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June 10, 2021

**Statement by Mr. Sylla and Mr. Lopes Varela on Panama
(Preliminary)
Executive Board Meeting
June 14, 2021**

We thank staff for their set of reports and Mr. Bevilaqua, Mr. Fuentes, and Mr. Maciá for their informative Buff statement.

Continued supportive macroeconomic policies while paving the way for a sound fiscal consolidation path would be helpful to put the economy back to pre-pandemic levels.

Before the pandemic, Panama's economy was ranked the most prolonged and fastest-growing among its peers in Latin America over the last several years due to firm policy measures orientated towards investment and services exports. The country has turned into a high-income economy, with the highest per capita income in the region and considerable improvements in social conditions. However, Panama has been severely affected by the Covid-19 pandemic. The lockdowns and containment measures and the disruptions to global trade have weakened Panama's near-term outlook. As a result, the country is expected to have fallen into its worst recession (17.9 percent), and its fiscal position to have worsened in 2020. While the economy is anticipated to bounce back strongly in 2021, with growth estimated to reach 12 percent, Panama continues to face considerable downside risks and uncertainty around the outlook. In this context, we see merit in maintaining support for economic recovery and gradually implementing the needed fiscal consolidation to preserve macroeconomic stability over the medium term. We broadly concur with the thrust of the staff's appraisal and policy advice and would like to offer the following remarks.

We commend the authorities' vaccination efforts that have helped reduce Panama's COVID fatality and cases. We welcome the inclusion of the *COVID-19 in Panama* in Annex VI, an illustrative example of the correlation between improvements in prevention (contagion) and vaccination and the importance of vaccines in the recovery process. Hence, Panama should be used as a showcase that, in fact, vaccination policy is an economic policy. We are also pleased to note that financing is not a binding constrain as the authorities have already allocated an adequate amount to acquire vaccines to the entire population, and we encourage its speedy delivery.

A robust fiscal framework is critical to foster the budgetary process and fiscal sustainability. The authorities' use of the flexibility created by the Social and Fiscal Responsibility Law (SFRL) through a temporary increase of the Non-Financial Public-Sector (NFPS) fiscal deficit to mitigate the impact of the shocks and accommodate needed health and social spending amid loss of revenue is much appreciated. Looking ahead, we support the gradual fiscal consolidation path envisaged by the amended fiscal rule to return to the fiscal deficit of 1.5 percent of GDP over the medium term and curb the public debt to 56.5 percent of GDP by 2026. Therefore, we encourage the authorities to uphold their commitment to that rule to avoid slippage of SFRL fiscal targets and preserve policy credibility. Adjustment efforts should be aimed at raising more tax revenues and improving the quality of public spending while adjusting its composition to support critical social and infrastructure expenditures. We concur with staff that there is room for further strengthening of the tax administration given the still elevated tax evasion ratio in Panama. We also emphasize the need to enhance Public Financial Management (PFM) systems and prevent arrears buildup. In this regard, we positively note the authorities aim to improve budgeting, expenditure control, accounting practices and to subscribe to the SDDS by 2022, which are important to reinforce fiscal transparency.

Substantial efforts are essentially needed to safeguard financial integrity and credibility. We welcome the progress made in the legal framework, including legislation to criminalize tax evasion as a base offense to money laundering. However, we note that more needs to be done to align AML/CFT to global transparency criteria and to address shortcomings flagged in FATF recommendations. We, therefore, encourage the authorities to take resolute actions that would allow, as soon as possible, their removal from the FATF grey list to ensure further credibility in their position as a regional business and financial hub. *Staff update on this is welcome.* Pursuing measures that enhance the AML/CFT oversight further and sanctions against its non-compliance would be appropriate.

Finally, further strengthening of the financial regulatory oversight and monitoring is warranted. We welcome the fact that the financial sector remains well capitalized and sound amid shocks. However, we encourage the authorities to have a concrete plan in place to ensure regulatory forbearance is appropriately provided and unwind as the crisis wanes. Continued efforts are also necessary to monitor the market and operational risks, particularly with regards to ad-hoc provisioning on modified loans, crisis management, and asset quality to safeguard financial stability.