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ROOM C-120

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SM/86/240
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

October 6, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Panama - Staff Report for the 1986 Article IV Consultation

The following corrections have been made in SM/86/240 (9/11/86):

Page 14, Table 6: revised

Page 19, Table 8: figures in 1984 column revised

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

Fund, the Investment Fund of Venezuela, and Petroleos Mexicanos). Partly as a result of the reduced liquidity position of the National Bank, ^{1/} its credit to the private sector in 1985 declined slightly.

The authorities noted that the 1986 program called for a net repayment by the nonfinancial public sector to the National Bank of the amount of the excess over the ceiling on National Bank credit to the nonfinancial public sector at end-1985 (B 63 million). Such a repayment would contribute to the strengthening of the liquidity of the Bank. Under the program, banking system credit to the public sector would decline by almost 2 percent in 1986, while credit to the private sector would increase by more than 4 percent.

3. External policies

The latest estimates indicate that the current account deficit of the balance of payments will narrow from 6.7 percent of GDP in 1985 to 5 percent of GDP in 1986 (Table 6). The revised projection for 1986 may be compared with the original program target of 6.1 percent of GDP, and reflects stronger nonfactor services receipts. In the revised balance of payments projection for 1986, the current account deficit is financed in approximately equal parts by public sector borrowing and private capital flows.

It may be recalled that a key objective of the 1986 financial program is to limit the amount of external borrowing of the nonfinancial public sector and to improve the maturity structure of the public sector external debt. Although debt contracted on commercial terms is expected to increase by US\$45 million on a net basis during 1986, its share in total external debt is expected to remain unchanged at about 58 percent, while total external debt as a percent of GDP is expected to decline by some 2 percentage points to 76 percent at the end of 1986 (Table 7). Debt service (after rescheduling) in relation to exports of goods and nonfactor services is projected to stay at about 31 percent in 1986, unchanged from a year earlier; the rescheduling of amortization payments to commercial banks in 1985-86 reduced this ratio by 20 percentage points in 1986 from what it would have been without the rescheduling.

The authorities are concerned about the external debt situation over the medium term. Amortization payments to foreign and domestic commercial banks peak in the period 1987-91, with some US\$1.4 billion falling due. The authorities indicated that they are given consideration to negotiating a multi-year rescheduling arrangement with commercial banks, which would allow the present administration to formulate

^{1/} For purposes of fulfilling its obligations as a commercial bank and its clearing obligations in the banking system, the National Bank considers as its liquidity position the liquid assets it holds in other commercial banks plus the unutilized portion of the lines of credit from foreign commercial banks.

Table 6. Panama: Summary Balance of Payments

(In millions of U.S. dollars)

	1982	1983	1984	Est. 1985	1986 Prog. 1/	Proj.
<u>Current account</u>	<u>-405.4</u>	<u>-202.5</u>	<u>-237.9</u>	<u>-240.4</u>	<u>-227.5</u>	<u>-174.9</u>
<u>Goods and services</u>	<u>-451.0</u>	<u>-246.8</u>	<u>-317.3</u>	<u>-323.6</u>	<u>-306.5</u>	<u>-253.9</u>
Trade balance	-1,007.8	-926.9	-917.0	-929.3	-880.6	-892.2
Exports, f.o.b.	321.8	305.6	286.4	310.9	340.3	332.9
Petroleum trade	-242.5	-262.2	-211.4	-171.9	-159.8	-91.7
Imports, f.o.b.	-1,087.1	-970.3	-991.9	-1,068.3	-1,061.1	-1,133.4
Freight and Insurance	-53.4	114.2	59.0	83.0	12.7	48.9
Transportation	392.4	349.7	343.9	353.1	352.2	383.1
Travel	93.0	101.3	118.6	135.0	134.4	141.7
Investment income	-349.8	-324.2	-334.8	-426.6	-41.0	-435.2
Of which: interest public debt	-343.9	-281.5	-309.6	-328.6	-333.0	-335.3
Government, n.i.e.	-12.0	-13.5	-8.1	-8.4	-9.3	-9.3
Other services	486.5	452.6	421.0	469.7	505.1	509.1
Colon Free Zone	219.9	142.3	148.6	170.9	189.3	193.3
Rest of the world	266.6	310.2	272.4	298.7	315.9	315.8
<u>Unrequited transfers</u>	<u>45.6</u>	<u>44.3</u>	<u>79.3</u>	<u>83.3</u>	<u>79.0</u>	<u>79.0</u>
<u>Capital account</u>	<u>366.7</u>	<u>121.8</u>	<u>157.7</u>	<u>33.2</u>	<u>227.5</u>	<u>173.7</u>
<u>Official capital</u>	<u>510.2</u>	<u>302.1</u>	<u>214.2</u>	<u>38.8</u>	<u>125.5</u>	<u>126.7</u>
Nonfinancial	435.8	143.2	98.3	34.9	196.8	195.8
Official banks	74.4	158.9	115.9	3.9	-71.3	-69.1
<u>Other official bank transactions</u>	<u>0.4</u>	<u>-86.7</u>	<u>-12.5</u>	<u>134.5</u>	<u>--</u>	<u>-48.3</u>
<u>Private capital</u>	<u>-143.9</u>	<u>-93.6</u>	<u>-44.0</u>	<u>-140.1</u>	<u>102.0</u>	<u>95.3</u>
Direct investment	0.8	54.9	37.3	90.6	71.3	76.5
Direct private borrowing	116.4	-151.9	-49.8	-8.4	-32.5	-153.0
Private banks net monetary movements	-261.1	3.4	-31.5	-223.3	63.2	171.8
<u>Net errors and omissions (including valuation adjustment)</u>	<u>38.7</u>	<u>80.7</u>	<u>80.3</u>	<u>207.1</u>	<u>--</u>	<u>1.2</u>
<u>Memorandum item</u>						
Current account as a percentage of GDP						
Before transfer payments	-10.5	-5.6	-7.0	-6.7	-6.1	-5.0
After transfer payments	-9.5	-4.6	-5.2	-5.0	-4.5	-3.4

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

1/ As described in EBS/86/114, May 28, 1986.

Table 8. Panama: Medium-Term Scenario

	1984	Est. 1985	1986	1987	1988	Proj. 1989	1990	1991
(In millions of U.S. dollars)								
Current account	-238	-240	-174	-181	-193	-192	-195	-196
Trade balance	-917	-929	-892	-953	-1,018	-1,099	-1,179	-1,265
Exports	286	311	333	362	377	395	415	439
Imports (including net petroleum)	-1,203	-1,240	-1,225	-1,315	-1,395	-1,494	-1,594	-1,704
Interest on public debt	-310	-329	-335	-316	-313	-295	-288	-277
Other	989	1,018	1,053	1,087	1,137	1,202	1,272	1,346
Capital account	238	240	174	-272	-234	-121	79	87
Public sector	214	39	127	-345	-313	-192	13	29
Of which: IMF	98	6	8	-54	-69	-49	-60	-38
Official bank	-13	135	-48	-18	-18	-26	-32	-39
Private capital <u>1/</u>	36	66	96	91	97	96	96	98
Financing gap (public sector)	--	--	--	453	427	313	116	108
Public sector debt	3,767.1	3,885.8	3,993.7	4,108.3	4,230.0	4,359.3	4,497.2	
Bilateral and multilateral	1,577.7	1,650.9	1,758.8	1,873.4	1,995.1	2,124.4	2,262.3	
Commercial	2,189.4	2,234.9	1,781.7	1,354.5	1,041.3	925.3	817.1	
Cumulative financing gap	--	--	453.2	880.4	1,193.6	1,309.6	1,417.8	
Debt service								
Amortizations								
On debt outstanding end-1986								
Before rescheduling		406.6	592.5	667.7	611.5	460.7	273.7	198.9
After rescheduling		172.4	222.8	667.7	611.5	479.6	309.5	274.2
On debt contracted after 1986		--	--	--	--	--	--	15.2
Interest <u>2/</u>		334.9	340.6	319.9	316.8	299.4	291.8	280.9
(In percent)								
Indicators								
Current account/GDP		-5.0	-3.4	-3.4	-3.4	-3.2	-3.0	-2.8
Total public sector debt/GDP <u>3/</u>		78.5	76.4	74.0	71.7	69.5	67.4	65.2
Debt service/exports of goods and nonfactor services								
Before rescheduling		41.3	51.0	52.1	47.3	37.1	26.5	22.1
After rescheduling <u>4/</u>		28.3	30.8	52.1	47.3	38.1	28.1	25.5
Debt service/GDP								
Before rescheduling		15.5	18.3	18.3	16.2	12.5	8.7	7.2
After rescheduling <u>4/</u>		10.6	11.1	18.3	16.2	12.8	9.3	8.3
Effective interest rate on total external debt		9.0	8.9	8.1	7.8	7.2	6.8	6.3

Sources: World Bank; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Includes interest on internal bonds.

3/ Under the assumption that principal payments on commercial debt are rolled over.

4/ Does not assume any rescheduling after 1986.

terms similar to those received in the recent past, while net private sector capital inflows are projected to decline in relation to GDP from the relatively high ratio expected for 1986 to the ratio that prevailed in 1985. The projection points to financing gaps over the medium term equivalent to the amount of principal repayments on commercial debt, including commercial bank loans and bonds; the financing gap averages US\$440 million in 1987 and 1988, declines to US\$310 million in 1989, and to US\$110 million in 1990 and 1991. ^{1/}

These projections underscore the difficult situation that Panama faces during the period 1987-91--notwithstanding a significant adjustment in the external current account--unless it can negotiate a restructuring of the maturities of its commercial debt. Under the assumption that maturities on commercial debt after 1986 would be rolled over or refinanced, the debt service ratio would be made more manageable for Panama. On this basis, the ratio of outstanding public sector debt to GDP nevertheless would decline from 76 percent in 1986 to 65 percent in 1991. At the same time, the share of commercial debt in total outstanding debt would fall from 57 percent in 1986 to 50 percent in 1991. Also, the effective interest rate on total external debt would decline from 8.9 percent in 1986 to 6.3 percent in 1991, reflecting an improvement in the structure of the debt.

VI. Staff Appraisal

Following the successful implementation of the economic program in 1983-84, the Government of Panama adopted a new economic program in mid-1985 which was aimed at consolidating the gains made in the preceding 2 years and was supported by a 21-month stand-by arrangement from the Fund. This program was designed to reduce the overall financing requirement of the nonfinancial public sector and to strengthen the liquidity position of the National Bank.

The overall deficit of the nonfinancial public sector in 1985 was reduced to 1.7 percent of GDP, about one half the programmed level, because of lower than expected current expenditures and a curtailment in investment spending associated with a shortfall in external financing. However, the reduction in the fiscal deficit was not sufficient to

^{1/} Under the assumption that Panama would be able to make the principal repayments on debt of a commercial nature, the external public debt service ratio would increase from 31 percent of exports of goods and nonfactor services in 1986 to an average of 50 percent in 1987-88, but would subsequently decline to 25 percent by 1991 (taking into account the effect of the 1985-86 restructuring agreement). The increase in the debt service ratio in 1987-88 is, thus, associated with a peak in the amortization of commercial debt in these years (equivalent to about 23 percent of exports of goods and nonfactor services).