the previous administration, higher electricity subsidies, and rising operational costs (linked to the step-up in public investment over the past few years). Revenues were flat in 2014, despite a temporary tax moratorium to encourage settlement of unpaid taxes.

Operations of the Non-Financial Public Sector
(in millions of USD)

	2013	2014	% change
Revenues	9,950	10,063	1.1
Current Revenues	9,754	9,983	2.4
of which tax revenues	4,859	4,826	-0.7
Capital Revenues	183	78	-57.4
Expenditures	10,976	11,943	8.8
Current Expenditure	6,961	7,779	11.8
of which Current Primary Expenditure	6,138	6,940	13.1
Capital Expenditure	4,014	4,160	3.6
Balance	-1,026	-1,880	
Balance as % of 2007-base GDP	-2.4	-4.1	

Source: Panama National authorities.

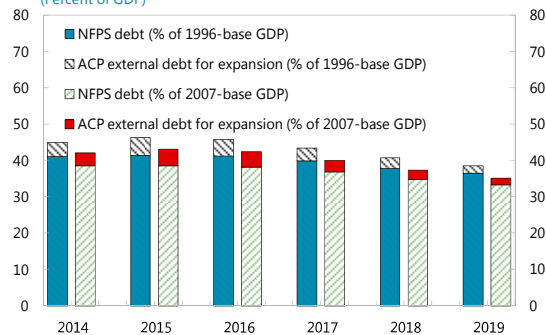
6. Starting in 2015, the current design of the fiscal framework implies that the overall fiscal deficit will systematically exceed the SFRL deficit ceilings (that apply to the adjusted fiscal deficit) under current projections, while the adjusted overall fiscal deficit specified by the framework would remain in compliance with the SFRL ceilings.

The Law establishing the Sovereign Wealth Fund (Fondo de Ahorro de Panama, FAP) revised the fiscal framework and aimed at removing the cyclical effect on government spending of the Canal contributions. In particular, from 2015 onwards, it allows the overall fiscal deficit to exceed the SFRL deficit ceilings (that apply to the adjusted fiscal deficit)

insofar as contributions from the Canal to the budget are below 3.5 percent of GDP. (If above 3.5 percent of GDP, the difference would instead be credited to the FAP.) In line with this feature of the fiscal framework, the 2015 overall fiscal deficit is budgeted at 3.7 percent of 2007-base GDP, in order to accommodate past commitments on capital expenditures as well as a projected weak revenue performance. In the coming years, Canal contributions are likely to continue to fall short of the 3.5 percent of GDP threshold and, as a result, the overall fiscal deficit is expected to exceed the SFRL ceilings (that apply to the adjusted fiscal deficit) by 1–2 percent of GDP per year.

Debt

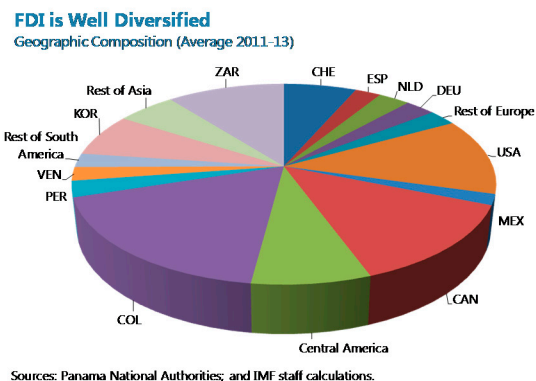
(Percent of GDP)



Sources: Panama National Authorities; and IMF staff calculations.

7. Public debt to GDP increased in 2014 but, even with the higher deficit path, will start to move onto a declining path. Total public sector gross debt (including Canal-related debt) increased to about 46 percent of 1996-base GDP in 2014, reversing the declining trend seen

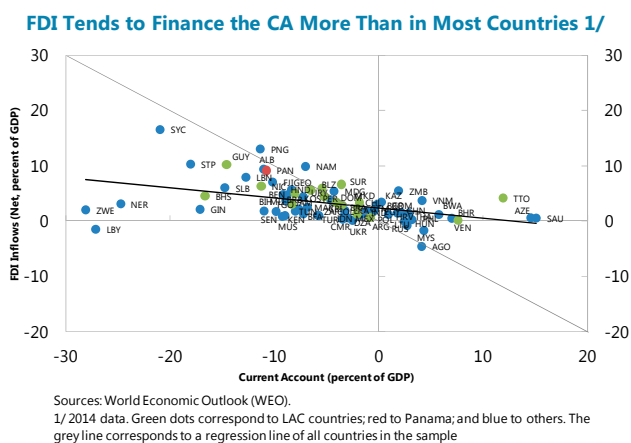
since 2005. Nonetheless, public debt is viewed as sustainable (Annex V) and, under the planned policies outlined in the authorities' five-year strategic plan (see below), total public sector gross debt is expected to decline by about 5 percentage points of GDP by 2019. However, the broad set of potential public liabilities is larger, encompassing the unfunded pension liabilities (estimated at about US\$10.7 billion or 24 percent of 2014 GDP, see Box 1), pending government obligations associated with turnkey projects (currently about US\$3 billion) or the contingent liabilities linked to public companies (about US\$ 4 billion). In September 2014 and March 2015 Panama issued two ten-year bonds, each for US\$1.25 billion. Both issuances included strengthened *pari passu* clauses that expressly exclude the obligation to effect ratable payments, in line with IMF recommendations. The March 2015 bond (which further includes an enhanced collective action clause) priced at a spread of 178 basis points—very low by historical standards—above the ten-year U.S. Treasury bonds, with an effective interest rate of 3.89 percent.



8. The authorities released a five-year strategic plan in January. The plan was focused on social, economic, fiscal, and financial issues, and was designed in consultation with the private sector, within the fiscal constraints of the existing SFRL. Its goals are to catalyze investment and support growth in key sectors (logistic, agriculture, tourism, and mining), and promote socio-economic developments (in part by enhancing the education system, social programs, infrastructure, and labor markets).

9. The external current account deficit remains elevated, with FDI as the main source of financing.

The current account deficit reached 12 percent of GDP in 2014—owing in part to strong investment-related imports—but should moderate over time (to around 6 percent of GDP in 2019–20) as investment winds down and the corresponding projects start generating exports. The deficit is expected to continue to be financed by buoyant foreign direct investment inflows (including in the mining, logistics, and energy sectors). For example, the ongoing copper mining project is expected to bring additional investments of about US\$4½ billion in 2015–17. By end-2014, Panama had signed thirteen Free Trade Agreements and three more are under negotiation (see Annex VI). The overall effect on bilateral trade is expected to be substantial over time.



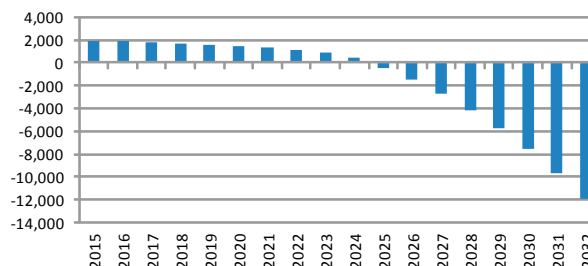
Box 1. Panama: The Exclusively Defined Benefit Portion of the Pension System

The Social Security Agency (CSS) is an autonomous public agency in charge of managing the social security system.

The CSS runs four independent programs: 1) disability, old age and death benefits; 2) health and maternity care; 3) professional risks; and 4) administration.

The main pension program was reformed in 2005. The disability, old age and death benefits (Invalidez, Vejez y Muerte, IVM) accounts for more than one half of the CSS revenues and expenditures. Before the reform in 2005, the IVM was entirely a defined benefit system and overly generous. As the IVM faced both actuarial and cash deficit, the eligibility requirements were tightened and contribution rate was raised. However, the reform was incomplete due to strong public oppositions, and only postponed the actuarial imbalance of the defined benefit portion of the system.

Reserves of Subsystem of Exclusively Defined Benefit IVM (2015-2032, \$ millions)



Source: National authorities.

The IVM after the 2005 reform includes two subsystems: the subsystem of exclusively defined benefit (old system) and the subsystem of mixed defined benefit and defined contribution (new system). Affiliation to the CSS is mandatory for most workers in the private sector and all workers in the public sector. The subsystem of exclusively defined benefit covers most of the affiliates from the pension system before the reform. Starting in 2008, all new affiliates entering the system started to contribute to the new system. For affiliates under the old system, workers earning less than US\$500 a month as well as workers older than 35 years of age in 2008 continued to contribute to the exclusively defined benefit scheme. Workers below 35 years of age and earning more than US\$500 a month had the option of either staying in the old system or contributing to the new system. Surpluses in one subsystem cannot be used to finance deficits in the other subsystem.

Main Parameters of the Defined Benefit Public Pension System

	Panama	Brazil	Spain	France	Germany
Financing					
Total contribution of eligible earning:	13.5	31.0	28.3	16.7	19.6
Contribution rate: Employee	9.25	11.0	4.7	6.8	9.8
Contribution rate: Employer	4.25	20.0	23.6	9.9	9.8
Eligibility					
Minimum years of Contribution	20	15	15	41.5	5
Retirement Age: Male	62	65	67	65	67
Retirement Age: Female	57	60	67	65	67
Benefits					
Replacement rate	60% of average best 10 years wage	80% of average wage	50% of wage	Median of 59.1%	5% of the relevant average earnings

Source: Pension at a Glance, OECD and G20 indicators

The unfunded pension liabilities in the exclusively defined benefit system are estimated at almost US\$11 billion.

Actuarial studies indicate that the exclusively defined benefit subsystem will incur losses in cash terms from 2016 onward and reserves will be depleted in 2024. The projected actuarial deficit by 2032 amounts to US\$6½bn in NPV terms. No actuarial study covering the period beyond 2032 has been conducted. However, since the last associate is currently expected to retire in 2048, the CSS estimates that the NPV of all future liabilities of this system could amount to US\$10.7 billion in NPV terms. To the extent that the defined benefit component of the new system has similar features, it is also expected to eventually become unsustainable.

Urgent reforms are required to ensure the financial sustainability of the system. Even after the 2005 reform, the IVM program remains generous by international standards, more than in most Latin American and several West European countries. Raising retirement ages, and unifying female and male retirement age, would not only enhance CSS sustainability but also have a positive impact on labor supply and GDP¹ (measures would need to be taken to protect the income of those that cannot continue to work). Further reduction in replacement rates could also be considered.

1. By equalizing retirement age for women and men at 62, the number of active contributors to the exclusively defined benefit system could increase by about 22,700, or 1.3 percent of the labor force based on current demographic structure.

10. Banking sector conditions remain supportive of growth but some signs of exuberance are visible. Overall credit to the private sector grew in line with nominal GDP in 2014 (remaining at about 90 percent of GDP) and is expected to continue to do so in the medium term. Construction credit has slowed, converging to the lower growth rate of mortgage and consumer credit (see Figure 3). However, due to the difficulties in the Colon Free Zone (ZLC), growth in credit to commerce stalled in 2014. Panama's credit and funding risks have declined and the banking system remains sound. Bank performance indicators are sound with low credit risk, significant balance sheet buffers, and robust asset quality (see Box 2 and Table 5). At the same time, mortgage delinquencies are somewhat elevated (at about 4 percent in December 2014), and there is anecdotal evidence of overcapacity in commercial real estate (although data on the property sector is poor).

11. The authorities are working to strengthen the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework. A 2012 assessment by Fund staff highlighted significant shortcomings in Panama's AML/CFT framework. Subsequently, the Financial Action Task Force (FATF) publicly identified Panama among countries which have strategic AML/CFT deficiencies. The authorities and the FATF agreed on a plan to address these deficiencies and to bring the framework in line with the international standard by mid-2015. The plan includes strengthening laws and regulations, implementing measures to freeze terrorist assets, improving customer due diligence (CDD) practices, strengthening the Financial Intelligence Unit (UAF), expanding suspicious reporting to all financial institutions and Designated Non-Financial Businesses and Professions (DNFBPs), and improving international cooperation. In February, the FATF recognized Panama's progress in the areas of issuing guidance about suspicious reporting, improving the UAF's capacity, and issuing regulations on bearer shares, but noted that Panama needs to complete its plan to address all the identified deficiencies.

RISKS TO THE OUTLOOK

12. Near-term risks mostly relate to the global outlook. With around 5 percent of world trade passing through the Panama Canal and a very globalized financial system, the country is highly exposed to external shocks. Slower-than-expected global growth or weaker trade represents a key downside risk. An abrupt surge in global financial market volatility or an upward shift in global interest rates would feed quickly into the local financial system. However, strong fundamentals and the room to implement a countercyclical fiscal response would mitigate the impact of such external shocks.

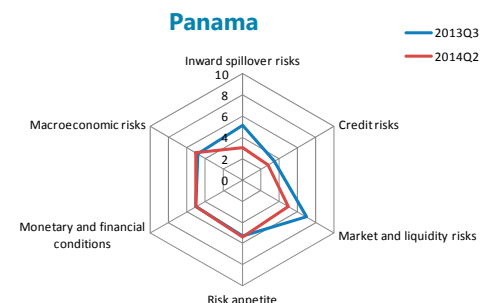
13. Perhaps more serious is the potential negative impact from inadequately tackling financial transparency shortcomings. Conducting international transactions has become somewhat more difficult due to concerns over transparency and weaknesses of the AML/CFT framework, including through increased due diligence by correspondent banks. Delaying reforms to financial integrity and transparency could have negative implications for the economy through higher costs of trade settlements, difficulty in obtaining cross-border borrowing, and potential decline in FDI.

Box 2. Panama’s Financial Sector Remains Sound

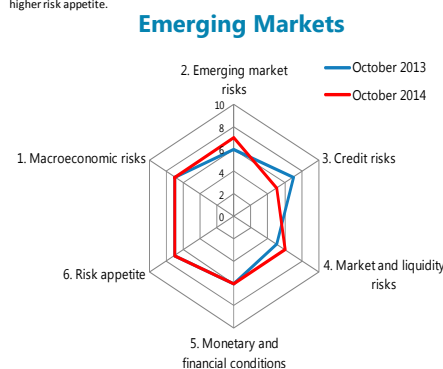
Credit, funding, and spillover risks for Panama have declined. Lower credit risks result mainly from the recent deceleration in credit growth. Market and liquidity risks have declined as the banks have become less reliant on nonresident deposits and foreign liabilities to fund their domestic credit. Inward spillover risks have waned as the economy has become less trade dependent.

Macroeconomic risks to the financial system are low, but have been shifting. The higher budget deficit and lower investment growth have been more pronounced in 2014 than in the past few years, but these are currently offset by lower spreads, open access to international markets, and low unemployment. Largely reflecting global forces, financial conditions in Panama and investors’ appetite for Panamanian assets have been broadly unchanged over the past year.

Panama’s financial system displays low vulnerability. The Financial Soundness Indicators heatmap provides a snapshot of banking sector vulnerabilities, suggesting a low credit cycle risk, good loan-to-deposit ratio, adequate balance sheet buffers, good asset quality, and very low NPL ratio despite recent increases. However, anecdotal evidence points to possible overcapacity in commercial real estate.



Source: National authorities and staff calculations. Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.



Source: GFSR (2014), national authorities, and staff calculations. Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite. *The Financial Stability Map methodology is explained in Ricardo Cervantes, Phakawa Jeasakul, Joseph F. Maloney, and Li Lian Ong (2014), IMF Working Paper 14/99.

Panama	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Credit cycle	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	1.6	1.9	0.3	0.6	-0.4	-1.1	-0.6
Growth of credit / GDP (% , annual)	1.6	1.9	0.3	0.6	-0.4	-1.1	-0.6
Credit-to-GDP gap (st. dev)	-1.2	-1.2	-1.1	-1.2	-1.4	-1.2	-0.8
Balance Sheet Structural Risk	L	L	L	L	L	L	L
Deposit-to-loan ratio	106.7	106.8	105.3	107.6	109.4	109.6	109.2
Balance Sheet Buffers	L	L	L	L	M	L	L
Leverage	L	L	L	L	L	L	L
Leverage ratio (%)	10.4	10.2	10.2	9.9	10.2	10.2	10.3
Profitability	L	L	L	L	L	L	L
ROA	1.5	1.5	1.4	1.4	1.6	1.5	1.5
ROE	13.1	14.0	12.6	13.8	15.5	15.0	14.4
Asset quality	L	L	M	L	H	M	L
NPL ratio	1.0	1.0	1.2	1.1	1.4	1.2	1.1
NPL ratio change (% , annual)	-23.3	-13.7	17.7	-10.5	40.0	10.8	-14.0

Source: National authorities and staff calculations.

*Based on the credit cycle and financial soundness indicators heatmap developed by the IMF’s Monetary and Capital Markets Department.

POLICY ISSUES

The most immediate priority is to finalize the process of enhancing financial integrity. There is also a need to strengthen the medium-term fiscal framework and build fiscal buffers. Monitoring, supervision, and regulation of the financial sector should continue being enhanced. Ensuring a smooth transition to a robust and inclusive medium-term growth path will require efforts to boost productivity and competitiveness.

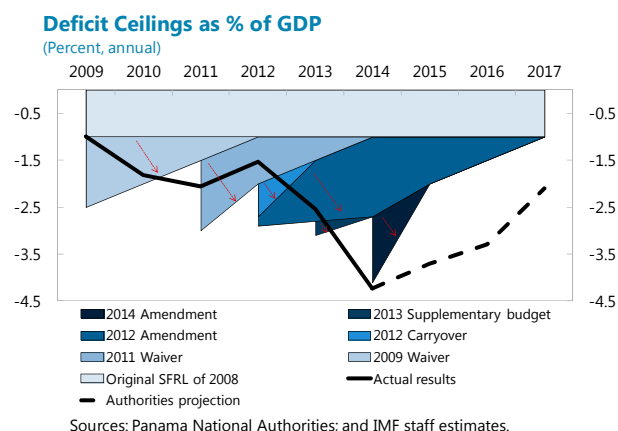
A. Strengthening Financial Integrity

14. It is essential to finalize the action plan Panama agreed with the FATF (see the Risk Assessment Matrix in Annex II). Since the FATF identified Panama as having strategic AML/CFT deficiencies, many countries have instructed their financial institutions to scrutinize transactions linked to Panama. According to the authorities and private sector, maintaining correspondent relationships with foreign banks and conducting international trade and banking transactions has become more challenging, although with modest overall impact so far. The authorities are continuing to work on the action plan agreed with the FATF and have adopted legislative amendments aimed at expanding the list of predicate offenses to money laundering (ML), dealing with the freezing of terrorist assets, and strengthening preventative AML/CFT controls (particularly related to beneficial ownership).

15. Staff commended the authorities for their significant efforts. In particular, the passing of a new anti-money laundering law in April 2015 is an important step. Now, Panama needs to quickly implement the rest of the action plan so as to avoid FATF calling for greater scrutiny of transactions linked to Panama. In particular, regulations implementing the legislative changes need to be finalized in a timely fashion. The authorities reiterated their strong commitment, and indicated that—while there may be short-term costs associated with complying with international transparency requirements (FATF action plan)—the long-term (net) benefits of having a financial sector grounded in transparency are significant.

B. Strengthening the Fiscal Framework and Building Fiscal Buffers

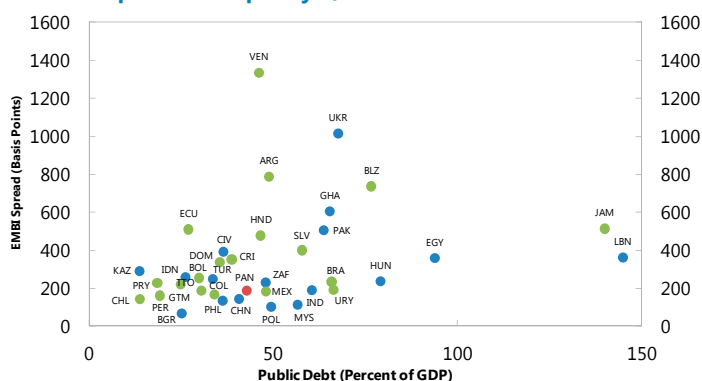
16. The fiscal framework needs to be revamped. Over the past 5 years, the deficit ceilings in the original SFRL have been repeatedly changed through amendments to the law. Under the current fiscal framework, the threshold for the Canal contribution to the budget is too high compared with current projections, thus allowing for overall fiscal deficits larger than the SFRL ceilings applicable to the adjusted deficit over the medium term. Based on current projections, the overall fiscal deficit is expected to



exceed the adjusted overall fiscal deficit by a cumulative 6 percent of GDP over the next five years. Meanwhile, no resources are expected to be transferred to the Sovereign Wealth Fund in the foreseeable future.

17. Strengthening the fiscal framework is a priority. To ensure fiscal discipline and enhance the role of the medium-term fiscal framework as an anchor, staff urged the authorities to refrain from changing the SFRL ceilings and to review the fiscal framework taking into consideration updated projections of Canal contributions relative to GDP (or to consider alternative smoothing frameworks, such as cumulating all Canal contribution in the FAP and spending a smoothed disbursement from the fund). In addition, to further strengthen the fiscal framework, consideration should be given to lowering the level and broadening the definition of the net debt target that is embedded in the SFRL.² Indeed, exposures to shocks and contingent liabilities, large unfunded future pension liabilities, and the temporary financing needs of a liquidity facility to backstop the banks argue for larger fiscal buffers (especially in light of the absence of monetary policy). The net debt definition could be broadened to include, for example, other outstanding public liabilities (such as obligations associated with turnkey projects) and liquid public financial assets. It would also be important for any congressional approval of a deficit that temporarily exceeds the medium-term path to be accompanied by compensatory adjustments in future years. Automatic remedial actions (e.g. to limit future spending in the years following a deficit overrun) could also be considered. Finally, to ensure the effectiveness of the revised SFRL, a more explicit and comprehensive accountability and transparency framework will also need to be put in place. Accompanying the improvements in the fiscal framework, a comprehensive strategy should be developed to manage public assets and liabilities, and to undertake a public risk assessment of the liabilities for which the government may be responsible.

Debt is moderate but fiscal shocks could push it into a range where spread rises quickly 1/



Sources: World Economic Outlook (WEO) and Bloomberg. 1/ 2014 data. Green dots correspond to LAC countries; red to Panama; and blue to others.

Subsidies (in \$ millions)

	Actual 2012	Actual 2013	Budget 2014	Budget 2015
TOTAL	1251.2	1193.0	1424.2	1613.5
<i>as % of GDP</i>	3.5	3.0	3.3	3.4
To Households	854.6	702.8	953.4	1096.7
To Social Security	222.9	230.7	221.0	417.8
To Corporates	173.7	259.5	249.8	99.0

Source: National Authorities.

² The SFRL prescribes a limit of 40 percent to GDP for net debt (Non Financial Public Sector debt minus the Sovereign Wealth Fund assets) to GDP.

18. Policy efforts should be bolstered to raise tax revenues and streamline current expenditures. An increase in revenues could be achieved by strengthening tax collection and reviewing tax policy. The newly established Dirección General de Ingresos (DGI) should continue its efforts to expand capacity and enhance efficiency. Addressing the unfunded pension liabilities will require not only public funding, but also reforming the pension system (for example by raising and unifying the retirement age, and by closing the gap between contributions and payouts). The planned revision of the electricity subsidies is a positive step and is in line with the authorities' broader objective of aligning tariffs with costs through the existing automatic adjustment framework (while planned investments are expected to reduce inefficiencies in the energy sector, see Box 3). More broadly, the targeting of other subsidies should be improved.

19. In addition, meeting the authorities' fiscal deficit limits presented in the five-year strategic plan may require fiscal adjustments. Staff's nominal GDP projection (with 2007 as the base year) for 2015 is 5 percent lower than the one in the five-year strategic plan, which implies that meeting the authorities' deficit limit of 3.7 percent of GDP for 2015 is likely to require an adjustment of 0.2 percent of GDP from the Budget. Additional adjustments (totaling about 0.4 percent of GDP) would be necessary to keep the 2019 Non Financial Public Sector (NFPS) debt (i.e. excluding the Canal-related debt) below the authorities' implicit target of 35 percent of GDP.

20. The authorities shared staff concerns. They agree that regularly changing deficit ceilings undermine credibility. They furthermore mentioned that the fiscal framework envisaged in Law 38 of 2012 was created at a time when Canal contributions were projected to be much higher as a share of GDP than currently envisaged. As such a framework is helpful for expenditure smoothing and for counter cyclical purposes, the authorities were inclined to amend the law rather than either eliminate it or replace it with an alternative framework. They are considering asking for technical assistance on the fiscal framework. They are committed to empowering the DGI as well as lowering subsidies and enhancing the associated targeting. The authorities unified the taxation rate on alcoholic content, with an expected tax revenue increase of \$38 million, and plan to reduce special tax advantages and close loopholes, such as those on preferred shares. This would help fund the increase in nominal pension payments (which are not indexed to inflation) planned for this year. The authorities are aware of the optimism embedded in the GDP projections, and are committed to maintaining both the deficit within the limits announced in the five-year plan and the 2019 NFPS debt below 35 percent of GDP. The adjustment is likely to fall on capital expenditure in 2015 and on both capital and current expenditure in subsequent years.

21. The authorities are also committed to continue strengthening public financial management tools. The government just launched a new platform for centralized management of financial information (Integración y Soluciones Tecnológicas del Modelo de Gestión Operativa, ISTMO), which would enhance transparency and efficiency, as well as help cap budgetary allocations. The new system should encompass twenty-four central government agencies by end-2015, and the decentralized institutions by end-2016. Regulation related to the Single Treasury Account was approved in the fall of 2014 and the implementation is starting. By end-2015 the accounts of the central government agencies that participate in the first phase of ISTMO (representing about two thirds of total funds in those accounts) should be unified in the single account, while the accounts of other agencies should be included in the subsequent two years.

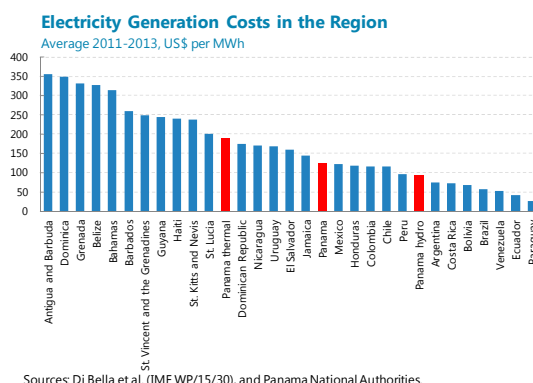
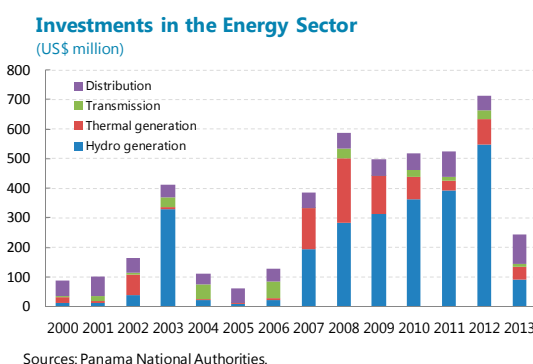
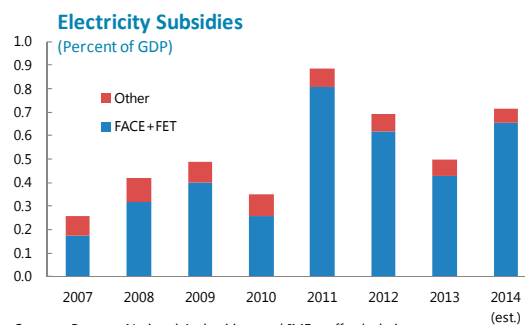
Box 3. Panama's Electricity Subsidies

Electricity tariffs in Panama are subsidized, and about three-quarters of the subsidies are not targeted. Panama has two main electricity subsidies. The Tariff Stabilization Fund (FET), established in 2004, is targeted at low-energy users and is intended to cushion tariffs against movements in international oil prices. The Energy Compensation Fund (FACE), established in 2011, aims to stabilize tariffs for all users, and to compensate three generation companies for forgone earnings due capacity constraints in transmission (associated with weak investments by the state-owned ETESA). In 2014, FACE represented about 75 percent of total electricity subsidies.

Subsidies increased in 2014 owing to external and internal factors, uncovering vulnerabilities in the energy sector. Pre-tax subsidies experienced a marked increase in 2014 on the back of high oil prices, a drought, and an explosion in a large thermal plant (the last two prompted the government to purchase energy from less efficient plants). Total pre-tax subsidies are estimated to have reached US\$320mn in 2014, or about 0.7 percent of GDP, while post-tax subsidies are estimated to be about US\$60mn higher on account of foregone tax revenues.

Lower oil prices and an increase in tariffs are expected to reduce the fiscal burden in 2015. Tariffs have been increased in January 2015 by between 6 and 25 percent, for about one-fourth of consumers. Coupled with lower oil prices, this is expected to cause a significant reduction in subsidies from the levels envisaged in the 2015 budget (prepared in September 2014), which projected electricity subsidies at about US\$350mn.

Going forward, investments in the energy sector are expected to bring about necessary efficiency improvements in generation and transmission. With the economy growing rapidly, energy consumption has been increasing steadily, while investments in thermal generation and transmission have remained subdued in the last few years. Authorities pointed out that, as a result, transmission capacity is below generation capacity, and thermal generation is partially inefficient. The government announced plans for US\$5bn investments in the energy sector during 2015–2019, with ¼ expected to come from public sources. Investments plans in generation are expected to total US\$3.2bn (US\$1.3bn in hydro, US\$0.9bn in coal, and US\$1bn in gas). Investments in transmission, estimated at US\$1.2bn, include US\$0.5bn for the interconnection with Colombia, and US\$0.2 and US\$0.5bn for the third and fourth transmission lines, respectively.



C. Bolstering Financial System Resilience

22. The banking sector remains generally healthy, but greater vigilance will be needed in the context of slowing growth. The banking system is well-capitalized and profitable, but pockets of vulnerability exist. Strong lending activity in recent years has generally not impaired credit quality, as evidenced by a low nonperforming loan ratio (below 2 percent). Capital buffers are well above the required Basel I minimum, profit margins are large, and liquidity holdings remain ample as banks self-insure against sudden stops. Credit risk stress-tests conducted by the mission confirm that banks would be able to withstand significant real and financial shocks. However, the authorities need to continue enhancing cross-border supervision and the monitoring of idiosyncratic, systemic, and external risks. For example, developing an indicator of core liquidity and analyses of the transmission of financial shocks would be valuable.

23. Macrofinancial linkages also need to be monitored closely. Mortgage delinquencies stand at just below 5 percent of loans, household indebtedness is growing faster than the economy, and there are signs of overcapacity in segments of the commercial real estate market. These growing imbalances may dampen price developments and construction activity, which underscores the need for active macroprudential policies. Macroprudential policy-making is still at an early stage, and recent efforts to collect real estate price data need to be complemented with additional information (such as on commercial real estate prices and corporate leverage). Efforts should be made to develop instruments (such as loan-to-value and debt-service-to-income ratios) and build a coherent macroprudential policy framework.

24. The authorities need to undertake further steps to fully implement the recommendations of the 2011 Financial Sector Assessment Program (FSAP) (Annex III). A key priority is to create a facility for the provision of temporary liquidity to banks (which may need to be financed with public funds initially). Although the nonbank financial sector is relatively small³, there is a need for upgrading legislation on nonbank financial intermediaries—especially cooperatives and insurance companies, but also trust funds and public accountants—in order to improve the regulation, supervision, and accountability of these entities. A deposit insurance scheme for small deposits would protect the majority of depositors, mitigate the risk of runs, and complement social protection policies.

25. The authorities broadly concurred with the need for such reforms. They pointed to recent efforts to adopt parts of Basel II/III banking regulations, improve loan classification and provisioning, identify systemically important banks, monitor systemic risks, and improve the bank supervisor's financial stability report. They plan to revisit the accounting regulation for insurance companies in light of international standards. The authorities do not perceive significant financial stability risks at present, as they see economic prospects as being favorable over the next five years. However, they share the concern about the weakening of relations with corresponding banks. They

³ As of 2013, the assets of insurance companies, credit cooperatives, and finance companies accounted for 5 percent, 4.4 percent and 3 percent of GDP respectively.

consider financial sector exposures to the real estate as still healthy, despite some excesses in the commercial segment.

D. Ensuring a Sustainable and Inclusive Growth Path

26. Sustaining future growth will require steady improvements in training, education, healthcare, and institutions. Economic growth has facilitated important progress in poverty reduction over the past decade (see Figure 6). Going forward, capital accumulation in the public sector is expected to decelerate, and growth will need to depend much more on raising productivity. It will be essential to continue efforts to improve the quality of public education and healthcare, address skill mismatches including through internship and training programs, promote greater female labor force participation (e.g. by increasing the flexibility of working arrangements), and strengthen institutions. To secure enhancement in the quality of education, the authorities need to make sure that the two large increases in teachers' salary planned over the next few years are adequately anchored to advancements in teachers' qualifications. The authorities indicated that they are undertaking a concerted effort to improve education, enhance job qualifications, reduce skills mismatches, tackle youth unemployment, and integrate foreign workers.

27. Staff analysis suggests that there are signs that the current account deficit is excessive, but this is expected to self-adjust as investment projects wind down and exports increase (Annex IV). The current account continues to be financed by FDI, while the external debt is deemed sustainable and resilient to shocks (Annex V). There is no compelling evidence of a need for an adjustment in the real exchange rate. Authorities are not overly concerned about the current account deficit and indicated that the economy has historically shown ample flexibility in responding to changes in the external environment.

E. Other Issues

28. Staff encouraged the authorities to formulate an exit strategy for the price controls. The authorities should take advantage of the declining international food and fuel prices and phase out price controls by mid-year. If there are concerns over noncompetitive behavior of food retailers—a principal motivation for the price controls—these should be tackled through an anti-trust framework. The authorities mentioned that the legal process to implement effective anti-trust measures can extend over several years, and that the Constitution itself limits the entrance of foreign players in the retail market.

29. Statistics need to be significantly improved. There is an urgent need to publish the full 2007-base national accounts and to improve data reporting for other series relevant for macroeconomic monitoring. Beyond national accounts, weaknesses are particularly evident in balance of payment statistics: official statistics may severely underestimate oil imports and service exports as well as stocks of outward FDI and inward portfolio equity (on the basis of what reported by other countries). Timeliness and consistency of data reporting needs to be improved. Gaps in financial sector data (such as real estate prices and corporate leverage) also limit the authorities'

ability to properly assess financial sector risks. The authorities indicated they are making progress towards the SDDS subscription, and that limited budgetary resources and weak collaboration among government agencies is slowing down the process.

STAFF APPRAISAL

30. Given the risks to Panama's economy, it is essential to fully bring the financial integrity framework in line with the international standard. After the FATF identified Panama as having strategic AML/CFT deficiencies in 2014, maintaining correspondent relationships with foreign banks and conducting international trade and banking transactions has become to some extent more challenging, although with modest overall impact so far. The authorities are clearly committed to implementing the recommendations of the IMF AML/CFT assessment and the action plan agreed with the FATF. The passing of a new anti-money laundering law in April 2015 is a crucial step. It is now essential that they continue with their efforts in this regard.

31. Strengthening the fiscal framework is a priority. The authorities should refrain from changing the SFRL ceilings and should review the threshold for the Canal contribution in the fiscal framework that allows for the overall fiscal deficit to be above the SFRL deficit ceilings (that apply to the adjusted fiscal deficit) at current projections (or consider alternative smoothing frameworks), in order to strengthen the fiscal anchor. The authorities should also consider lowering the level and broadening the definition of the net debt target that is embedded in the SFRL. The need for larger fiscal buffers is highlighted by exposures to shocks and contingent liabilities, large unfunded future pension liabilities, and the temporary financing needs of a liquidity facility to backstop the banks. The net debt definition could be broadened to include for example other outstanding public liabilities and liquid public financial assets. Finally, a more explicit accountability framework will also need to be put in place.

32. Policy efforts should be devoted to raising tax revenues and streamlining current expenditures. The authorities should speed up the process of enhancing the capacity and efficiency of the DGI, while strengthening tax collection and reviewing tax policy. Addressing the unfunded pension liabilities will require not only public funding but also reforming the pension system. The planned improvement in the level and targeting of electricity subsidies is welcome, as well as the authorities' broader objective of aligning tariffs with costs through the existing automatic adjustment framework. Efforts in improving targeting should also be undertaken for other subsidies.

33. Concerted effort should be made to fully implement the 2011 FSAP recommendations. The authorities are enhancing financial sector regulation, including steps to align capital regulation with the Basel III framework and to require minimum capital for financial holding companies. Given the system's openness and the lack of a lender of last resort, a key priority is to create a facility for the provision of temporary liquidity to banks, while small deposits could be protected via a deposit insurance scheme. Legislation for the nonbank financial sector should be modernized.

34. It is essential to enhance the ability to monitor and assess idiosyncratic, systemic, and external risks in the financial sector. There is also a need to monitor closely macrofinancial linkages as well as build a macroprudential policy framework and continue developing the corresponding tools—for example to mitigate potential adverse developments in the real estate sector.

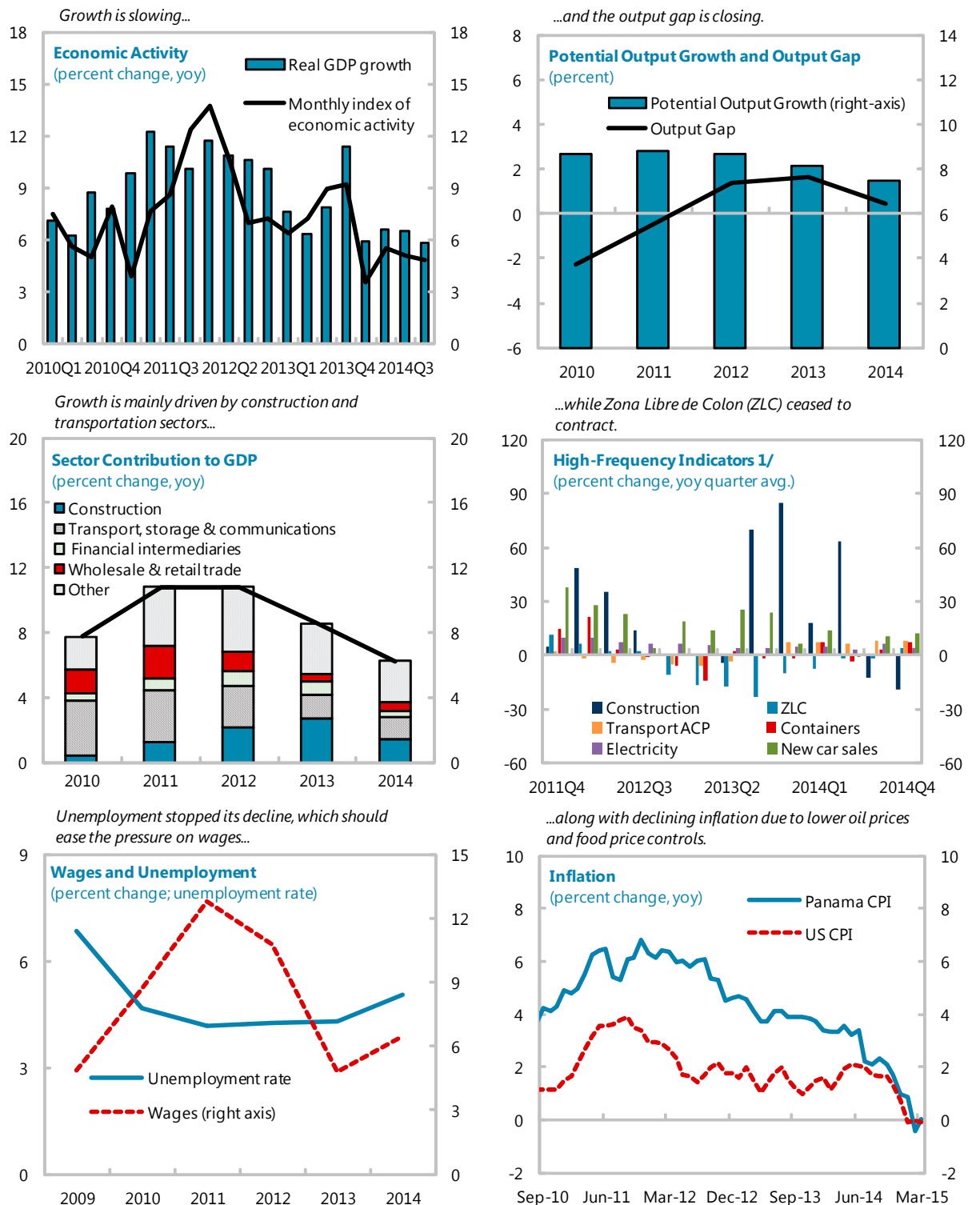
35. Sustaining equitable and inclusive growth will require steady improvements in training, education, healthcare, and institutions. Going forward, productivity is likely to gain more importance as a key engine of growth. Given the inevitable lags in influencing productivity, it is crucial to intensify efforts in areas that still need progress, for example by improving the quality of public education and healthcare, addressing skill mismatches through internship and training programs, promoting greater female labor force participation (e.g. by increasing the flexibility of working arrangements), and strengthening institutions. Doing so will enhance human capital, reduce skills shortages and youth unemployment, improve the business environment, as well as raise productivity and living standards.

36. Advantage should be taken of the decline in international food and fuel prices to phase out price controls by mid-year. Concerns over noncompetitive behavior of food retailers should be tackled through an anti-trust framework.

37. Statistics need to be significantly improved. There is an urgent need to publish the full 2007-base national accounts, improve data reporting for series relevant for macroeconomic monitoring and for risk assessment (such as national accounts, government finance, financial sector, and balance of payment statistics), including with respect to their timeliness and consistency.

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

Figure 1. Panama: Real Sector Developments, 2009–15

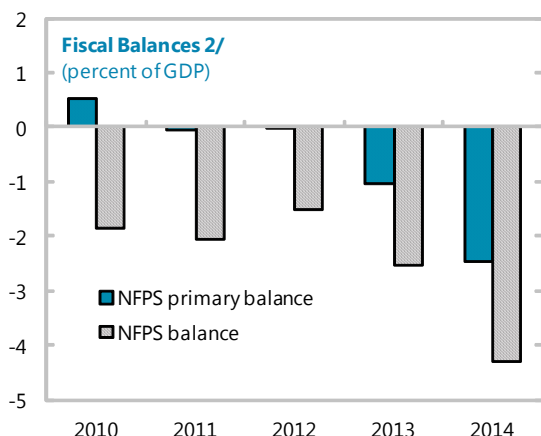


Source: National Authorities; and IMF staff calculations.

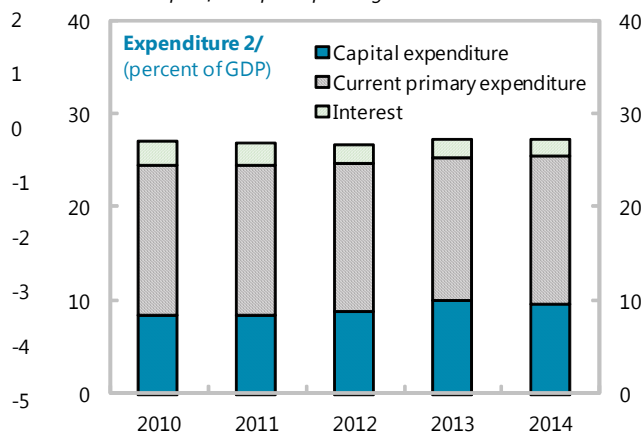
1/ Zona Libre de Colon (ZLC) measured in gross metric tons; and electricity consumption in kWh.

Figure 2. Panama: Fiscal Developments, 2010–19

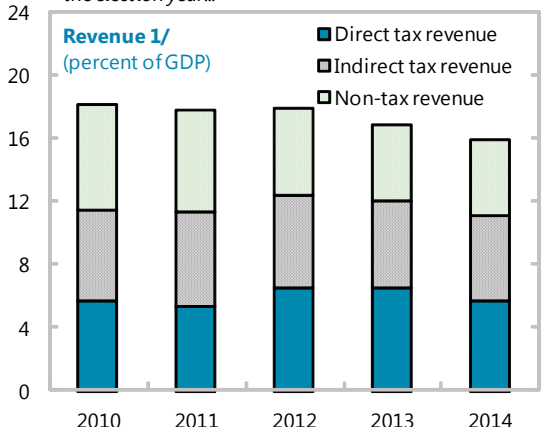
Deficits rose in 2014...



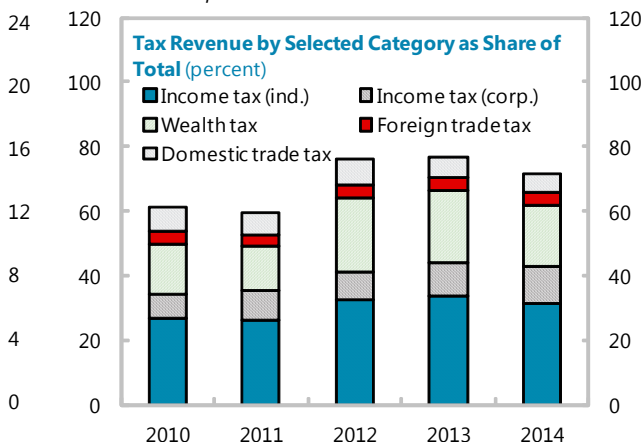
...despite flat capital spending...



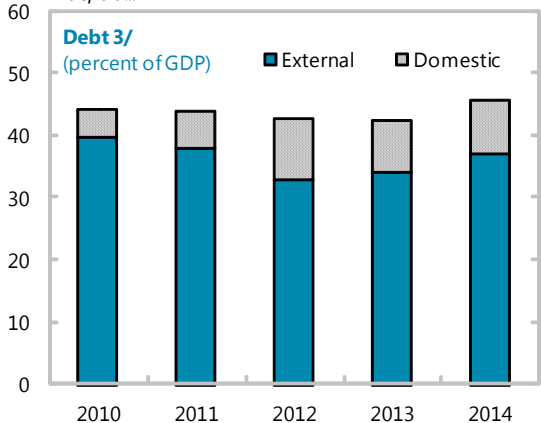
...owing in part to a decline in tax revenues during the election year...



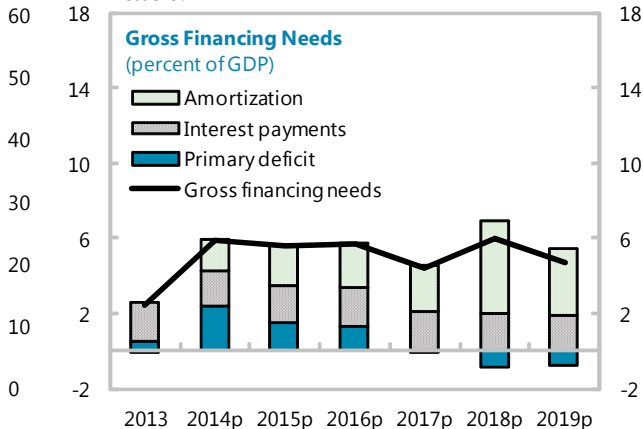
...amid quite stable reliance on income tax.



Public debt to GDP shifted upward against higher deficit...



...but financing needs are expected to remain broadly stable.



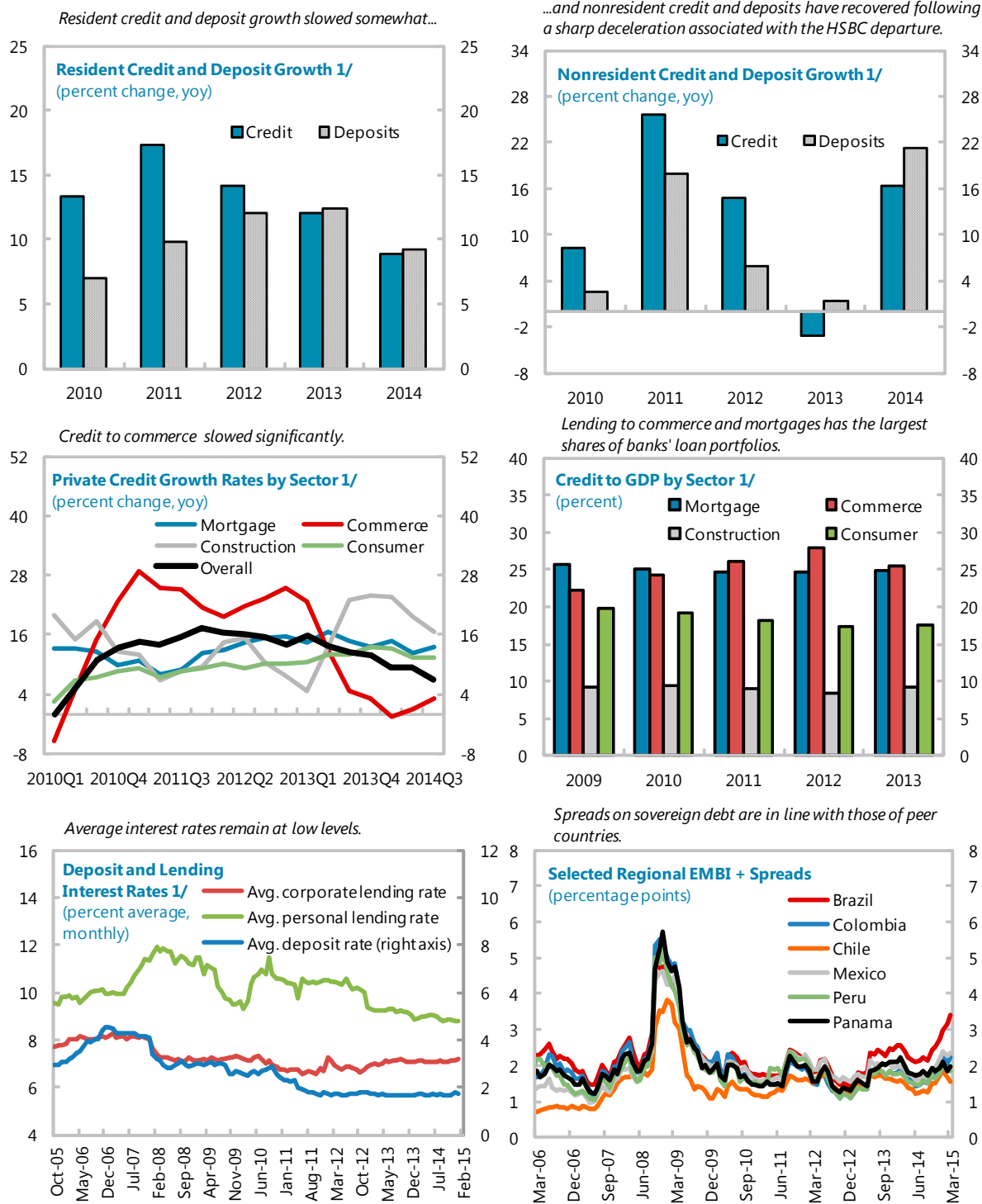
Sources: National Authorities; and IMF staff calculations.

1/ Data refer to the Central Government.

2/ Non-financial Public Sector.

3/ Includes external debt for the Canal expansion.

Figure 3. Panama: Financial Sector Developments, 2005–15



Source: National Authorities; Bloomberg; and IMF staff calculations.
1/ Banks with general licenses.

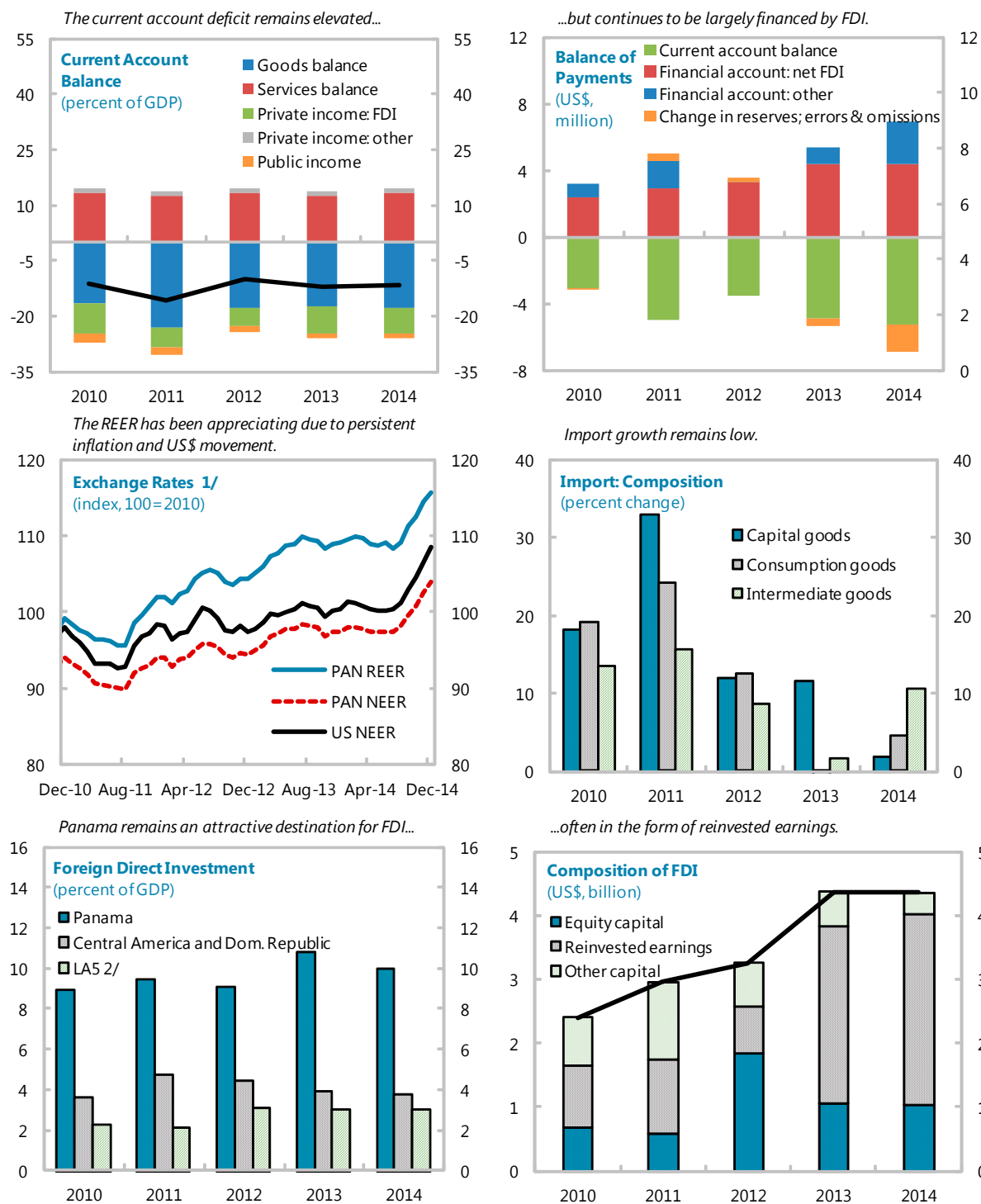
Figure 3. Panama: Financial Sector Developments, 2005–15 (Concluded)

Most banks are well capitalized and profitable.



Source: IMF Financial Soundness Indicators Database.

Figure 4. Panama: External Sector Developments, 2010–14



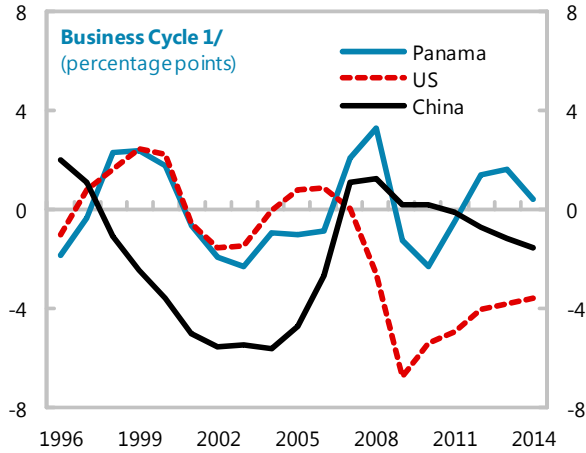
Source: National Authorities; WEO; and IMF staff calculations.

1/ Excluding Venezuela.

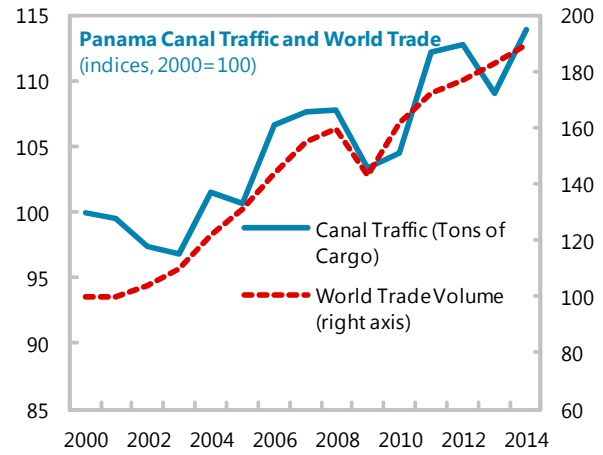
2/ LA5 refers to Brazil, Chile, Colombia, Mexico, and Peru (WEO).

Figure 5. Panama: External Linkages, 1996–2014

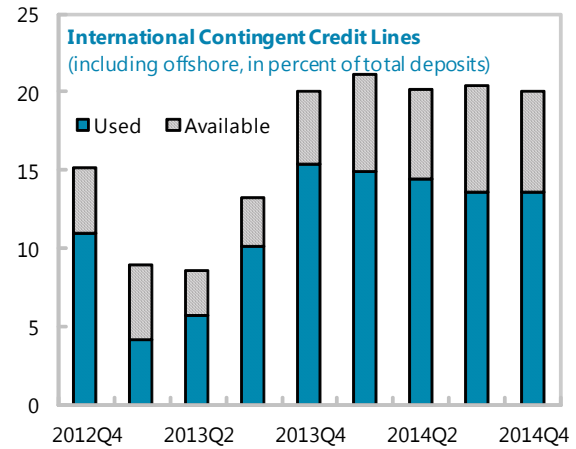
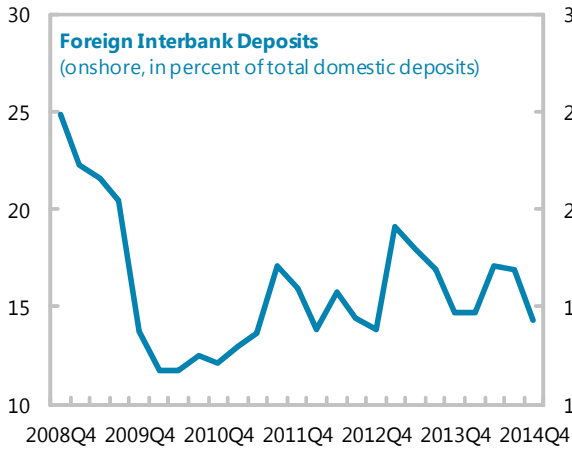
Panama's business cycle tracks that of the U.S. and China...



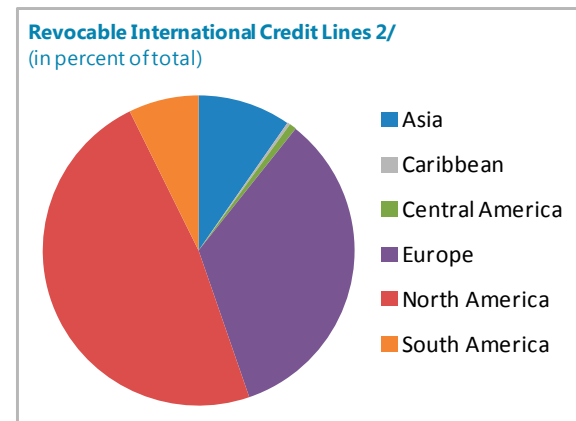
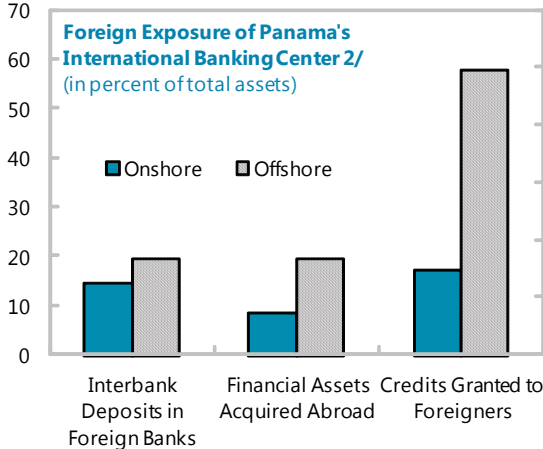
...while world trade drives Panama Canal traffic.



Foreign funding has increased after the sharp slowdown in 2009-10.



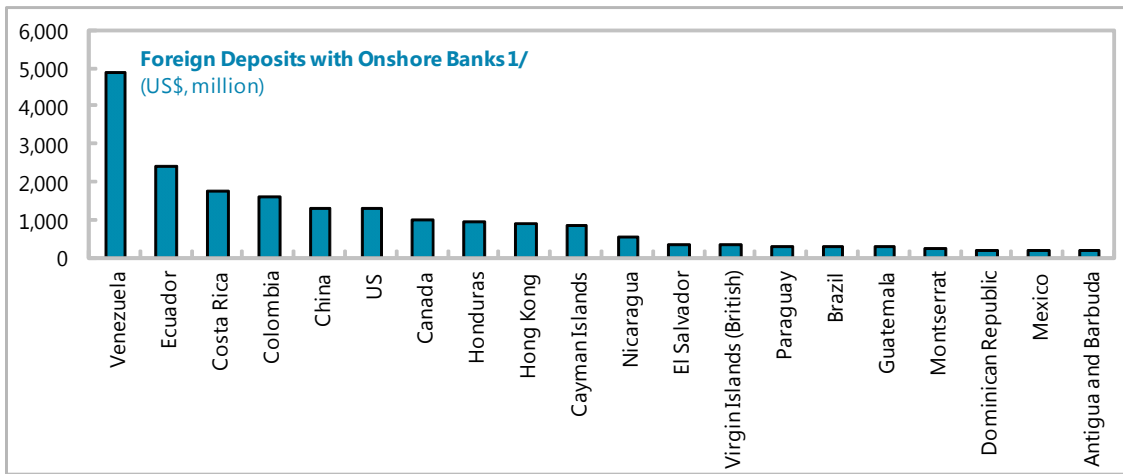
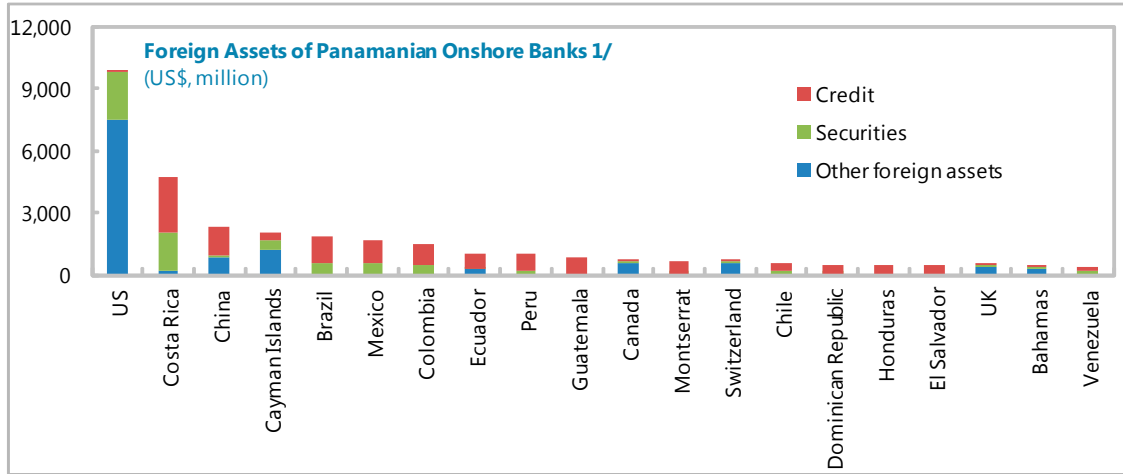
Foreign exposures are significant, and credit lines are mainly with advanced economies.



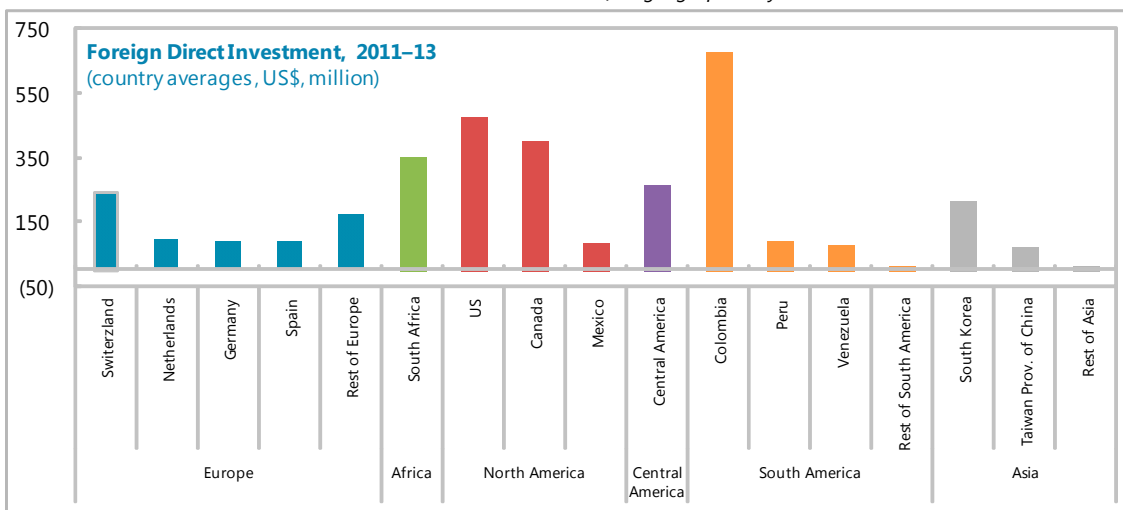
Source: National Authorities; and IMF staff calculations.
 1/ Percentage deviation of real GDP from potential GDP.
 2/ As of December 2014.

Figure 5. Panama: External Linkages, 1996–2014 (Concluded)

Banking sector exposures reflect Panama's role as a regional banking hub.

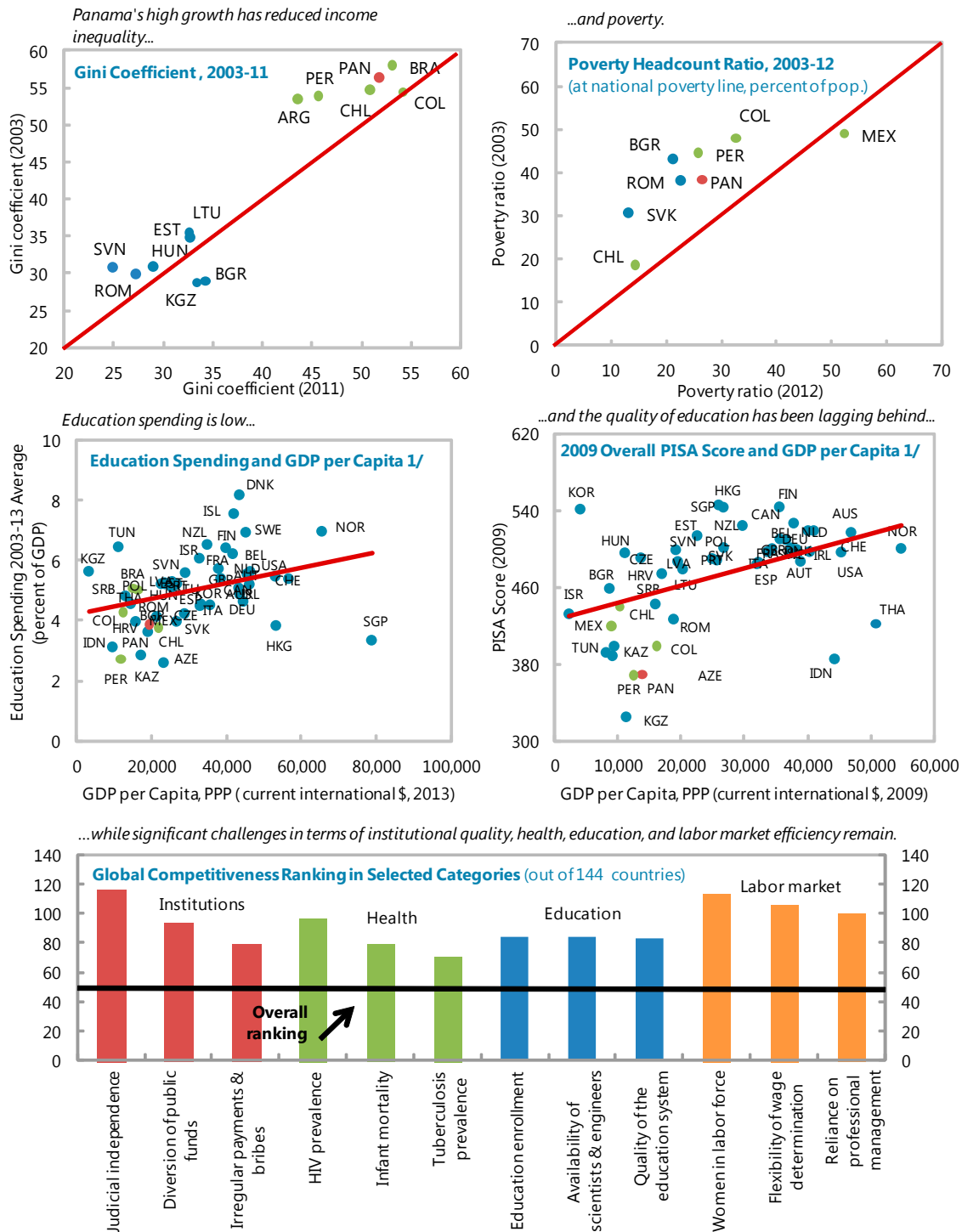


FDI to Panama is well diversified geographically.



Source: Panama National Authorities; and IMF staff calculations.
1/ November 2014 data.

Figure 6. Panama: Social and Labor Indicators, 2003–14



Sources: National Authorities; World Development Indicators; Global Competitiveness Report and IMF staff estimates and calculations.

1/ Green dots correspond to LAC countries.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2013)	3.9	Poverty line (percent, 2013)	25.8			
Population growth rate (percent, 2013)	1.7	Adult literacy rate (percent, 2010)	94.0			
Life expectancy at birth (years, 2012)	77.0	GDP per capita (USD, 2013)	10,490			
Total unemployment (August, 2014)	4.8	IMF Quota (SDR, million)	206.6			
				Est. 1/	Proj.	
	2011	2012	2013	2014	2015	2016
	(Percent change)					
Production and prices						
Real GDP (1996 prices) 1/	10.9	10.8	8.4	6.2	6.1	6.4
Consumer price index (average)	5.9	5.7	4.0	2.6	0.9	2.0
Consumer price index (end-of-year)	6.3	4.6	3.7	1.0	2.4	2.0
Domestic demand (at constant 1996 prices) 1/						
Public consumption	1.6	5.9	4.5	6.6	8.9	6.9
Private consumption	19.3	-3.6	11.1	10.7	8.2	7.3
Public investment 2/	34.9	26.4	12.7	0.7	-11.0	-10.1
Private investment	11.8	9.7	12.4	8.9	14.3	8.2
Financial sector						
Private sector credit	16.8	14.1	12.1	9.1	7.6	6.2
Broad money	9.3	10.3	8.6	8.1	8.2	8.6
Average deposit rate (1-year)	2.1	2.2	2.1	1.5	...	...
Average lending rate (1-year)	6.9	7.2	7.2	6.9	...	...
External trade						
Merchandise exports	29.4	35.9	-8.8	-2.5	-6.7	6.5
Merchandise imports	42.3	5.5	5.9	7.6	-3.7	6.2
	(In percent of GDP)					
Saving-investment balance						
Gross domestic investment	27.2	28.6	30.0	29.8	29.3	28.1
Public sector	12.8	12.9	13.5	12.9	10.7	9.0
Private sector	14.4	15.7	16.5	16.9	18.6	19.1
Gross national saving	11.3	18.8	17.8	17.8	18.9	18.1
Public sector	8.1	7.8	7.8	5.3	4.9	4.7
Private sector	3.2	11.0	10.0	12.5	14.0	13.4
Public finances 2/						
Revenue and grants	29.0	29.0	28.2	26.1	25.8	25.6
Expenditure	33.4	32.2	32.7	32.7	31.7	30.0
Current, including interest	20.6	20.1	19.2	19.8	21.0	21.0
Capital	12.8	12.1	13.5	12.9	10.7	9.0
Overall balance, including ACP 3/	-4.4	-3.2	-4.6	-6.6	-5.9	-4.4
Overall balance, excluding ACP 3/	-2.1	-1.5	-2.5	-4.3	-3.8	-3.7
External sector						
Current account	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0
Net exports from Colon Free Zone	0.8	1.5	2.5	1.9	1.4	1.3
Net oil imports	1.4	0.2	0.8	1.0	0.7	0.9
Foreign direct investment	9.4	9.1	10.8	9.9	10.0	9.8
Total public debt						
Total debt 2/	43.8	42.6	41.7	45.6	47.3	47.2
External 2/	37.7	32.9	33.1	36.7	36.5	34.0
Domestic	6.1	9.7	8.5	8.9	10.8	13.2
Memorandum items:						
GDP (in millions of US\$, current price, 1996-base) 1/	31,320	35,938	40,393	43,784	47,478	51,579
GDP (in millions of US\$, current price, 2007-base) 1/	33,271	37,956	42,648	46,212	50,111	54,439

Sources: Comptroller General, Superintendency of Banks; the World Bank; and IMF staff estimates.

are still based on GDP with base year of 1996. GDP figures have been revised upward. The revision encompasses changing the base year from 1996 to 2007 as well as enhancing the computation methodology due to the implementation of key recommendation of the new 2008 System of National Accounts (2008 SNA). The upward revision to nominal GDP is between 5.6 to 8.2 percent, depending on the year.

2/ Includes Panama Canal Authority (ACP).

3/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

Table 2. Panama: Summary Operations of the Non-Financial Public Sector 1/
(In percent of GDP)

	2011	2012	2013	2014	Proj.	
					2015	2016
Revenues	24.8	25.1	24.6	23.0	22.8	22.7
Current revenue	25.2	25.0	24.1	22.8	22.8	22.7
Tax revenue	11.3	12.4	12.0	11.0	11.6	11.8
Nontax revenue of central government	6.4	5.5	4.8	4.8	4.1	4.0
o/w: Panama Canal fees and dividends	3.3	2.7	2.4	2.3	2.2	1.9
Social security agency	6.5	6.1	6.6	6.4	6.6	6.4
Public enterprises' operating balance	0.5	0.4	0.3	0.3	0.3	0.3
Other 2/	0.5	0.6	0.4	0.3	0.2	0.2
Capital revenue	0.1	0.1	0.5	0.2	0.0	0.0
Expenditure	26.9	26.6	27.2	27.3	26.6	26.4
Current primary expenditure	16.1	15.8	15.2	15.9	16.4	16.3
Central government 3/	9.2	9.4	8.8	9.5	9.6	9.3
Rest of the general government	6.8	6.4	6.4	6.3	6.8	7.1
Social security agency	6.2	5.8	5.9	5.8	6.3	6.5
Decentralized agencies	0.6	0.6	0.5	0.5	0.6	0.6
Interest	2.4	2.1	2.0	1.9	2.3	2.4
Capital	8.4	8.7	9.9	9.5	7.8	7.6
Overall balance, excluding ACP 4/	-2.1	-1.5	-2.5	-4.3	-3.8	-3.7
Panama Canal Authority (ACP)						
Revenue	7.4	6.7	6.0	5.4	5.2	4.9
Current primary expenditure	2.0	2.0	1.7	1.8	2.0	2.0
Transfers to the government	3.2	2.8	2.4	2.3	2.2	1.9
Interest payments	0.1	0.2	0.3	0.3	0.2	0.2
Capital expenditure	4.3	3.4	3.6	3.4	2.9	1.4
Overall balance	-2.3	-1.7	-2.0	-2.3	-2.2	-0.7
Overall balance, including ACP	-4.4	-3.2	-4.6	-6.6	-5.9	-4.4
Net financing, excluding ACP	2.3	1.5	3.0	4.3	3.8	3.7
External	1.3	0.2	2.8	5.0	1.2	0.5
Domestic	0.9	1.3	0.3	-0.7	2.6	3.2
Memorandum items:						
Primary balance (excluding ACP)	-0.1	0.0	-1.0	-2.5	-1.3	-0.7
Structural primary balance (excluding ACP) 6/	0.0	-0.3	-1.4	-2.5	-1.3	-0.7
Primary balance (including ACP)	-1.9	-0.9	-2.3	-4.4	-3.4	-1.7

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

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

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

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

4/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

5/ Starting from 2015, excluding overspending allowed under Article 34 of Law 38 of 2012.

6/ Structural primary balance adjusted for output gap.

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

	2011	2012	2013	2014	Proj.	
					2015	2016
Revenues and grants	17.8	17.9	17.1	15.9	15.7	15.8
Current revenue	17.7	17.9	16.8	15.8	15.7	15.8
Taxes	11.3	12.4	12.0	11.0	11.6	11.8
Direct taxes	5.3	6.5	6.5	5.6	6.1	6.3
Income tax	4.6	5.8	5.8	5.0	4.9	5.0
Tax on wealth	0.6	0.7	0.7	0.7	1.2	1.3
Indirect taxes	6.1	5.9	5.5	5.4	5.5	5.5
Import tax	1.3	1.5	1.0	0.9	0.8	0.8
ITBMS	3.3	3.0	3.1	3.0	3.3	3.3
Petroleum products	0.3	0.3	0.3	0.3	0.2	0.2
Other tax on domestic transactions	1.2	1.1	1.1	1.2	1.1	1.1
Nontax revenue	6.4	5.5	4.8	4.8	4.1	4.0
Dividends	3.0	2.5	4.7	4.3	4.0	3.6
Of which: Panama Canal Authority	2.2	1.8	1.5	1.5	1.4	1.2
Panama Canal Authority: fees per ton 1/	1.2	0.9	0.9	0.9	0.8	0.7
Transfers from decentralized agencies	1.0	0.7	0.6	0.6	0.4	0.4
Other	1.2	1.4	-1.4	-0.9	-1.1	-0.8
Capital revenue	0.0	0.0	0.3	0.1	0.0	0.0
Grants	0.1	0.0	0.0	0.0	0.0	0.0
Total expenditure	21.4	21.6	21.3	20.9	19.3	18.7
Current	13.3	12.6	11.9	12.6	13.2	13.0
Wages and salaries	4.5	4.4	4.4	4.5	4.6	4.6
Goods and services	3.6	1.8	1.7	1.8	1.9	1.9
Current expenditure of CSS	1.0	0.6	0.6	0.6	0.3	0.5
Transfers to public and private entities	1.8	3.7	3.2	3.7	4.0	3.5
Interest	2.3	2.1	2.0	1.9	2.3	2.4
Domestic	0.2	0.3	0.4	0.4	0.6	0.7
External	2.2	1.8	1.7	1.5	1.7	1.7
Capital	8.0	9.0	9.4	8.3	6.0	5.7
Savings 2/	4.4	5.3	5.0	3.2	2.4	2.7
Overall balance 3/	-3.6	-3.7	-4.2	-4.9	-3.6	-2.9
Financing (net)	3.6	3.6	4.4	5.1	3.6	2.9
External	1.3	0.2	2.8	5.0	1.2	0.5
Domestic	2.2	3.3	1.7	0.1	2.4	2.5
Memorandum items:						
Primary balance	-1.2	-1.7	-2.2	-3.0	-1.2	-0.5
GDP (in millions of US\$)	31,320	35,938	40,393	43,784	47,478	51,579

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes public service fees.
2/ Current revenues and grants less current expenditure.
3/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

Table 4. Panama: Monetary Accounts 1/

	2011	2012	2013	2014	Proj.	
					2015	2016
(In millions of U.S. dollars at end-period)						
Net foreign assets	7,259	5,847	5,830	6,055	6,771	7,563
Short-term foreign assets, net	7,261	5,849	5,832	6,057	6,773	7,565
National Bank of Panama	2,665	2,307	3,038	3,466	3,768	4,104
Rest of banking system	4,597	3,542	2,794	2,591	3,004	3,461
Long-term foreign liabilities	2	2	2	2	2	2
National Bank of Panama	2	2	2	2	2	2
Rest of banking system	0	0	0	0	0	0
Net domestic assets	19,115	23,306	26,145	28,135	30,777	33,228
Public sector (net credit)	-3,636	-3,575	-5,366	-6,190	-6,204	-6,304
Central government (net credit)	-550	311	-781	-1,232	-1,246	-1,346
Rest of the public sector (net credit)	-3,086	-3,886	-4,585	-4,958	-4,958	-4,958
Private sector credit	28,553	32,590	36,543	39,878	43,022	46,057
Private capital and surplus	-6,931	-6,856	-7,128	-8,128	-8,814	-9,575
Other assets (net)	1,129	1,147	2,096	2,574	2,773	3,050
Domestic liabilities to private sector	27,116	29,916	32,484	35,110	37,972	41,252
Total deposits	26,666	29,501	32,116	34,719	37,548	40,791
Demand deposits	6,227	7,067	7,695	8,213	8,906	9,675
Time deposits	13,864	15,174	16,485	17,681	19,073	20,720
Savings deposits	6,574	7,260	7,936	8,824	9,569	10,395
Bonds	451	415	367	391	424	461
12-month change in relation to liabilities to the private sector at the beginning of the period)						
Net foreign assets	-5.1	-5.2	-0.1	0.7	2.0	2.1
Net domestic assets	11.2	15.5	9.5	6.1	7.5	6.5
Public sector credit (net)	-3.6	0.2	-6.0	-2.5	0.0	-0.3
Private sector credit	16.5	14.9	13.2	10.3	9.0	8.0
Private capital and surplus	2.0	-0.3	0.9	3.1	2.0	2.0
Other assets (net)	0.2	0.1	3.2	1.5	0.6	0.7
Liabilities to the private sector	9.3	10.3	8.6	8.1	8.2	8.6
Memorandum items:						
(12-month percent change)						
M2 2/	9.3	10.3	8.6	8.1	8.2	8.6
Private sector credit	16.8	14.1	12.1	9.1	7.9	7.1
(In percent of GDP)						
Onshore banks						
Domestic private sector credits	91.2	90.7	90.5	91.1	90.6	89.3
Foreign credits	38.4	38.5	33.1	35.6	...	...
Domestic private sector deposits	85.1	82.1	79.5	79.3	79.1	79.1
Government deposits	14.0	14.2	15.4	17.0	...	...
<i>Of which</i> , central government	3.9	3.4	4.0	5.7	...	...
Foreign deposits	50.9	46.9	42.2	43.6	...	...
Offshore banks						
Credits	32.3	26.9	26.8	24.2	...	...
Deposits	26.5	26.4	26.3	25.4	...	...

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and IMF staff calculations.
1/ Domestic banking system only (comprises general license banks; does not include offshore banks), unless otherwise specified. Nonresident deposits, credit, and investment are reported in the net foreign assets.
2/ M2 consists of onshore 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)

	2011	2012	2013	2014				LA5 4/
	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Sept. 2014
Asset quality								
Nonperforming loans as percent of total loans								
Banking system	1.3	1.3	1.1	1.4	1.2	1.1	1.4	3.0
Domestic banks	1.4	1.3	1.0	1.3	1.3	1.2	1.6	
Foreign banks	1.2	1.3	1.3	1.5	1.1	1.0	1.3	
Ratio of provisions to nonperforming loans								
Banking system	160.7	178.2	171.2	172.5	171.6	113.2	88.8	n.a.
Domestic banks	157.7	183.2	155.3	165.4	151.5	105.3	95.4	
Foreign banks	152.8	160.2	174.4	166.3	175.7	110.5	73.0	
Profitability								
Net income on average assets								
Banking system	1.7	1.7	1.4	1.6	1.5	1.5	1.5	1.9
Domestic banks 2/	1.5	1.6	1.4	1.2	1.2	1.2	1.2	
Foreign banks	1.9	1.8	1.4	1.9	1.8	1.7	1.7	
Liquidity								
Ratio of liquid assets to total assets								
Banking system	17.6	16.9	17.7	17.4	18.1	18.5	19.5	18.9
Domestic banks	17.6	16.1	16.8	16.6	17.0	18.7	18.6	
Foreign banks	16.5	15.8	17.6	19.5	19.4	18.3	20.0	
Ratio of liquid assets plus marketable securities to total deposits 3/								
Banking system	37.9	34.4	35.3	35.4	36.0	35.8	37.7	n.a.
Domestic banks	34.4	31.9	31.8	31.8	29.3	31.1	31.0	
Foreign banks	41.4	37.1	39.5	42.3	41.5	38.8	41.4	
Capital adequacy ratios								
Ratio of capital to risk-weighted assets								
Banking system	15.5	15.7	14.8	15.0	14.9	14.9	14.7	15.4
Domestic banks	17.6	16.9	15.9	15.8	12.0	16.2	15.8	
Foreign banks	14.3	14.7	13.7	14.1	14.0	13.8	13.7	
Ratio of capital to total assets								
Banking system	11.2	10.4	9.8	10.0	10.0	10.1		10.6
Ownership								
Foreign banks' share of domestic banking system assets								
	53.3	51.7	49.1	52.0	51.7	49.1	49.8	n.a.

Sources: Superintendency of Banks; Financial Soundness Indicators (FSI) Database; and IMF staff calculations.

1/ Domestic banking system only, comprises general license banks; does not include offshore banks.

2/ For Panama, average of domestic private banks and state-owned banks.

3/ For Panama, liquid assets, as defined in Article 75 of the 2008 Banking Law, also include marketable short-term securities.

4/ LA5 includes Brazil, Chile, Colombia, Mexico and Peru. The source is IMF FSI database (may not be fully comparable with Panama figures).

Table 6. Panama: Medium-Term Balance of Payments

	2011	2012	2013	2014	Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
(In millions of U.S. dollars)										
Current account	-4,993	-3,528	-4,918	-5,257	-4,941	-5,174	-4,747	-4,089	-4,024	-4,248
Trade balance excluding Colón Free Zone	-7,480	-6,938	-7,974	-8,973	-8,761	-9,288	-8,797	-8,420	-9,223	-9,871
Exports, f.o.b.	3,145	4,274	3,898	3,801	3,547	3,777	4,709	6,020	6,543	7,123
Imports, f.o.b.	-10,624	-11,212	-11,872	-12,774	-12,308	-13,065	-13,507	-14,440	-15,766	-16,994
Net exports from Colón Free Zone	263	524	997	826	679	669	722	778	837	902
Re-exports, f.o.b.	13,782	14,584	13,262	11,531	11,432	12,268	13,159	14,102	15,090	16,165
Imports, f.o.b.	-13,519	-14,060	-12,265	-10,705	-10,753	-11,598	-12,437	-13,324	-14,253	-15,263
Services, net	3,933	4,696	5,058	6,001	5,939	6,521	7,239	7,857	8,533	9,297
Travel, net	2,144	2,498	2,614	2,578	2,567	2,830	3,175	3,534	3,941	4,411
Transportation, net	1,738	2,331	2,678	3,266	3,204	3,509	3,866	4,106	4,358	4,632
Other services	51	-133	-234	157	168	182	198	217	235	254
Income, net	-1,979	-1,757	-3,102	-3,124	-2,928	-3,218	-4,065	-4,472	-4,353	-4,773
Private sector	-1,377	-1,159	-2,480	-2,525	-1,998	-2,301	-2,798	-3,345	-3,478	-3,558
<i>Of which: Direct Investment</i>	-1,695	-1,700	-2,991	-3,031	-2,501	-2,807	-3,165	-3,377	-3,484	-3,538
Public sector	-603	-598	-621	-599	-930	-917	-1,267	-1,127	-875	-1,215
<i>Of which: NFPS interest</i>	-644	-929	-799	-767	-933	-920	-1,271	-1,130	-879	-1,218
Current transfers, net	202	88	63	120	130	142	154	168	183	197
Capital and financial account	4,568	3,272	5,388	6,950	5,230	5,494	5,103	4,494	4,427	4,670
Financial account	4,568	3,272	5,388	6,950	5,230	5,494	5,103	4,494	4,427	4,670
Public sector, medium and long-term	455	103	1,515	2,292	495	178	353	302	248	240
Nonfinancial public sector 1/	423	-45	1,577	2,221	424	107	282	230	177	169
Other net flows	39	155	-56	78	78	78	78	78	78	78
Private sector, medium and long-term	3,907	4,576	3,589	5,455	5,870	6,248	6,642	6,170	6,144	6,196
Direct investment (net)	2,956	3,254	4,373	4,351	4,727	5,043	5,365	4,781	4,786	4,815
Portfolio investment	800	770	-243	-139	-204	-274	-350	-434	-518	-607
Loans	151	552	-541	1,244	1,347	1,478	1,627	1,822	1,876	1,988
Short-term flows	206	-1,408	284	-797	-1,136	-931	-1,893	-1,977	-1,965	-1,767
Public sector	29	-178	129	110	118	120	120	121	121	121
Private sector	177	-1,230	156	-906	-1,254	-1,051	-2,013	-2,098	-2,086	-1,888
Errors and omissions	197	292	-68	-466	0	0	0	0	0	0
Overall balance	-228	36	402	1,227	288	320	356	405	403	421
Financing	228	-36	-402	-1,227	-288	-320	-356	-405	-403	-421
Net foreign assets of the BNP	228	-36	-402	-1,217	-288	-320	-356	-405	-403	-421
Memorandum items:	(In percent of GDP)									
Merchandise exports	10.0	11.9	9.7	8.7	7.5	7.3	8.4	9.8	9.8	9.9
Merchandise imports	-33.9	-31.2	-29.4	-29.2	-25.9	-25.3	-24.1	-23.5	-23.7	-23.6
Net exports from Colón Free Zone	0.8	1.5	2.5	1.9	1.4	1.3	1.3	1.3	1.3	1.3
Current account	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0	-8.5	-6.7	-6.1	-5.9
<i>Of which: related to Canal Expansion</i>	-3.4	-2.8	-2.9	-2.8	-2.4	-1.3	-0.4	-0.3	-0.3	-0.3
Direct foreign investment	9.4	9.1	10.8	9.9	10.0	9.8	9.6	7.8	7.2	6.7
External public debt	37.7	32.9	33.1	36.7	36.5	34.0	31.5	28.9	26.7	24.7

Sources: Office of the Comptroller General; and IMF staff calculations.

1/ Includes disbursements to ACP.

Table 7. Panama: Medium-Term Macroeconomic Framework

	2011	2012	2013	2014	Proj.					
					2015	2016	2017	2018	2019	2020
(Percent change)										
Economic growth and prices										
Real GDP at market prices	10.9	10.8	8.4	6.2	6.1	6.4	6.7	7.1	6.3	6.0
CPI (period average)	5.9	5.7	4.0	2.6	0.9	2.0	2.0	2.0	2.0	2.0
CPI (end of period)	6.3	4.6	3.7	1.0	2.4	2.0	2.0	2.0	2.0	2.0
(Percent of GDP)										
Savings and investment										
National savings	11.3	18.8	17.8	17.8	18.9	18.1	19.5	21.2	21.8	21.3
Public sector	8.1	7.8	7.8	5.3	4.9	4.7	6.0	6.6	6.3	6.4
Private sector	3.2	11.0	10.0	12.5	14.0	13.4	13.6	14.7	15.5	14.9
Gross domestic investment	27.2	28.6	30.0	29.8	29.3	28.1	28.0	27.9	27.9	27.2
Public sector	12.8	12.9	13.5	12.9	10.7	9.0	7.1	6.5	6.3	6.1
Private sector	14.4	15.7	16.5	16.9	18.6	19.1	20.9	21.4	21.6	21.1
External savings	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0	-8.5	-6.7	-6.1	-5.9
Nonfinancial public sector, excluding ACP										
Revenue	24.8	25.1	24.6	23.0	22.8	22.7	23.4	23.6	23.2	23.0
Revenue, excluding ACP transfers	21.5	22.3	21.7	20.5	20.6	20.7	20.7	20.5	20.3	20.4
Expenditure	26.9	26.6	27.2	27.3	26.6	26.4	25.8	25.2	25.0	24.7
Primary balance	-0.1	0.0	-1.0	-2.5	-1.3	-0.7	0.3	1.1	0.9	0.7
Overall balance 1/	-2.1	-1.5	-2.5	-4.3	-3.8	-3.7	-2.4	-1.6	-1.7	-1.7
Net external financing	1.3	0.2	2.8	5.0	1.2	0.5	0.7	0.6	0.4	0.4
Net domestic financing	0.9	1.3	0.3	-0.7	2.6	3.2	1.7	1.0	1.3	1.3
Panama Canal Authority (ACP)										
Revenue	7.4	6.7	6.0	5.4	5.2	4.9	5.5	5.4	5.4	5.5
Current expenditure	2.0	2.0	1.7	1.8	2.0	2.0	1.9	1.8	1.7	1.6
Transfers to the government	3.2	2.8	2.4	2.3	2.2	1.9	2.7	3.1	2.9	3.0
Interest payments	0.1	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.1
Capital expenditure	4.3	3.4	3.6	3.4	2.9	1.4	0.2	0.2	0.2	0.2
Overall balance	-2.3	-1.7	-2.0	-2.3	-2.2	-0.7	0.5	0.2	0.4	0.5
Nonfinancial public sector, including ACP										
Overall balance	-4.4	-3.2	-4.6	-6.6	-5.9	-4.4	-1.9	-1.4	-1.3	-1.2
Total public debt 2/	43.8	42.6	41.7	45.6	47.3	47.2	45.2	42.5	40.5	38.7
o/w: ACP	2.9	2.9	2.9	3.9	5.0	4.7	3.7	3.0	2.3	1.7
External										
Exports, f.o.b., excluding Colón Free Zone	10.0	11.9	9.7	8.7	7.5	7.3	8.4	9.8	9.8	9.9
Imports, f.o.b., excluding Colón Free Zone	-33.9	-31.2	-29.4	-29.2	-25.9	-25.3	-24.1	-23.5	-23.7	-23.6
Net exports of Colón Free Zone	0.8	1.5	2.5	1.9	1.4	1.3	1.3	1.3	1.3	1.3
Current account balance	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0	-8.5	-6.7	-6.1	-5.9
Foreign Direct Investment	9.4	9.1	10.8	9.9	10.0	9.8	9.6	7.8	7.2	6.7
(In millions of U.S. dollars)										
Memorandum items:										
Nominal GDP	31,320	35,938	40,393	43,784	47,478	51,579	56,137	61,328	66,498	71,899
External debt (public, percent of total non-bank external debt)	37.7	32.9	33.1	36.7	36.5	34.0	31.5	28.9	26.7	24.7
External Debt (excluding banks, percent of GDP)	57.8	53.7	50.9	48.4	47.8	46.4	45.4	44.1	43.1	42.2
External Debt (excluding offshore banks, percent of GDP)	117.4	111.6	109.6	112.8	111.4	109.2	107.4	105.2	103.2	101.4
External Debt (including all banks, percent of GDP) 3/	163.1	154.3	148.9	150.4	148.7	147.0	144.1	140.7	137.9	135.3

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

1/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

2/ Includes external debt for Panama Canal expansion.

3/ Includes offshore banks.

Table 8. Panama: Vulnerability Indicators

	2011	2012	2013	Est.	Proj.	
				2014	2015	2016
Financial indicators						
Broad money (12-month percent change)	9.3	10.3	8.6	8.1	8.2	8.6
Private sector credit (12-month percent change)	16.8	14.1	12.1	9.1	7.9	7.1
Deposit rate (6-month; in percent) 1/	1.9	1.9	1.8	...	...	...
External indicators						
Merchandise exports (12-month percent change)	29.4	35.9	-8.8	-2.5	-6.7	6.5
Merchandise imports (12-month percent change)	42.3	5.5	5.9	7.6	-3.7	6.2
Current account balance (in percent of GDP)	-15.9	-9.8	-12.2	-12.0	-10.4	-10.0
Capital and financial account balance	14.6	9.1	13.3	15.9	11.0	10.7
<i>Of which: direct investment</i>	9.4	9.1	10.8	9.9	10.0	9.8
Public sector external debt (in percent of GDP)	37.7	32.9	33.1	36.7	36.5	34.0
In percent of exports of goods and services 2/	102.9	83.9	90.8	103.5	114.2	107.4
External interest payments						
In percent of exports of goods and services 2/	5.6	6.6	5.4	4.9	6.2	5.6
External amortization payments						
In percent of exports of goods and services 2/	4.5	6.5	5.2	1.2	4.9	2.6
REER, percent change (average, depreciation -)	1.7	3.9	4.5	-2.0	...	...
Gross international reserves at end of period						
In millions of U.S. dollars 3/	2,733	2,413	3,144	3,572	3,874	4,210
In months of imports of goods and services	2.0	1.6	2.0	2.4		
In percent of broad money 4/	10	8	10	10	10	10
In percent of short-term external debt 5/	32	26	31	35	34	37
(In millions of U.S. dollars)						
Memorandum items:						
Nominal GDP	31,320	35,938	40,393	43,784	47,478	51,579
Exports of goods and services 2/	11,483	14,099	14,746	15,528	15,169	16,350
Imports of goods and services 2/	15,029	16,342	17,661	18,500	17,991	19,118
Sources: Ministry of Economy and Finance; and IMF staff calculations.						
1/ One-year average for the banking system, comprises general license banks, excluding offshore banks.						
2/ Includes net exports of the Colón Free Zone.						
3/ Corresponds to gross foreign assets of the National Bank of Panama (a publicly-owned commercial bank).						
4/ M2 consists of resident bank deposits only; estimates of U.S. currency in circulation are not available.						
5/ Excludes off-shore banks' external liabilities. Short-term public external debt includes next year amortization.						

Annex I. Implementation of Past IMF Policy Advice

The authorities' macroeconomic policies over the last year have been broadly in line with past Fund advice. Some reforms have been delayed by the election and change in administration. During the 2014 Article IV consultation, Directors emphasized that continued commitment to strong macroeconomic and financial policies as well as structural reforms would be important to safeguard against external and domestic shocks, and to support strong and sustainable growth. Directors underscored that the credibility of the fiscal framework needs to be strengthened and fiscal stance tightened to provide a cushion against external shocks. Directors encouraged swift implementation of the remaining 2011 FSAP recommendations, and underscored the importance of stepping up efforts to strengthen the AML/CFT regime, including implementation of the recommendations of the AML/CFT assessment report. They encouraged the authorities to further enhance the quality of public education and upgrade skills of the labor force.

Fiscal policy. Staff advised the authorities to keep the fiscal deficit below the SFRL ceiling. In 2014, fiscal deficit exceeded the SFRL ceiling mainly due to overspending of the previous administration and underperformance of revenues. Going forward, the fiscal framework allows the fiscal deficit to exceed the SFRL ceilings up to the amount that budget contributions from the Canal are below 3.5 percent of GDP. The authorities have started to review the current fiscal framework and taken measures to increase revenues. A new platform for public sector financial information management (ISTMO) is being adopted. Its full implementation would facilitate upgrading the public sector accounting standard and the implementation of a Single Treasury Account.

Financial sector reforms. Further progress has been made in implementing the 2011 FSAP recommendations. The authorities issued a regulation on the Consolidated Supervision of Banking Groups in August 2014. Steps have been taken to adopt the international financial reporting standards and align capital regulation with the Basel III framework. Banks are required to take measures to identify the ultimate beneficiaries of their corporate clients. The Financial Coordination Council is becoming more active in the identifying and monitoring systemic risk.

Transparency. The authorities are clearly committed to implementing the recommendations of the IMF AML/CFT assessment and the action plan agreed with the FATF. In February 2015, the FATF recognized steps being taken to address the deficiencies in the AML/CFT framework, and indicated that the authorities should continue pressing ahead with their work agenda. A new anti-money laundering law was passed by the National Assembly in April 2015.

More inclusive growth. The authorities are enhancing social protection programs and evaluating how to better target them. Reforms to the education system include deeper emphasis on computer and language skills as well as on the training of teachers. To address skill mismatches and shortages, vocational education is being improved and a job market database (encompassing both employment opportunities and potential job applicants) has been initiated.

Annex II. Panama Risk Assessment Matrix¹

Nature/Source of Main Threats	Risk	Impact	Effect	Policy Response
External Risks				
A surge in global financial market volatility.	H	M/H	Reduction in capital inflows and/or an increase in capital outflows, accompanied by difficulty in rolling over financing, freezing of foreign credit lines, and increasing spreads and domestic rates.	State to provide fiscal and liquidity support. Deficit financing more tilted to domestic market. Current account to adjust automatically through lower imports.
Persistent dollar strength.	H	M	In light of the dollarization, a stronger dollar implies real appreciation for Panama. In turn, this may reduce exports and adversely impact banks' exposure to exporters.	Current account to adjust automatically through lower imports. State to offer liquidity support if necessary.
Protracted period of slower growth in: <ul style="list-style-type: none"> • Advanced economies • Emerging economies Sharp growth slowdown in China.	H M L	H	Reduction in exports due to subdued external demand as well as lower receipts from the Canal due to weaker global trade. The adverse impact upon economic activity may be particularly severe in the Colon Free Zone given its high reliance on foreign trade.	Current account to adjust automatically through lower imports. State to offer liquidity support if necessary.
Bond market stress from a reassessment of sovereign risk in: <ul style="list-style-type: none"> • Euro area • United States. 	M L	M	Higher financing costs, less favorable financing conditions, and potential capital outflows.	Intensify monitoring and supervision. Fiscal consolidation.
Domestic Risks				
Delays in strengthening the AML/CFT framework.	L	H	Severe disruption in the ability to undertake international transactions: higher costs of trade settlements, difficulty in obtaining cross-border borrowing, and potential decline in FDI.	Enhance efforts in improving financial integrity and transparency and comply with the international standard for AML/CFT.
Further disruption to the Canal expansion.	L	L	Negative effects on growth and employment in the short term and exports and revenues in the medium term.	Reduction in medium term fiscal expenditure plans.
Further relaxation of deficit targets.	L	H	Larger borrowing and contribution to fiscal vulnerability. Reduced market confidence.	Build fiscal buffer and commit to fiscal targets below the SFRL ceilings.
<p>1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.</p>				

Annex III. Implementation of 2011 FSAP Recommendations

Recommendation	Status/Expected Completion Date
Banking Oversight	
Finalize and implement regulations on operational and interest rate risks.	The SBP issued a regulation on operational and market risk in December 2011 and has plans to introduce capital charges for these risks in 2016.
Enhance systemic risk monitoring and the capacity to implement macro-prudential policies.	<ul style="list-style-type: none"> • A new credit regulation incorporating dynamic provisioning and accounting treatment of restructured loans was issued in May 2013. • The Financial Coordination Council was established and continues to strengthen its capacity in order to implement macroprudential policies. • A regulation on the Consolidated Supervision of Banking Groups was released in August 2014. • A draft law on Trust Funds was released in January 2015; legislation on Certified Public Accountants is pending but a register for external accountants is being established.
Develop capital adequacy and regulatory reporting standards for holding companies.	Regulation establishing a minimum capital requirement for bank holdings was issued in February 2015, while also aligning capital requirements for banks with Basel III rules.
Develop concentration limits and risk management requirements for interbank deposits.	No plans to develop such requirements. The authorities noted that the law allows them to introduce such limits and requirements for individual banks as needed.
Enhance offsite supervision to develop a view on macroprudential and systemic risk trends.	<ul style="list-style-type: none"> • Off-site supervision was improved in 2012 through requirement for banks to report monthly performance and early warning indicators to the SBP. • The SBP has developed methodologies to identify systemically important banks and measure interconnectedness between banks. • The SBP was initiated an upgrade of its Financial Stability Report (to be published now on a semi-annual basis).
Regulate and effectively supervise cooperatives that provide credit and savings products.	A draft law on cooperatives, which would upgrade regulation and strengthen supervision in that sector, continues to be developed.
Insurance Sector Oversight	
Approve draft Insurance Law with strengthened prudential requirements.	The law creating the Superintendencia of Insurance was adopted in 2012 (Ley 12-2012).
Strengthen disclosure of performance indicators and brokers' commissions.	Not implemented.
Securities Market Oversight	
Strengthen the budgetary position, and the supervisory and enforcement capabilities of the supervisor (National Securities Commission).	Law 67 (dated 1 September 2011) upgraded the Commission to a Superintendency (SMV), strengthening its supervisory and enforcement capacity as well as its budgetary position. Further strengthening the enforcement capacity of the SMV is needed.

Payments and Securities Systems Oversight	
Create a comprehensive payments system law guaranteeing payment finality.	No initiatives so far.
Adopt an RTGS or Hybrid Payments System.	No initiatives so far.
Financial Safety Nets	
Conclude studies and introduce a banks' liquidity facility.	Ongoing. The authorities set up a steering group with private sector representation. A strategy has been developed with assistance of external consultants. The stake holders are being consulted on the strategy to establish a liquidity facility.
Establish a deposit insurance scheme.	No initiatives so far.
Capital Market Development	
Build a single yield curve across domestic and global bonds by dual listing and extending market making to global bonds.	Ongoing. The authorities have been making efforts to extend market making to global bonds.
Review and restructure or close public development banks and guarantee funds.	Medium-term recommendation. No initiatives so far.

Annex IV. External Sector Assessment

A number of methodologies suggest that there are moderate signs of temporarily excessive current account deficit, but no indication of a real exchange rate misalignment.

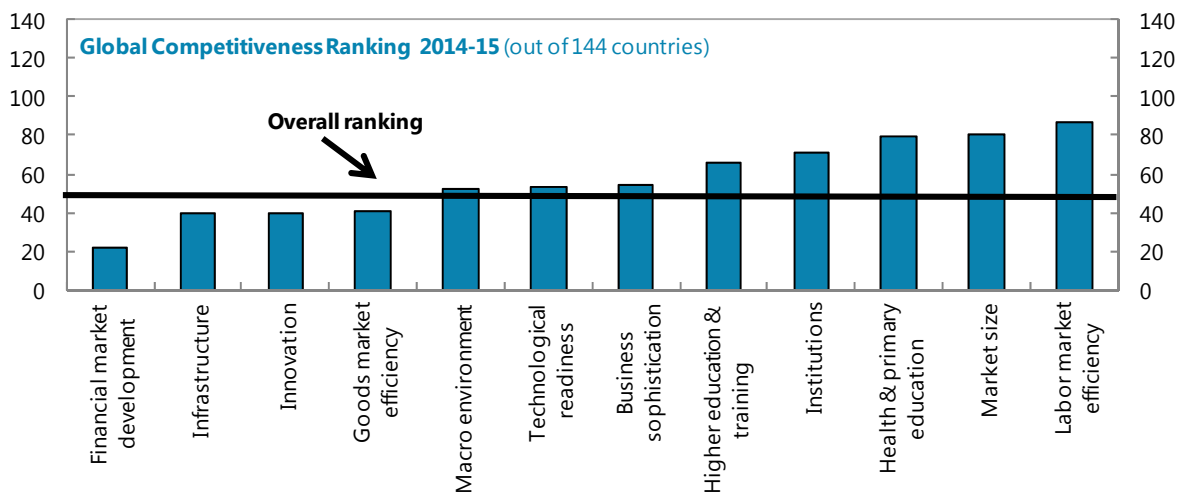
Panama: External Assessment Results (in percent) 1/						
	Underlying CA/Y	CA/Y Norm	NFA/Y	NFA/Y- stabilising CA/Y	CA/Y gap	REER gap
MB Approach	-12.0	-5.7			-6.3	
ES Approach	-12.0		-88.9	-7.3	-4.7	
MB Approach with MT CA/Y	-6.6	-5.7			-0.9	
REER (INS measure)						-4.1
REER (relative to EBA countries)						3.8

1/ The MB approach calculates the norm in the current account to GDP ratio (CA/Y), based on an approach similar to the [IMF External Balance Assessment methodology](#) (EBA), adding Panama to the EBA sample. The ES approach calculates the difference between the underlying CA to GDP ratio (2014, adjusted for output gap) and the CA to GDP ratio stabilizing the 2014 NFA to GDP ratio. The REER approach uses EBA-like regressions to explain the REER. CA/Y and NFA/Y are measured in percent of GDP. REER is measured in percent. The MB Approach with Medium-Term current account presents an underlying current account where exports are adjusted for risk.

Panama's current account deficit remains elevated, but the gap is closing fast over the medium term. The CA deficit has been larger than the value explained by fundamentals and desirable policies since mid-2000s—apart from the sharp adjustment during the global crisis—and the gap is now about 6 percent (see the Annex table). The ES methodology points to a somewhat smaller but still large CA imbalance. However, the MB and ES gaps fail to capture the impact on the current account of temporarily high investment which, over the medium term, will raise both productive capacity and exports and facilitate a correction in the CA temporary imbalance. Accounting for the reduction in investment and the increase in exports over the medium term, the deviation of the CA from fundamentals would be around 1 percent of GDP. Strong and stable FDI inflows are expected to continue to finance the bulk of external CA deficits in the coming years (Table 7), and external debt is deemed sustainable and resilient to shocks (see Annex V).

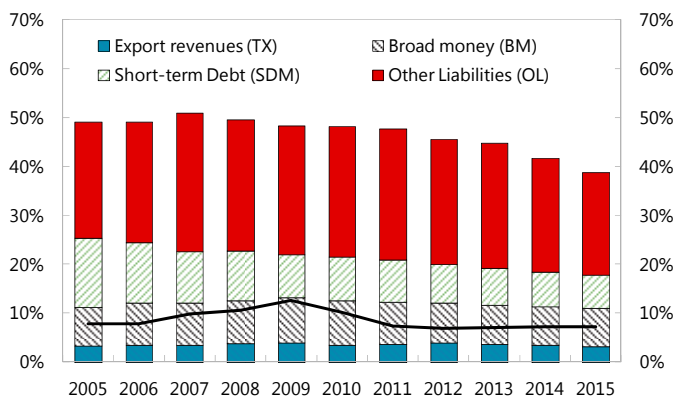
The REER does not appear misaligned. The REER depreciated substantially in the early 2000s and subsequently started appreciating as inflation picked up. In 2014 the REER depreciated by 2 percent due to lower inflation than in Panama's trading partners (most notably due to the high inflation in Venezuela which makes up 10 percent of total trade). Excluding Venezuela, REER appreciated in 2014 by about 2 percent and the REER model points to a slight overvaluation (4 percent).

Panama remains the second most competitive economy in Latin America, after Chile. When compared to its overall Global Competitiveness Index, Panama's strengths are in financial market development, infrastructure, and goods market efficiency. The main challenges remain in labor market efficiency, healthcare and primary education, institutions, and higher education and training. Panama is behind Colombia, Peru and Chile in the 2015 Doing Business report, with its main strengths being reported in "trading across border" and "access to credit", and weaknesses in "ease of paying taxes" and "resolving insolvency".



Reserves appear low by standard reserves metrics, but these may be misleading for Panama. Panama is a fully dollarized economy and official reporting of reserves is close to the net foreign assets of the main public bank (Banco Nacional de Panama). However, Panamanian banks also have solid reserves buffers and access to contingent credit lines. In addition, the government has access to other U.S. dollar assets (such as the Sovereign Wealth Fund, and deposits held in domestic banks). Nonetheless, the authorities need to take steps to build policy buffers and lessen vulnerabilities over the medium term, including by lowering net debt and establishing a liquidity facility for banks.

Assessing Reserve Adequacy (ARA) Metric Decomposition Panama



Sources: World Economic Outlook (WEO); and IMF staff estimates.

Annex V. Debt Sustainability Analysis (DSA)

Panama: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

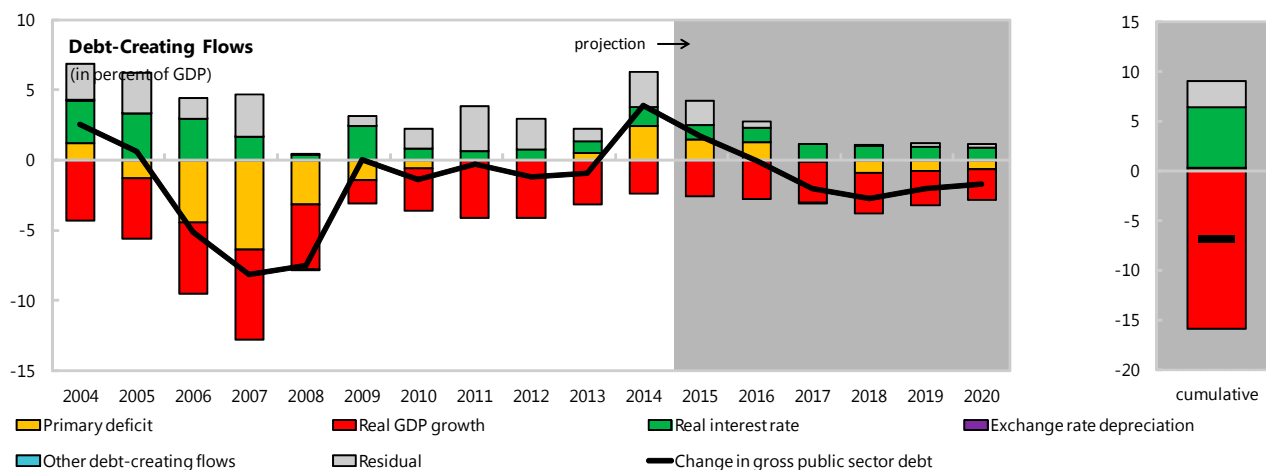
(In percent of GDP, unless otherwise indicated)

Debt, Economic, and Market Indicators ^{1/}

	Actual			Projections						As of February 28, 2015		
	2004-2012 ^{2/}	2013	2014	2015	2016	2017	2018	2019	2020			
Nominal gross public debt	51.9	41.7	45.6	47.3	47.2	45.2	42.5	40.5	38.7	Sovereign Spreads EMBIG (bp) ^{3/}	189	
Public gross financing needs	1.4	2.4	5.9	7.4	6.6	5.3	7.2	6.3	8.1	5Y CDS (bp)	123	
Real GDP growth (in percent)	8.7	8.4	6.2	6.1	6.4	6.7	7.1	6.3	6.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.1	3.7	2.1	2.2	2.1	2.0	2.0	2.0	2.0	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	12.1	12.4	8.4	8.4	8.6	8.8	9.2	8.4	8.1	S&Ps	BBB	BBB
Effective interest rate (in percent) ^{4/}	6.7	5.4	5.0	4.7	4.7	4.7	4.6	4.6	4.5	Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual				Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020			
Change in gross public sector debt	-2.3	-0.9	3.9	1.7	0.0	-2.0	-2.8	-2.0	-1.7	-6.8		
Identified debt-creating flows	-4.2	-1.9	1.4	-0.1	-0.5	-1.9	-2.8	-2.3	-2.0	-9.5		
Primary deficit	-1.8	0.5	2.4	1.5	1.2	-0.1	-0.9	-0.8	-0.6	0.3	-1.3	
Primary (noninterest) revenue and grants	24.3	24.6	22.9	22.8	22.7	23.4	23.6	23.2	23.0	138.6		
Primary (noninterest) expenditure	22.5	25.1	25.4	24.2	23.9	23.3	22.6	22.5	22.4	138.9		
Automatic debt dynamics ^{5/}	-2.4	-2.4	-1.0	-1.6	-1.7	-1.8	-1.9	-1.5	-1.3	-9.8		
Interest rate/growth differential ^{6/}	-2.4	-2.4	-1.0	-1.6	-1.7	-1.8	-1.9	-1.5	-1.3	-9.8		
Of which: real interest rate	1.8	0.8	1.3	1.0	1.1	1.1	1.0	1.0	0.9	6.1		
Of which: real GDP growth	-4.2	-3.2	-2.4	-2.6	-2.8	-2.9	-2.9	-2.5	-2.2	-15.9		
Exchange rate depreciation ^{7/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
PS: Privatization proceeds and sales of assets (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
CG: Privatization Proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual, including asset changes ^{8/}	1.9	0.9	2.5	1.8	0.4	-0.1	0.0	0.3	0.3	2.7		



Source: IMF staff.

1/ Public sector debt and financing needs includes those of the Non-Financial Public Sector and the external financing needs of the Panama Canal expansion.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+gr)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

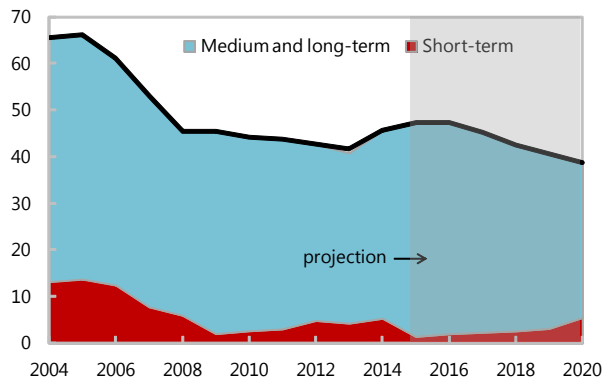
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Panama: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

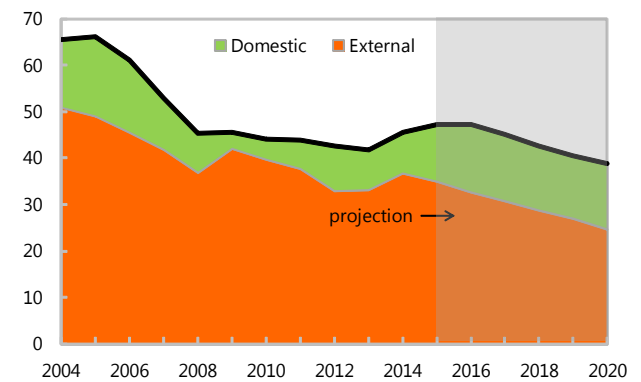
By Maturity

(in percent of GDP)



By Market

(in percent of GDP)



Alternative Scenarios

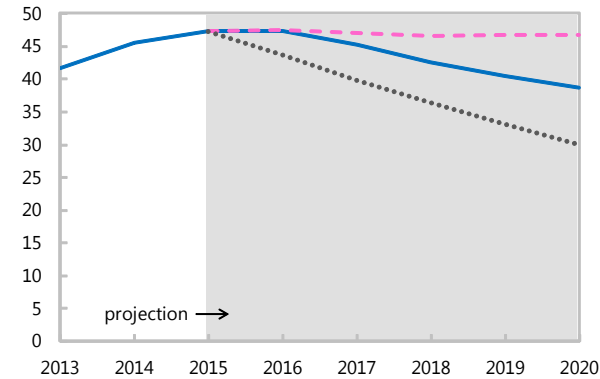
— Baseline

..... Historical

- - - Constant Primary Balance

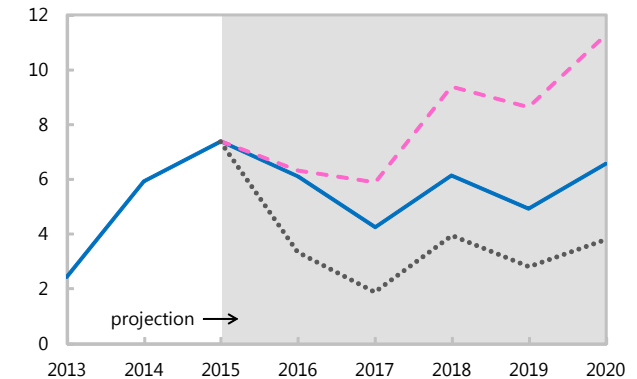
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020	Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	6.1	6.4	6.7	7.1	6.3	6.0	Real GDP growth	6.1	8.5	8.5	8.5	8.5	8.5
Inflation	2.2	2.1	2.0	2.0	2.0	2.0	Inflation	2.2	2.1	2.0	2.0	2.0	2.0
Primary Balance	-1.5	-1.2	0.1	0.9	0.8	0.6	Primary Balance	-1.5	1.4	1.4	1.4	1.4	1.4
Effective interest rate	4.7	4.8	4.8	4.7	4.7	4.6	Effective interest rate	4.7	4.8	4.8	4.8	4.8	4.7
Constant Primary Balance Scenario													
Real GDP growth	6.1	6.4	6.7	7.1	6.3	6.0							
Inflation	2.2	2.1	2.0	2.0	2.0	2.0							
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5							
Effective interest rate	4.7	4.8	4.8	4.7	4.7	4.6							

1/ Historical scenario assumes real GDP growth and primary balance convert to 10 year (2004-2013) historical average from 2015 onwards.

Source: IMF staff. Gross financing needs in 2018 includes an expected amortization on existing debt in the amount of US\$1.3 billion.

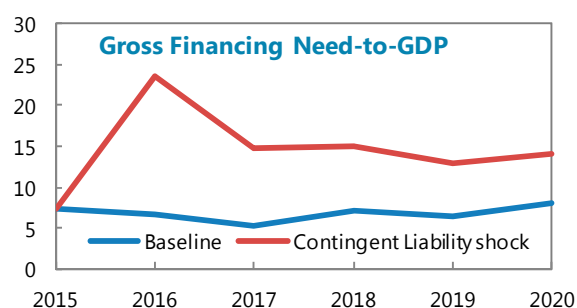
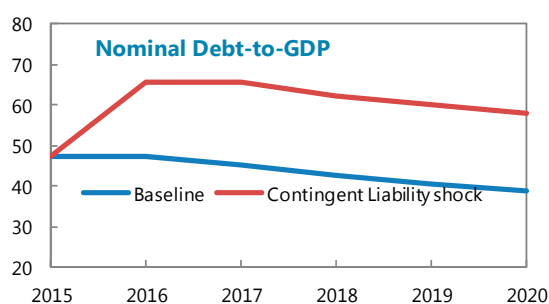
Panama Public DSA Stress Test

Two additional stress tests are conducted—a near-term financial contingent liability shock and a medium-term output and financial condition shock.

The near-term financial contingent liability shock assumes a one-standard-deviation shock to GDP growth in 2016–17, and a public expenditures shock in the amount of 10 percent of

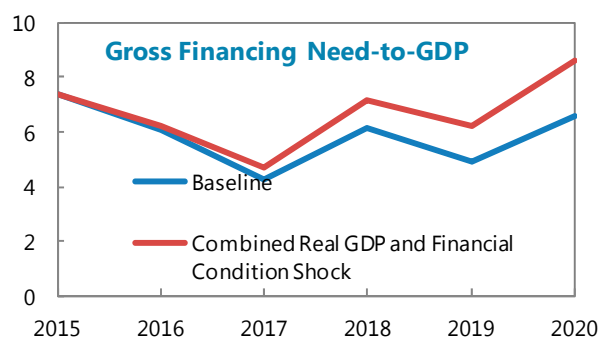
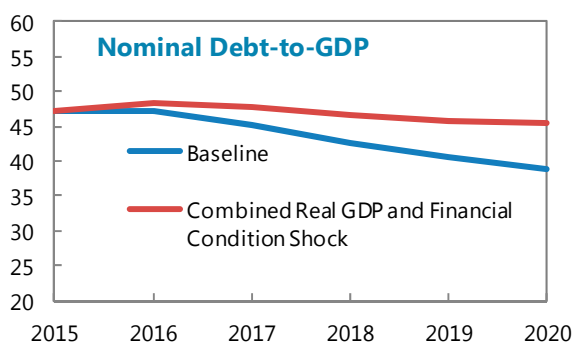
banking system's assets in 2016; at the same time, for every 1 percentage of GDP increase in primary balance, financing costs increase by 25 basis points. Public debt increases to 65½ percent of GDP in 2016-17 in this scenario, but resumes to a declining path afterwards.

Financial Contingent Liability Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	6.1%	3.9%	4.2%	7.1%	6.3%	6.0%
Inflation (GDP Deflator change)	2.2%	1.5%	1.4%	2.0%	2.0%	2.0%
Non-interest revenue-to-GDP ratio	22.8%	22.7%	23.4%	23.6%	23.2%	23.0%
Non-interest expenditure-to-GDP ratio	24.2%	40.6%	23.3%	22.6%	22.5%	22.4%
Primary Balance	-1.5%	-17.9%	0.1%	0.9%	0.8%	0.6%
Interest rate shock (bpts) compared to baseline	0	417	0	0	0	0



The medium-term output and financial condition shock assumes GDP growth slows down to 4 percent from 2016 onward and financing costs increase by 400 basis points compared to baseline (this is similar to what happened in the 2009 crisis). The impact on public debt is limited.

Combined Real GDP and Financial Condition Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	6.1%	4.0%	4.0%	4.0%	4.0%	4.0%
Inflation (GDP Deflator change)	2.2%	2.1%	2.0%	2.0%	2.0%	2.0%
Non-interest revenue-to-GDP ratio	22.8%	22.7%	23.4%	23.6%	23.2%	23.0%
Non-interest expenditure-to-GDP ratio	24.2%	23.9%	23.3%	22.6%	22.5%	22.4%
Primary Balance	-1.5%	-1.2%	0.1%	0.9%	0.8%	0.6%
Interest rate shock (bpts) compared to baseline	0	400	400	400	400	400



Sources: Panama authorities; and IMF staff calculations.

Panama: External Debt Sustainability Framework, 2009–20

(In percent of GDP, unless otherwise indicated)

	Actual												Debt-stabilizing non-interest current account ^{7/}	
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020		
Baseline: External debt ^{1/}	119.4	113.2	117.4	111.6	109.6	112.8	111.4	109.2	107.4	105.2	103.2	101.4	-10.2	
Change in external debt	-1.9	-6.2	4.2	-5.8	-2.0	3.2	-1.4	-2.2	-1.9	-2.2	-2.0	-1.9		
Identified external debt-creating flows (4+8+9)	-10.4	-10.3	-8.9	-14.3	-11.0	-4.2	-5.9	-6.3	-7.8	-8.1	-7.3	-6.5		
Current account deficit, excluding interest payments	-5.9	5.6	10.6	4.9	7.6	7.9	6.3	5.9	4.3	2.5	1.9	1.8		
Deficit in balance of goods and services	-4.7	3.9	10.5	4.8	4.7	4.9	4.5	4.1	1.5	-0.3	-0.2	-0.5		
Exports	39.8	33.8	36.7	39.2	36.5	35.5	31.9	31.7	32.9	34.0	33.9	33.9		
Imports	35.1	37.7	47.1	44.0	41.3	40.4	36.5	35.8	34.4	33.7	33.7	33.5		
Net non-debt creating capital inflows (negative)	-5.2	-8.9	-9.4	-9.1	-10.8	-9.9	-10.0	-9.8	-9.6	-7.8	-7.2	-6.7		
Automatic debt dynamics ^{2/}	0.8	-7.0	-10.1	-10.2	-7.7	-2.1	-2.2	-2.4	-2.6	-2.8	-2.0	-1.6		
Contribution from nominal interest rate	6.6	5.8	5.4	4.9	4.6	4.1	4.1	4.1	4.1	4.1	4.1	4.1		
Contribution from real GDP growth	-4.5	-7.9	-10.6	-10.9	-8.3	-6.3	-6.3	-6.6	-6.7	-7.0	-6.1	-5.7		
Contribution from price and exchange rate changes ^{3/}	-1.4	-4.8	-4.8	-4.2	-4.0	-2.2	-2.4	-2.3	-2.1	-2.1	-2.1	-2.0		
Residual, incl. change in gross foreign assets (2-3) ^{4/}	8.5	4.1	13.1	8.5	8.9	9.6	6.9	6.4	8.1	8.0	7.4	6.7		
External debt-to-exports ratio (in percent)	300.0	335.0	320.3	284.5	300.2	318.0	348.7	344.6	326.7	309.0	304.4	298.8		
Gross external financing need (in billions of US dollars) ^{5/}	7.9	9.1	12.7	12.6	15.0	15.8	16.0	17.0	16.4	16.4	17.3	17.6		
in percent of GDP	32.7	33.6	40.7	34.9	37.1	36.0	33.6	33.0	29.2	26.8	26.0	24.4		
Scenario with key variables at their historical averages ^{6/}														
External debt						109.6	105.9	99.5	92.9	87.9	83.0	77.5	71.6	-13.5
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.9	7.5	10.8	10.7	8.4	6.2	6.1	6.4	6.7	7.1	6.3	6.0		
GDP deflator in US dollars (change in percent)	1.1	4.2	4.4	3.7	3.7	2.1	2.2	2.1	2.0	2.0	2.0	2.0		
Nominal external interest rate (in percent)	5.7	5.4	5.5	4.8	4.6	4.1	4.0	4.0	4.1	4.2	4.3	4.3		
Growth of exports (US dollar terms, in percent)	11.5	-5.0	25.6	22.8	4.6	5.3	-2.3	7.8	12.8	13.2	8.0	8.2		
Growth of imports (US dollar terms, in percent)	-16.6	20.3	44.8	7.1	5.3	6.1	-2.1	6.6	4.5	7.1	8.4	7.4		
Current account balance, excluding interest payments	5.9	-5.6	-10.6	-4.9	-7.6	-7.9	-6.3	-5.9	-4.3	-2.5	-1.9	-1.8		
Net non-debt creating capital inflows	5.2	8.9	9.4	9.1	10.8	9.9	10.0	9.8	9.6	7.8	7.2	6.7		

1/ The external debt excludes the offshore banks.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency, equal to zero for Panama), and α = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator). Given $\varepsilon = 0$ for Panama, this term becomes $-\rho(1+g)/(1+g+\rho+g\rho)$.

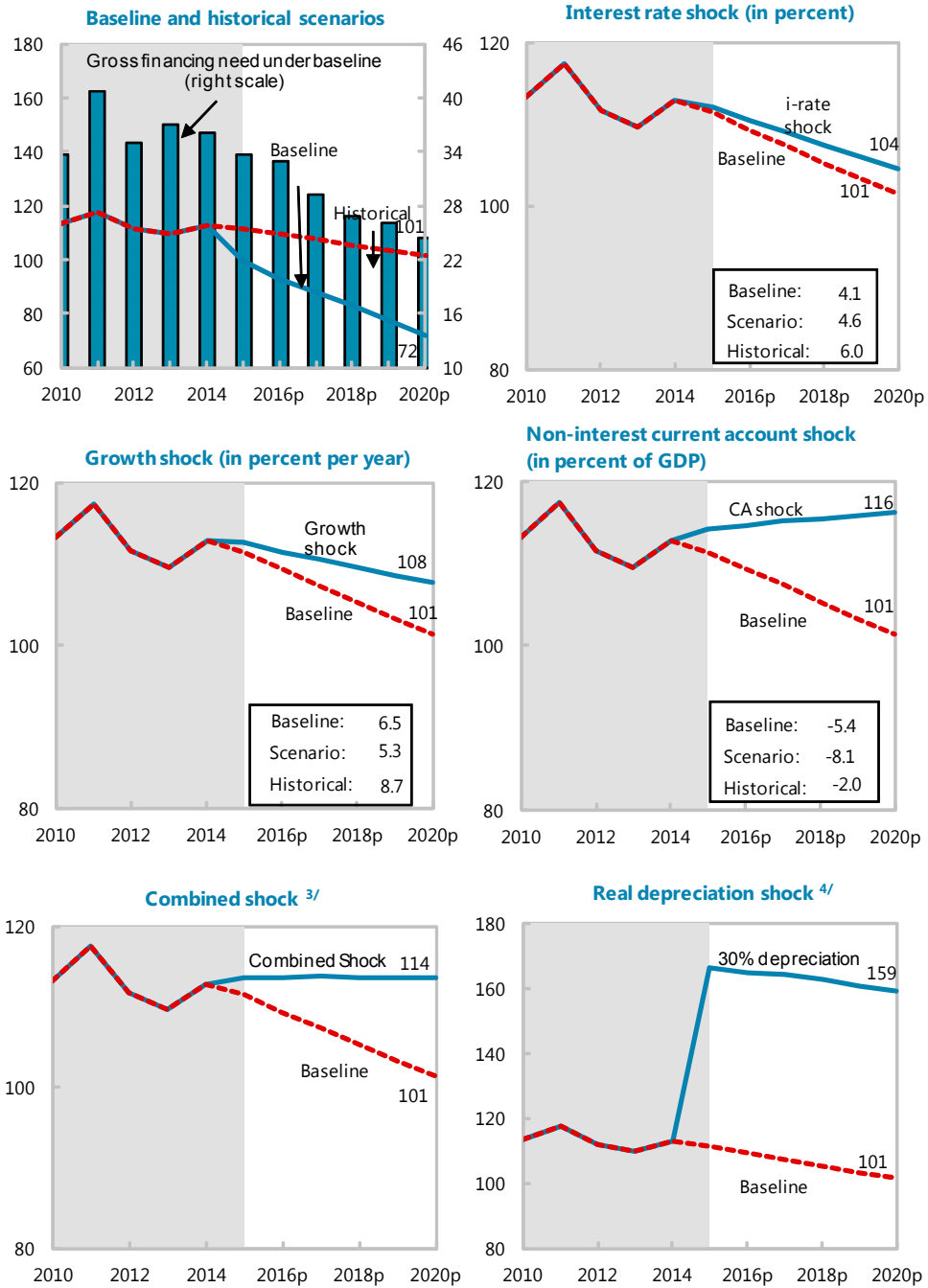
4/ For projection, line includes the impact of price and exchange rate changes.

5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

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



Sources: International Monetary Fund, Country desk data, and IMF staff calculations.

^{1/} Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown. In all scenarios, gross foreign assets are assumed to increase as in the baseline model.

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

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

^{4/} One-time real depreciation of 30 percent occurs in 2015.

Annex VI. Existing and Forthcoming Free Trade Agreements

Panama has been actively promoting further integration to the world economy through Free Trade Agreements (FTAs). A total of thirteen FTAs have come into force since the first one in 2003.

Agreements with the United States, Canada and the European Union came into effect during 2012 and 2013.¹ An FTA with the EFTA states (Iceland, Liechtenstein, Norway and Switzerland; jointly negotiated with Costa Rica) came into effect in 2014, and covers trade in goods, services, investment and government procurement. EFTA states eliminated all custom duties on industrial products (including fish) immediately, whereas Panama will do so after a transitional period, with all trade in such goods to be duty free by 2029 at the latest.

Panama has now signed agreements with all four members of the Pacific Alliance.

The FTAs with Mexico and Colombia are expected to come into effect in 2015. The agreement with Mexico will eliminate almost all tariffs in goods within five years of coming into effect. The FTA with Colombia will immediately suppress import tariffs on 49 percent of manufacturing goods, with another 50 percent to become duty free within twelve years. It also establishes duty-free quotas on primary products, with the quotas progressively increasing over time. Panama is an observant state in the Pacific Alliance, composed by Chile, Colombia, Mexico and Peru.² Signing FTAs with all four members is a prerequisite for accession to the Alliance.

The share of trade with FTA partner countries is rising rapidly. Partner countries with which an FTA is currently in force represented about 45 percent of trade in goods, and 40 percent of FDI inflows, in 2013. More precisely, exports and imports with partners with FTAs currently in force

FTAs in effect					
Partner country	In effect since	% of duty-free lines		Reduction program ends	
		2013	Final		
El Salvador	April 11, 2003	82.44	82.44	2013	
Taiwan Province of China	January 1, 2004	95.07	95.07	2013	✓
Singapore	July 24, 2006	76.18	97.42	2021	✓
Chile	March 7, 2008	74.30	97.30	2022	
Costa Rica	November 23, 2008	88.70	97.50	2026	
Honduras	January 8, 2009	8.10	87.20	2026	
Guatemala	June 20, 2009	84.89	97.39	2028	
Nicaragua	November 21, 2009	86.50	90.50	2024	
Peru	May 1, 2012	58.05	96.50	2029	
United States	October 31, 2012	73.32	99.97	2031	
Canada	April 1, 2013	75.70	98.80	2031	
European Union	August 1, 2013	50.89	94.62	2027	
EFTA 1/					
- Liechtenstein	August 29, 2014	59.51	93.24	2028	
- Norway	August 29, 2014	59.51	93.24	2028	
- Switzerland	August 29, 2014	59.46	93.27	2028	
- Iceland	September 5, 2014	59.48	93.29	2028	

Under negotiation	
Partner country	Status of negotiations
Colombia	Concluded September 20, 2013
Mexico	Concluded April 3, 2014
Israel	Second round March, 2015

¹ Iceland, Liechtenstein, Norway and Switzerland. Joint agreement with Costa Rica
Sources: Panama National Authorities, and WTO Trade Policy Review Panama 2014.

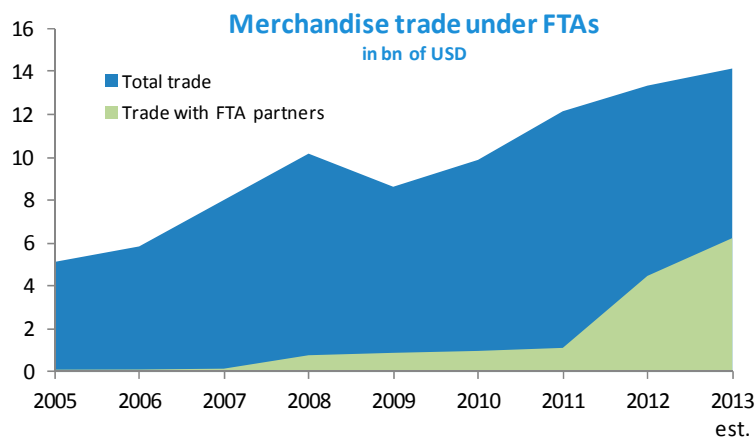
¹ These agreements were covered in greater detail in the Staff Report for the 2012 Article IV Consultation, Text Box 2, p. 9.

² The Pacific Alliance was established in April 2011. Panama and Costa Rica have applied for full membership in 2011 and 2013, respectively.

amounted in 2013 to about 70 and 40 percent, respectively. Colombia and Mexico combined represented around 2 percent of exports and 8 percent of imports, while FDI flows with these countries amounted to 14 percent of total FDI flows.

Recent and forthcoming FTAs are expected to have a significant effect on total trade in goods. Conservative estimates indicate that, all else equal,

signing an FTA increases bilateral trade by 77 percent.³ Given their weights in bilateral trade, the FTAs with the U.S. and the European Union are expected to increase Panama's total trade by about 18 percent and 7 percent, respectively. Similarly, the FTAs with Mexico and Colombia would cause an increase in trade of about 6 percent. The FTAs that have been signed with major partners will also support FDI flows over the medium term.



Note: For each year, the chart shows total trade, and trade with partners with which an FTA was in force at that time.

Sources: Panama National Authorities, and staff calculations

³ See unabridged version of Rose (2004, "Do We Really Know That the WTO Increases Trade?" American Economic Review, Vol. 94 No. 1, pp. 98-114). The specification including tariffs and fixed effects has a point estimate of 0.57 (s.e. of 0.18), which translates into an increase in trade of $\exp(0.57)-1$, or 77 percent (see Appendix 6). Most other estimates in the paper point to even larger effects.



PANAMA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 19, 2015

Prepared By

The Western Hemisphere Department

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RELATIONS WITH THE WORLD BANK-UNDER JMAP	4
RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK	5
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FUND RELATIONS

(As of March 31, 2015)

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

General Resources Account:	SDR Million	%Quota
Quota	206.60	100.00
Fund holdings of currency	194.75	94.27
Reserve Tranche Position	11.86	5.74

SDR Department:	SDR Million	%Allocation
Net cumulative allocation	197.01	100.00
Holdings	170.82	86.71

Outstanding Purchases and Loans: None

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

Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):¹

	Forthcoming			
	2015	2016	2017	2018
Principal				
Charges/Interest	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>
Total	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>

Implementation of HIPC Initiative: Not Applicable

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

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

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.

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.

Non-financial Relations**Exchange Rate Arrangement**

Panama uses the U.S. dollar as the primary means of payment in the local economy. Its national currency (balboa) is issued in the form of coins only and serves as a unit of account. The exchange rate of the balboa is fixed at 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.

Last Article IV Consultation

The 2014 Article IV consultation was concluded on May 9, 2014. Panama is on the standard 12 month consultation cycle.

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

Technical Assistance

Panama is a large recipient of technical assistance (TA) directly through the Fund or CAPTACDR. Latest assistance concentrated in the area of the national accounts, both on output compilation and producer price and export and import prices. Assistance was also provided in improving the external sector statistics. Assistance in the fiscal area included the practical application of the accounting policies established in the International Public Sector Accounting Standards (IPSAS), implementation of the single treasury account and medium-term expenditure framework. CAPTAC is delivering TA support in the areas of tax administration. In the financial area, TA concentrated mostly on improving financial supervision, and on International Financial Reporting Standards (IFRS) adoption.

Resident Representative: None.

RELATIONS WITH THE WORLD BANK-UNDER JMAP

(As of March 23, 2015)

Title	Products	Provisional Timing of Missions	Expected Delivery Date (Closing date)	
Bank Work Program	Metro Water and Sanitation Improvement Project	April 2015	September 30, 2015	
	Panama Enhanced Public Sector Efficiency Technical Assistance Loan	May 2015	September 30, 2016	
	Catastrophe Deferred Draw Down Disaster Risk Management Development Policy Loan Sustainable	April 2015	November 30, 2017	
	Production Systems and Conservation of Biodiversity Sustainable Energy in Panama	May 2015	December 20, 2019	
	Panama City Urban Planning Technical Assistance	May 2015	May 2015	
	WASH Poverty Diagnostic	June 2015	July 2015	
			September 2015	May 2016

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of March 27 2015)

In 2014, the IDB disbursed a total of US\$451.1 million. The Bank approved two loans for a total of US\$320 million during the year: One Policy Base Loan (Program for Stability and Fiscal and Financial Transparency) in the amount of US\$300 million and one loan for Sustainable Rural Electrification for US\$20 million.

The preliminary projection of disbursements for 2015 is around US\$216 million. The IDB expects to approve three loans for US\$250 million in the areas of Transparency and Equity Spending on Social Protection, Social Development and Inclusion and Sanitation.

Panama: Relations with the Inter-American Development Bank
(In millions of U.S. Dollars)

Operations			
Sector	Approved	Disbursed	Undisbursed Amounts
Education	100.0	33.4	66.6
Health	50.0	24.8	25.2
Reform/Modernization of the State	53.5	35.0	18.5
Energy	20.0	2.9	17.1
Science and Technology	19.7	15.9	3.8
Transport	70.0	28.0	42.0
Water and Sanitation	243.0	107.2	135.8
Total	556.2	247.3	308.9

Loan Transactions						
	2010	2011	2012	2013	2014	2015 ¹
a. Disbursements	302.2	181.1	170.8	305.1	451.1	215.7
b. Repayment	92.9	100.5	105.5	109.3	142.4	117.2
c. Net lending	209.3	80.6	65.3	195.8	308.7	98.5
d. Interest and charges	49.7	49.0	45.6	55.3	64.3	68.6
e. Subscriptions and contributions	0.7	1.9	3.6	0.0	2.0	1.7
f. Net transfer	158.9	29.6	16.1	140.5	242.4	28.2

Source: Inter-American Development Bank.

¹ Estimated.

STATISTICAL ISSUES

(As of March 25, 2015)

ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE

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

Real Sector: Although the timeliness of real sector data provision has improved, the data are often subject to sizable revisions. Preparation to change the base year of the national accounts (NA) to 2007 started in the second half of 2010 and preliminary rebased NA data from the production approach were published in March 2013. Preliminary NA data from the expenditure and income approaches will tentatively be available by the end of first semester 2015 with the compilation of the 2008-2012 supply and use tables. 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. Since 2011, progress was made in compiling financial intermediation services indirectly measured (FISIM) on a monthly basis following the 2008 *System of National Accounts (2008 SNA)*, as well as in broadening the coverage of household output, employment, compensation of employees, and mixed income in informal activities for 2007-2012 due to the progress in the compilation of employment matrices. Quarterly GDP data and the monthly economic activity index have benefited from the use of monthly VAT records as source data, and from the correct application of the Denton Proportional method for aligning quarterly data to annual data (reducing further revisions) and X13 ARIMA-SEATS for seasonally and calendar-adjusting the quarterly series. In addition, IMF technical assistance has been provided to develop updated producer, export, and import price indices and to support the development of the quarterly economic surveys to non-financial enterprises.

Government finance statistics: Further efforts are needed to improve the quality of fiscal data. Apart from timeliness, consistency of data related to the transfers between public sector units should be improved; and the coverage of the public enterprises should be made universal. Since September 2004, the operational balance of the Panama Canal Authority (ACP) was excluded from the official definition of the nonfinancial public sector (NFPS) used for fiscal policy purposes. Information on the ACP is only available in the Annual Report posted in its website (www.pancanal.com) on a fiscal year basis. There is a need to ensure a consistent and timely flow of ACP statistics on a calendar year basis. Moreover, in 2011, three public enterprises have been excluded from the NFPS accounts and public debt (Tocumen International Airport, ETESA, an electricity distribution company, and ENA, the National Highway company). It would also be necessary to compile and disseminate information on these entities in a timely fashion. The 2012 decree establishing the Savings Fund of Panama (Fundo Ahorro de Panama, or FAP) mandated reporting of deferred payment schemes (e.g. turnkey projects) in budget documentation. The authorities are receiving technical assistance from the IMF Statistics Department (STA) to implement the Government Finance Statistics Manual 2001 (GFSM 2001) and the Fiscal Affairs Department (FAD) conducted a mission on observance of fiscal standards and codes (ROSC) in October 2005. The authorities, however, cannot elaborate fiscal statistics in accordance with GFSM 2001 without a priori reforming public accounting. The August 2012 CAPTAC report on fiscal statistics for financial programming also emphasized the need to increase the information and analysis of turnkey projects'

ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE (concluded)

impact on fiscal sustainability. In 2011 through 2013, FAD provided technical assistance in the area of public accounting, including implementation of government accounting reforms and the practical application of the accounting policies established in the International Public Sector Accounting Standards (IPSAS), an important step toward improving fiscal transparency. The financial accounting system was not prepared to support the recording of transactions and economic events under the accrual method. The authorities launched a new platform for centralized management of public sector financial information (Integración y Soluciones Tecnológicas del Modelo de Gestión Operativa, ISTMO), which would help enhance transparency and efficiency. Panama reports limited fiscal data to STA (for publication in the *International Financial Statistics* or the *Government Finance Statistics Yearbook*).

Monetary and Financial Statistics: Panama regularly reports monetary data for depository corporations using the standardized report forms (SRFs) for publication in the *International Financial Statistics*. Panama participated in a regional project for harmonizing monetary and financial statistics in Central America and the Dominican Republic, supported by CAPTAC. The aim was to facilitate cross-country comparison and regional analysis. The second stage of the harmonization project developed a work program to expand the institutional coverage to include other depository corporations and all other financial corporations (OFCs). In February 2014, Panama started to report Financial Soundness Indicators (FSIs) to STA on a regular (quarterly) basis with data beginning on 2005. Data gaps prevent a deeper analysis of systemic risks as the authorities do not collect adequate data on real estate prices, loan write-offs, loan-to-value ratios, and leverage indicators for households and corporate.

Balance of payments: Weaknesses in foreign trade flows calculations, particularly those involving the Colon Free Zone, need to be addressed. Substantial changes in the composition of trade flows over the last decade render the current methodology to estimate volume indices obsolete. Oil imports and service exports may have been underestimated. Quarterly data are available with a delay of about one quarter, and are subject to revisions thereafter. Revised estimates in key trade and investment data may result in substantial revisions of the current account of the balance of payments. These revisions may reflect improvements in coverage, but they also suggest that there is room for improvement in quality control procedures. Data on outward FDI and repatriation of profit and dividends from these investments are only collected from the financial private sector, implying that the current account deficit and the International Investment Position (IIP) are likely being overestimated, due to the lack of coverage of outward FDI of the nonfinancial private sector. Official statistics may also underestimate inward portfolio investment. The authorities conducted Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS) to improve external sector data quality in the context of CAPTAC Regional Harmonization Project of External Sector Statistics (RHPESS). Quarterly IIP data have been compiled since 2002, and annual data are available since 1998. TA has also been provided on the definition, compilation and dissemination of international reserves.

DATA STANDARDS AND QUALITY

Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000, but the metadata need to be updated. A data ROSC was published in October 2006. Following an SDDS assessment mission conducted by STA in April 2011, and in November 2013, the authorities have a work program aimed at meeting the requirements for Panama's subscription to the SDDS. An action plan has been prepared and followed up by subsequent missions.

Panama: Table of Common Indicators Required for Surveillance

(As of March 31, 2015)

	Date of latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶	Memo Items:	
						Data Quality–Methodological Soundness ⁷	Data Quality–Accuracy and Reliability ⁸
Exchange Rates	3/2015	3/2015	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities	12/2014	3/2015	M	M	M		
Reserve/Base Money	NA	NA	NA	NA	NA		
Broad Money	12/2014	3/2015	M	M	M		
National Bank of Panama Balance Sheet	1/2015	3/2015	M	M	A		
Consolidated Balance Sheet of the Banking System	12/2014	3/2015	M	M	M		
Interest Rates ¹	1/2015	3/2015	M	M	M		
Consumer Price Index	2/2015	3/2015	M	M	M	O, LNO, LO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ² – General Government ³	12/2014	2/2015	Q	Q	Q	LO, LNO, LO, O	O, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing ² –Central Government	12/2014	2/2015	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt ⁴	2/2015	3/2015	M	M	M		
External Current Account Balance	12/2014	3/2015	Q	Q	Q	LO, LO, O, LO	LO, O LO, LO, LNO
Exports and Imports of Goods and Services	12/2014	2/2015	M	M	M		
GDP/GNP	Q4/2014	3/2015	Q	Q	Q	O, O, O, LO	LO, LO, LNO, LO, LNO
Gross External Debt	2/2015	3/2015	M	M	M		
International Investment Position ⁵	12/2014	3/2015	Q	Q	Q		
<p>¹ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>² Foreign, domestic bank, and domestic nonbank financing.</p> <p>³ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.</p> <p>⁴ Including currency and maturity composition.</p> <p>⁵ Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore bank.</p> <p>⁶ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).</p> <p>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).</p> <p>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.</p>							

**Statement by Paulo Nogueira Batista, Executive Director for Panama,
Oliveira Lima, Alternate Executive Director,
and Alfredo Maciá, Advisor to the Executive Director
June 10, 2015**

1. The Panamanian authorities thank the IMF staff for their constructive assessment of the country's macroeconomic developments and policies. They also welcomed the Selected Issues paper, which covers topics of relevance for future reforms and policy decisions.

Recent Economic Developments

2. In spite of some moderation, Panama's economy continues to grow at a fast rate. Real GDP increased by 6.2 percent in 2014, compared to 8.4 percent in 2013.¹ Unemployment remains close to historical lows, at 4.8 percent in 2014. According to projections by the Economic Commission for Latin America and the Caribbean, Panama's economy will, once again, grow at the highest rate in Latin America in 2015 (7 percent). Growth will average 6.5 percent per year over the next five years according to staff's forecast and 6.7 percent according to the administration's projections in the 2016-2020 Medium Term Fiscal Framework (MTFF).

3. Achieving sustained and equitable growth is a key objective of the Panamanian government's five-year investment plan. The plan places an emphasis on social projects in priority areas – such as housing, education, water and sanitation, transportation, and security – and will be developed in tandem with major infrastructure projects, among which the Canal expansion, the second line of Panama City's metro, a new copper mine, and the fourth bridge over the Panama Canal to be bid in the third quarter of 2015. Gross domestic investment will remain elevated, close to 30 percent of GDP, as can be seen from the data provided in the staff report.

4. Panama remains the only country in Latin America that can exhibit “Asian” growth and investment rates. Our chair believes that Panama's experience with rapid development over a long period may hold important lessons for other countries, particularly in Latin America. It shows for instance the crucial importance of a coordinated public and private investment drive, with decisive participation of national authorities, in lifting the country's development horizon.

5. End-of-year consumer price inflation declined to 1.0 percent in 2014 from 3.7 in 2013. Lower commodity prices, particularly oil, and the price control policy on 22 food-basket products helped curb inflation. The number of products under price controls will remain the same until July 2015, and the authorities note that no supply shortages of those products were detected to date.

¹ GDP-related data in this buff statement take into account the change in the base year from 1996 to 2007, in accordance with the March 2015 report of the National Statistics Institute (<http://www.contraloria.gob.pa/inec/>).

6. The current account deficit decreased only slightly in 2014, to 12.0 percent of GDP. This large deficit, however, should not lead to erroneous conclusions. Infrastructure projects with high import content continue to broadly account for this external deficit. They also explain the composition of the capital account surplus, which is mostly associated with robust foreign direct investments.

Fiscal Policy and Public Financial Management

7. Soon after the new administration took office on July 1st, 2014, the Ministry of Economy and Finance (MEF) implemented a rigorous expenditures contention plan. Additionally, a moratorium law was approved, allowing late tax payments to be settled without interest and other surcharges until the end of 2014. The two measures combined had a fiscal impact of over 1 percent of GDP. Nonetheless, given the slippages which had occurred in the first half of the year, the National Assembly approved an increase in the ceiling established in the Social and Fiscal Responsibility Law (SFRL) for the non-financial public sector (NFPS) deficit from 2.7 to 4.1 percent of GDP in 2014. The final outturn of the NFPS deficit was however considerably lower, reaching 3.4 percent of GDP, according to information provided to us by the MEF.

8. From 2015 onwards, a provision in the law of Panama's Sovereign Wealth Fund (*Fondo de Ahorro de Panamá* – FAP) will enter into effect, establishing that contributions to the National Treasury from the Panama Canal Authority (*Autoridad del Canal de Panamá* – ACP) in excess of 3.5 percent of GDP be deposited in the FAP. The authorities note that this provision was already present in the text of Law 38, of 2012, which created the FAP and was developed with the advice of the IMF. The provision also establishes that the fiscal deficit ceiling should be applied to the “adjusted NFPS deficit”, calculated as the overall fiscal deficit adjusted by the difference between ACP's contributions and 3.5 percent of GDP. To face past commitments on capital expenditures, the authorities decided to use the additional room provided by projected ACP contributions of 1.8 percent of GDP in 2015 and, accordingly, budgeted the NFPS deficit for the year at 3.7 percent of GDP, instead of 2 percent as originally provided for in the SFRL.

9. According to MEF's estimations, NFPS debt (excluding debt of the ACP) increased in 2014 to 39.5 percent of GDP, up from 36.8 percent in 2013. It is however expected to return to the declining trend observed between 2005 and 2013, and reach the target of 34 percent of GDP by end-2020, as established in the MTFF. Credit rating agencies recently confirmed the investment grade of Panama's sovereign debt, emphasizing the dynamism and diversification of the economy.² In line with these ratings and assessments, Panama issued in March 2015 a USD 1.25 billion ten-year bond priced at a spread of 178 basis points above

² Panama's sovereign debt ratings are currently BBB according to Fitch and Standard and Poor's, and Baa2 according to Moody's, all of which with a stable outlook.

ten-year U.S. Treasury bonds. Such spread is very low by historical standards and corresponds to an effective interest rate of 3.89 percent per annum.

10. The MEF is strengthening the re-established directorate of general revenues (*Dirección General de Ingresos – DGI*). The revenue authority that was created in April 2013 to replace the DGI was declared unconstitutional and ordered dissolved in October 2014. The DGI is being reinforced through an increased budget, new hires, more intensive training, and improvements in information systems to allow cross-referencing tax information.

11. Considerable improvements are also being made in public financial management. The new centralized financial operations system will be fully operational by end-2015 in all central government agencies. The implementation of the Single Treasury Account will be completed over the next two to three years. These two initiatives are expected to considerably improve the controls, efficiency, and accountability of government finances.

12. The authorities have made significant progress in reducing electricity subsidies and related budget allocations since the beginning of 2015. Electricity subsidies are being more effectively targeted so as to benefit homes and small businesses consuming less than 400 kWh per month. The authorities project that this will reduce electricity subsidies from USD 400 million in 2014 to USD 62 million in 2015.

Financial sector

13. The banking system remains stable, well capitalized, and highly liquid. Several indicators reported by the Superintendencia of Banks (*Superintendencia de Bancos de Panamá – SBP*) have improved further at end-2014, from already comfortable levels at end-2013, as can be seen in Box 2 and Table 5 of the staff report. The capital adequacy ratio (CAR) stood at 14.8 percent, well above the statutory 8 percent requirement. According to the SBP, credit to the private sector increased 11.7 percent – mainly to housing, domestic consumption, and construction – and deposits were up 8 percent in 2014.

14. The regulatory and supervisory framework for the banking sector continues to be enhanced. Banking regulations were issued in 2014 on cross-border consolidated supervision and, in January 2015, on banks' capital requirements following Basel III standards. Banks and banking groups will be required to increase their capital starting in January 2016 and to be fully compliant with Basel III by 2019. The SBP has also widened its supervisory network to include, apart from banks, other financial institutions such as leasing and factoring companies, financial cooperatives, fund-remittance companies, and debit and credit card companies.

Anti-Money Laundering and Combating the Financing of Terrorism

15. The authorities have made substantial progress in Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). An Action Plan agreed with the Financial Action Task Force (FATF) to strengthen Panama's AML/CFT framework will be reviewed by that organization by end-June 2015. Key legal, institutional and legislative actions have been implemented to date, including:

- An AML/CFT Policy Unit was created in the MEF last October. The unit has issued policy guidelines and strengthened coordination among anti-money laundering domestic institutions, including the Financial Intelligence Unit.
- Budget allocations for the Financial Intelligence Unit tripled in 2015. This will significantly strengthen the unit's technical capabilities, improve its response capacity, and enhance its cooperation with international counterparts.
- New penal code legislation was approved in March this year classifying as crimes additional activities related to money laundering and financing of terrorism and also creating conditions for improved judicial assistance and cooperation with foreign institutions.
- New AML/CFT legislation was approved by the National Assembly on April 27, 2015 to strengthen controls and reinforce domestic and international cooperation – a crucial measure in the Action Plan to allow Panama to exit the FATF's grey-list. This legislation also creates the Intendance of Supervision and Regulations, within the MEF's structure, to exert surveillance on sixteen sectors of business activities and professions subject to controls on AML/CFT.

16. In addition, a new bearer shares law, also approved in April 2015, requires all common stocks to be registered with an authorized custodian by December 2015. The former law, of 2013, had a transition period until 2018 to enforce said registration. The new law also allows converting bearer shares into nominative shares. This measure and all other initiatives listed above show the determination of the Panamanian authorities in supporting the role and legitimacy of Panama as a banking center and in strengthening AML/CFT regulations and institutions.