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June 10, 2021

**Statement by Mr. Chodos and Mr. Hendrick on Panama
(Preliminary)
Executive Board Meeting
June 14, 2021**

We thank staff for the excellent report and Mr. Bevilaqua, Mr. Fuentes, and Mr. Maciá for their insightful Buff statement.

1. **Panama entered the pandemic with strong fundamentals, solid institutional policy frameworks, and a long track record of high economic growth.** From a position of economic strength and a timely package of economic and social measures to mitigate the negative effects of COVID-19, the economy is expected to have a strong rebound, with an estimated real GDP growth of 12 percent in 2021, after a severe contraction of 17.9 percent in 2020. We congratulate the authorities for the progress in the vaccination rollout and securing enough vaccines for the whole population. Successful completion of the vaccination targets will be crucial to support the ongoing economic recovery. *We take note that the contraction in construction and commerce accounted for about two thirds of the fall in real GDP in 2020. To better understand the impact of this sector in growth after the recovery, what factors have been driving the strong growth in the construction sector? Commercial real estate and regular housing? Is it mainly driven by residents, or there is an important component of non-residents investing in real estate in Panama? Staff's comments would be greatly appreciated.*

2. **We congratulate the authorities for their commitment to fiscal consolidation and compliance with the Social and Fiscal Responsibility Law (SFRL).** Like in the rest of the world, it is understandable that due to the additional expenditure and lower revenues related to the pandemic, a deterioration of the fiscal position is expected. It is commendable that the authorities managed to keep the same level of expenditure as envisaged in the 2020 budget, despite the COVID-19 -related additional spending, so that the increase in the fiscal deficit is explained only by the fall in revenues. Most countries allowed for a temporary relaxation of fiscal rule and/or higher-than-expected deficit, due to the extraordinary circumstances. *We would like to ask staff if the decision to reduce capital and current expenditure, to accommodate COVID-19 spending, was undertaken due to the lack of fiscal buffers? This does not seem to be the case, given the substantial increase of government deposits in*

the banking system. Also, the fact that Panama has access to international markets at a favorable rate, allows them to finance temporary higher spending. Could staff elaborate on the underlying reasons for this policy decision?

3. **We welcome the authorities' efforts to strengthen public financial management and the multi-year budget framework.** These tools will be instrumental in guiding the convergence to a lower medium-term fiscal target, by striking a right balance between revenue mobilization and the quality and quantity of public expenditure. Capacity building in some key public entities may be needed to ensure consistency of revenues and expenditure projections with macroeconomic forecasts, and rigorous costing of ongoing projects, among other factors. We encourage the authorities to resume their modernization strategy for the tax authority that was temporarily delayed by the pandemic. The estimated 2.0 percent of GDP in additional revenues estimated by staff could be crucial to increase social spending in health and education. This could be the "low hanging fruit", as opposed to political difficult elimination of VAT exemptions, or the long-pending issue of financial sustainability of the pension system, which could imply additional contingency public expenditure in the medium term.

4. **Panama's financial sector continues to display resilience, and it has maintained ample liquidity and strong capitalization.** The Superintendency of Banks has consistently done a good job on their regulatory and supervisory role, including the implementation of Basel III capital adequacy rules in 2018. We welcome the recent request of an FSAP update and for additional TA to enhance the macroprudential policy framework. It is well known that Panama is a very important international financial center, and there is a culture among bankers to preserve the credibility and reputation obtained throughout the years. Part of this culture includes minimizing intervention from the government, including the concept of Lender of Last Resort or even the idea of Deposit Insurance. *We wonder if the lack of use of the Fund for Economic Stimulus (FES) created last August 2020 could be explained by this factor, in addition to the fact that liquidity in the banking sector remained high as liquid assets are covering 64 percent of deposits as of end-February 2021. Staff's comments would be appreciated.*

5. **We welcome the authorities' commitment to make the necessary progress to complete its FATF's Action Plan, and to continue bolstering AML/CFT capacity.** We concur with staff that a prompt exit from the FATF's grey list will support confidence and Panama's status as a regional financial center. The expected TA from the European Union and the World Bank, as well as the support provided by the Fund, will be instrumental in helping the authorities to achieve this goal.

6. **We take positive note that the authorities remain focused on delivering on their commitment to subscribe to the SDDS by 2022.** Countries' experiences that have undertaken these tasks underscore the need for adequate resources and capacity building to recruit and retain know-how in the statistical areas of key public entities producing economic data. The ongoing Census and GDP rebasing will be already putting some pressure on the staff of those institutions. Fund TA will be very helpful during this transition.

With these comments, we wish Panama and its people every success in their future endeavors.