LAPSE OF TIME

SM/20/64

March 10, 2020

To:	Members of the Executive Board
From:	The Secretary
Subject:	**Panama—Staff Report for the 2020 Article IV Consultation**

Board Action:	Executive Directors' **consideration** on a lapse of time basis as management has determined it meets the established criteria as set out in Board Decision No. 15207 (12/74); there are no acute or significant risks, or general policy issues requiring a Board discussion.
Deadline to Request Board meeting:	**Friday, March 20, 2020** **12:00 (noon)**
Proposed Decision Deemed Approved:	Tuesday, March 24, 2020
Provisional Board Meeting Date: (if requested)	Tuesday, March 24, 2020
Proposed Decision:	Page 23
Publication:	Not yet decided* Press Release will be based on the staff appraisal if there is no request for a Board discussion, as attached.

***The Secretary's Department has been notified by the authorities that their explicit consent is required prior to the publication of Board documents. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities indicating that they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.**

Questions:	Mr. Santos, WHD (ext. 36629) Mr. Chow, WHD (ext. 36638) Ms. Rousset, WHD (ext. 34655) Ms. Bespalova, WHD (ext. 36435) Ms. Faltermeier, WHD (ext. 38024)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	After Board Consideration—European Investment Bank, Food and Agriculture Organization, Inter-American Development Bank, United Nations Development Programme, World Trade Organization

INTERNATIONAL MONETARY FUND

PANAMA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

March 9, 2020

KEY ISSUES

- **Background.** After 25 years of impressive performance with the economy expanding at 6 percent annually, growth slowed below 4 percent in 2018–19, with inflation falling below zero. A new government took office in July 2019 providing a fresh impulse for reforms. However, expenditure tightening after a shortfall in revenues kept the deficit at 3.1 percent of GDP in 2019, while previously unrecorded arrears of over 2 percent of GDP were uncovered. Panama returned to the Financial Action Task Force (FATF) grey list in June 2019, with limited impact on the economy thus far. Credit growth decelerated reflecting weak demand, while the current account deficit improved to 6½ percent of GDP in 2019.
- **Outlook and Risks.** Growth is expected to recover to 4.8 percent in 2020. However, the balance of risks is tilted to the downside. Domestic risks include setbacks in resolving fiscal policy imbalances and complying with the FATF action plan to exit the grey list. External risks include rising protectionism, weak global growth, coronavirus, sharp rise in risk premium that exposes vulnerabilities, an intensification of geopolitical tensions, cyberattacks, natural disasters and extreme climate events.
- **Policy Advice.** A gradual fiscal consolidation can address the large fiscal imbalances while being mindful of the weak economy. Tax and customs administration reforms are needed to address the shortfall in revenues and provide room for public investment and social spending. Further strengthening the fiscal framework transparency and governance can support policy credibility and reduce vulnerabilities to corruption. Efforts should be reinforced to improve the financial integrity framework and exit the FATF grey list, including by updating the national AML/CFT risk assessment, and demonstrating the ability to prosecute money laundering cases involving foreign tax crimes. Measures to further bolster the financial system should include adoption of regulations on banking resolution, cybersecurity, and fintech, elaboration of a crisis management plan and developing a mechanism to provide emergency liquidity to the financial system. Structural reforms to lift barriers to long-term growth by improving competitiveness, reducing poverty and inequality and addressing climate risks are needed to support healthy and inclusive growth, as well as preserve Panama's competitive advantage as an attractive destination for business.

Approved By	
Aasim M. Husain (WHD) and Zuzana Murgasova (SPR)	Discussions took place in Panama City during February 4–17, 2020. The staff team comprised Alejandro Santos (head), Olga Bespalova, Julian Chow, Julia Faltermeier, and Marina Rousset (all WHD). Alejandro Werner (Director WHD) and Afonso Bevilaqua (Executive Director OED) joined the mission during part of the second week. Paola Aliperti and Madina Toshmuhamedova (WHD) assisted the team from Washington. Alfredo Macia (OED) also participated in the meetings. The team met with Minister of Economy and Finance Héctor Alexander, Banks Superintendent Amauri Castillo, as well as other senior public officials, and private sector representatives.

CONTENTS

ANNEXES

APPENDIX

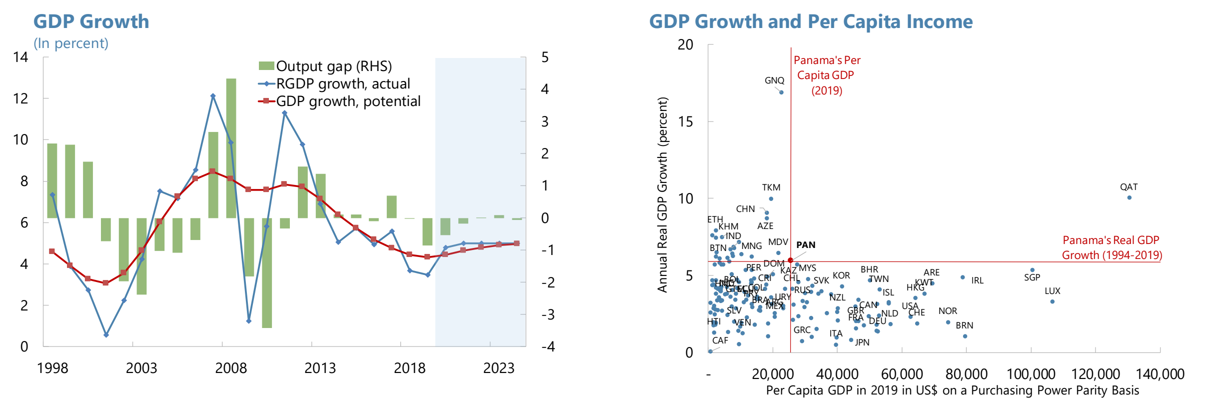
Acronyms

ACP	Panama Canal Authority
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BASEL III	International Regulatory Framework for Banks
BNP	National Bank of Panama
CAPTAC-DR	Regional Technical Assistance Center for Central America, Panama and the Dominican Republic
CFZ	Colon Free Zone
CIT	Corporate Income Tax
CPI	Consumer Price Index
DNFBPs	Designated Nonfinancial Businesses and Professions
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
e-GDDS	Enhanced General Data Dissemination System
FATF	Financial Action Task Force
FSR	Financial Stability Report
GAFILAT	Financial Action Task Force of Latin America
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
ICRG	International Cooperation Review Group
IFRS	International Financial Reporting Standards
INEC	National Institute of Statistics and Census
LAC	Latin America and the Caribbean
LCR	Liquidity Coverage Ratio
MEF	Ministry of Economy and Finance
ML/FT Risks	Money Laundering and Financing of Terrorism Risks
MPSA	Minera Panama S.A.
NFPS	Non-Financial Public Sector
NIIP	Net International Investment Position
NPLs	Non-performing Loans
NSDP	National Summary Data Page
NSFR	Net Stable Funding Ratio
PPP	Public-Private Partnership
OECD	Organization for Economic Co-Operation and Development
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
ROSCs	Report on the Observance of Standards and Codes
SBP	Superintendency of Banks of Panama
SDG	Sustainable Development Goals
SDSS	Special Data Dissemination Standard
SFRL	Social and Fiscal Responsibility Law
SIP	IMF Selected Issues Paper
SWF	Sovereign Wealth Fund
UAF	Financial Analysis Unit
WEF	World Economic Forum
WEO	World Economic Outlook
WHD	Western Hemisphere Department (IMF)

CONTEXT[1]

1. **After a prolonged period of impressive economic performance, Panama's growth slowed in 2018–19**. In the last quarter of a century, Panama enjoyed an unprecedented economic expansion—the longest and fastest in Latin America—yielding average annual growth of 6 percent. In fact, no economy in the world (other than Qatar) experienced faster growth at a higher per capita income than Panama during that period. Propelled by an investment boom, including the expansion of the Panama Canal and the construction of one of the largest copper mines in the world, Panama reached high-income status in 2017, according to the World Bank classification methodology, and enjoys the highest per capita income in Latin America. However, growth slowed below 4 percent in 2018–19 amid declining productivity. Faced with moderating population growth, future GDP growth will increasingly rely on improvements in productivity.

Growth: Analysis and World Comparisons



Sources: INEC, WEO database and IMF staff calculations.

2. **A new government took office in July 2019.** President Cortizo was elected in May 2019 for a five-year term without the possibility of reelection. With a coalition, his party holds the majority in the National Assembly providing the government with the political capital to address challenges such as the growth slowdown, a deteriorating fiscal position, the return to the FATF grey list, structural bottlenecks to higher productivity, and the still-high rates of poverty and inequality.

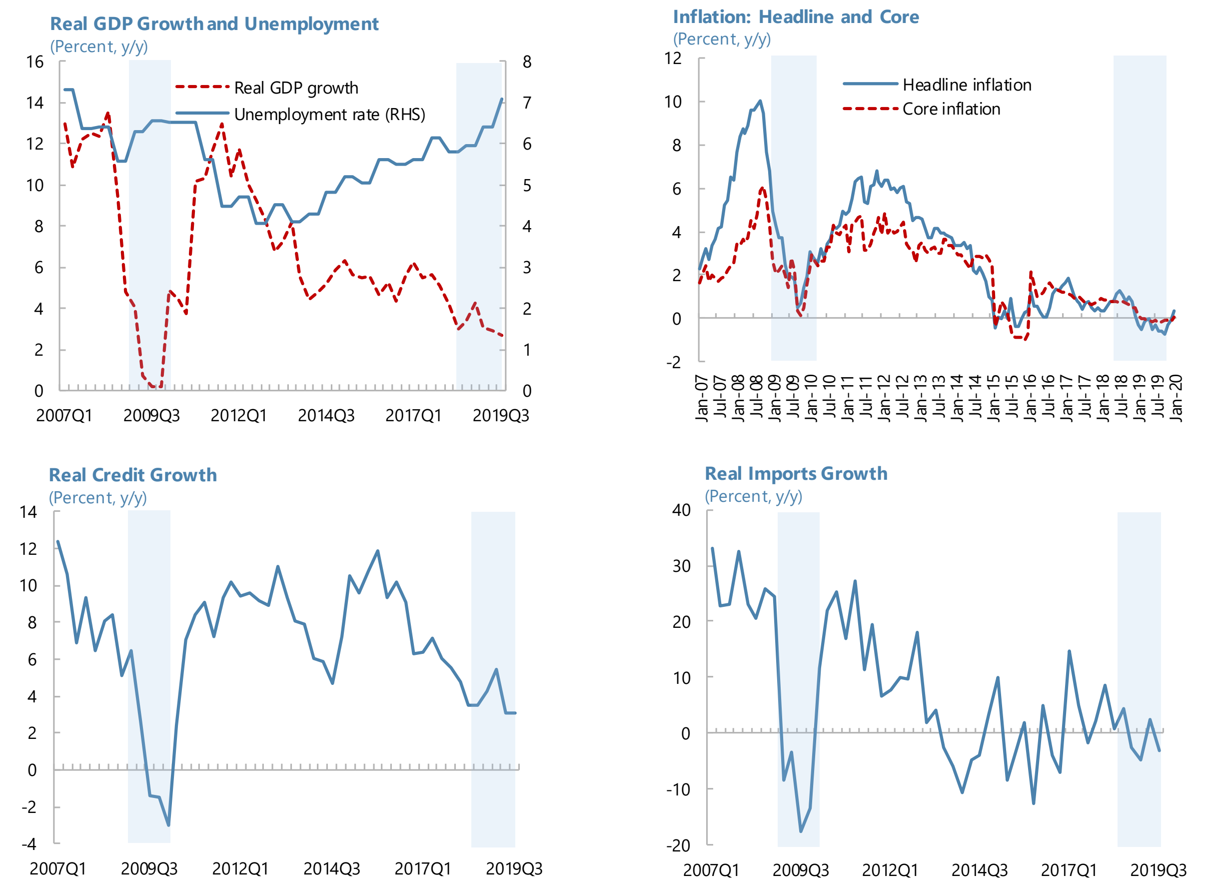
RECENT DEVELOPMENTS

3. **The economic slowdown, which began in mid-2018 due to a construction strike, extended into 2019.** Real GDP grew by about 3 percent in the first three quarters of 2019 (y/y) as construction and the service sector remained soft. Slower regional growth spilled over to Panama through sluggish tourism. However, output began to recover in the last quarter as a new copper

[1] Panama does not have a central bank or a monetary authority. The national currency of Panama is the balboa, but it is issued in the form of coins only and serves mostly as a unit of account. The exchange rate has been fixed one-to-one to the U.S. dollar since 1904. In practice, Panama uses the U.S. dollar as the primary means of payments in the economy and does not receive transfers from the U.S. in lieu of the seigniorage collected.

mine, *Cobre Panama*, launched full-scale commercial production, and the economy is estimated to have grown at 3½ percent in 2019. This slump in economic activity led to persistently subzero headline CPI inflation for most of the year and an increase in the unemployment rate to 7.1 percent in August 2019 (from 6.0 percent a year before).

Business Cycle: Downturn Comparisons



Sources: INEC and IMF staff calculations.

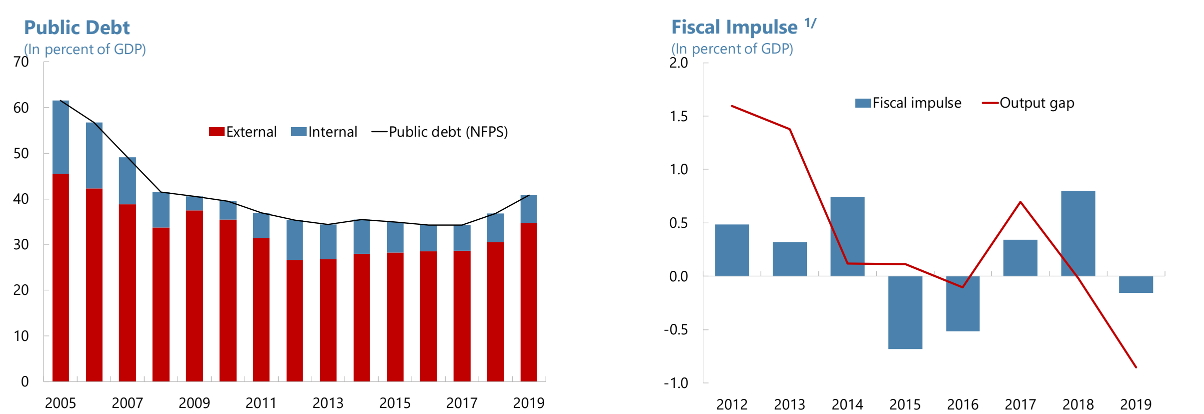
4. The fiscal deficit reached 3.1 percent in 2019 and the new government uncovered large unrecorded budgetary arrears. A shortfall in revenue compared to the budget of around 2¼ percent of GDP and high budgetary execution by the outgoing government at the beginning of 2019 required adjustments in the second half of 2019. In response to the fiscal deterioration, the government modified the Social and Fiscal Responsibility Law (SFRL) in October 2019, widening the 2019 deficit ceiling from 2 to 3½ percent of GDP and foreseeing its gradual reduction to 2¾ percent for 2020.[2] At the same time, the outgoing government accumulated unrecorded arrears

[2] A modification of the SFRL in October 2018 simplified the rule and established the deficit limit of 2 percent of GDP for 2018–19, while requiring a gradual reduction of the deficit to 1½ percent of GDP by 2022. A second modification to the SFRL took place in October 2019, whereby the NFPS deficit was relaxed to 3½ percent of GDP for 2019; 2¾ percent for 2020; 2½ percent for 2021; and 2 percent thereafter.

(from previous years) amounting to over 2 percent of GDP (US$1½ billion). The authorities are in the process of re-estimating the fiscal accounts for previous years to accrue the unrecorded expenditures. Staff estimates that a significant part of the arrears accumulation took place in 2018 and revised upward the fiscal deficit for that year to 3.2 percent of GDP (from 2 percent). Against that background, the fiscal deficit did not deteriorate much in 2019, and the fiscal stance was rather neutral. The recording of arrears, together with the still-high deficit, and pre-financing operations pushed up gross debt of the Central Administration to 46.2 percent of GDP, although it is 40.2 percent of GDP on a net basis and well below historical levels.[3]

5. **Panama returned to the FATF grey list.** The FATF had placed Panama under International Cooperation Review Group (ICRG) monitoring in 2014 but removed it from the list in 2016 recognizing substantial changes to the country's regulatory framework. However, in June 2019 the FATF placed Panama under its grey list again (despite the adoption of requested legislation on tax evasion) citing a low level of effectiveness in implementing its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime and some technical deficiencies identified within its legal framework.

Fiscal: Debt and Deficit

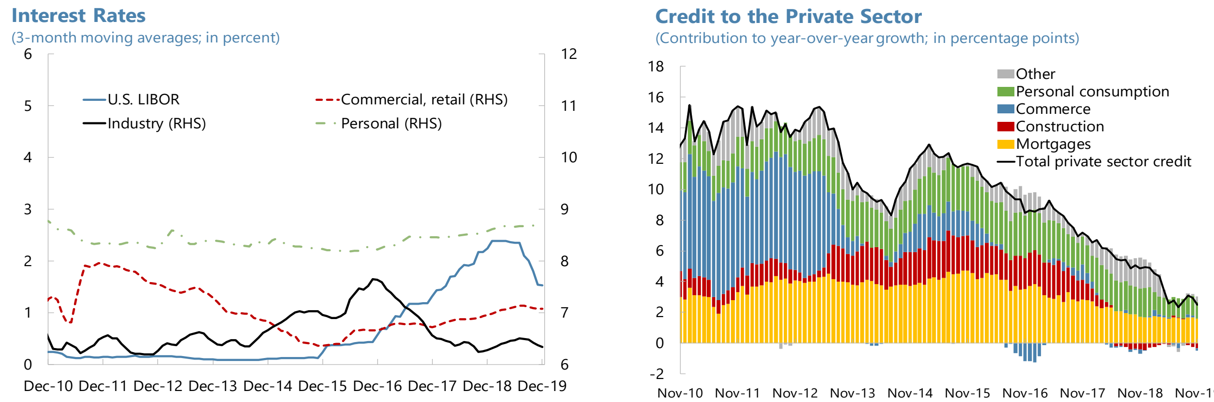


Sources: Panamanian Authorities and IMF staff calculations.
1/ Fiscal impulse is calculated as the change in the cyclically-adjusted primary balance of the NFPS; positive means fiscal loosening.

6. **Credit growth continued to slow as the economy remained weak.** Credit growth decelerated in 2019 to its lowest level in a decade (2.5 percent in November 2019, y/y). Lending rates have remained relatively stable while deposit growth slowed and non-performing loans (NPLs) have remained low and stable. Banks willingness to lend may have been affected by an oversupply in the high-value segments of the property market and government arrears to banks on the preferential interest rate subsidy. Overall, financial conditions have moderately tightened as in most economies in the region.

[3] The gross debt of the NFPS reached 40.8 percent of GDP in 2019, while the net debt amounted to 28.0 percent. The difference in gross debt is due to holdings of public bonds by the social security system, and the difference in net debt is due to sizable assets of the rest of the NFPS (mostly deposits of the social security system at BNP).

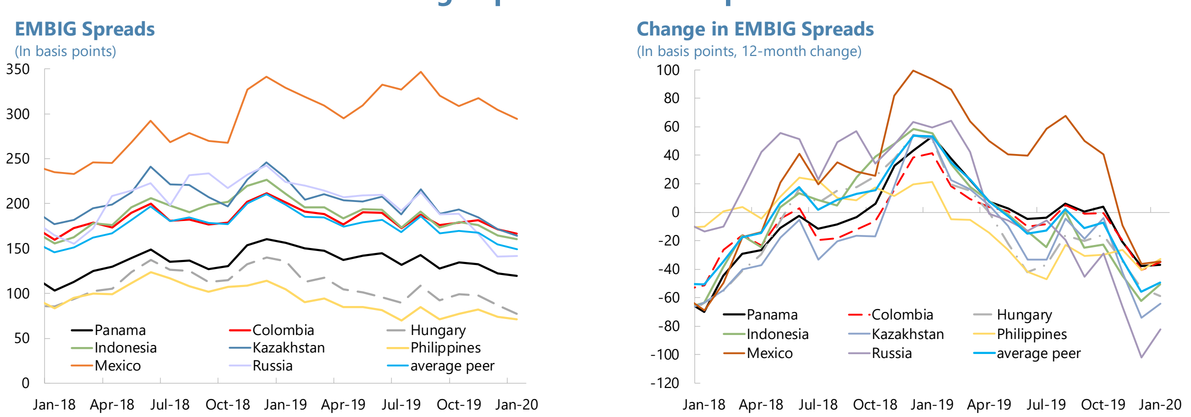
Credit: Costs and Components



Sources: SBP, Federal Reserve, IMF staff calculations.
Note (left chart): Comercial, industry and personal interest rates are the simple average of interest rates.

7. **The external current account deficit narrowed and remained adequately financed by foreign direct investment (FDI).** The external current account deficit is estimated to have fallen to 6.6 percent of GDP in 2019 (from 8.2 percent in 2018). Copper boosted exports in the second half of 2019, whereas lower domestic demand slowed import growth. Canal traffic and related transport service exports continued to grow. FDI remained high at 8 percent of GDP (similar to 2018) and continued to finance the current account deficit. The external position is considered moderately weaker than fundamentals and desirable policy settings, which is mostly due to the still-high investment rate (around 40 percent of GDP). Sovereign spreads are below the average of emerging economies with similar credit rating and have declined recently in tandem with its peers.[4]

Sovereign Spreads: Peer Comparisons[1]



Sources: Bloomberg and IMF staff calculations.
1/ List of countries include those emerging economies with the same credit rating as Panama (BBB according to Fitch).

8. **As the economic situation in Venezuela continues to deteriorate, an increasing number of Venezuelans have migrated to Panama, creating additional social pressures.** Preliminary estimates indicate that the number of Venezuelan migrants in Panama reached 130,000

[4] Panama's sovereign debt reached investment grade in 2010. Upgrades were achieved last year, Moody's upgraded Panama's sovereign rating to Baa1 in March 2019, and Standard and Poor's upgraded Panama's debt to BBB+ in April 2019, while Fitch has maintained its rating at BBB since June 2011, but recently lowered the outlook to negative.

in 2019 (both with legal status and in the process of regularization), which is ⅓ of total inward migration; representing about 3 percent of the population of Panama. Labor markets rigidities make it difficult for foreigners to work in Panama (according to the law, a local company can have up to 10 percent of foreign workers among its staff).

OUTLOOK AND RISKS

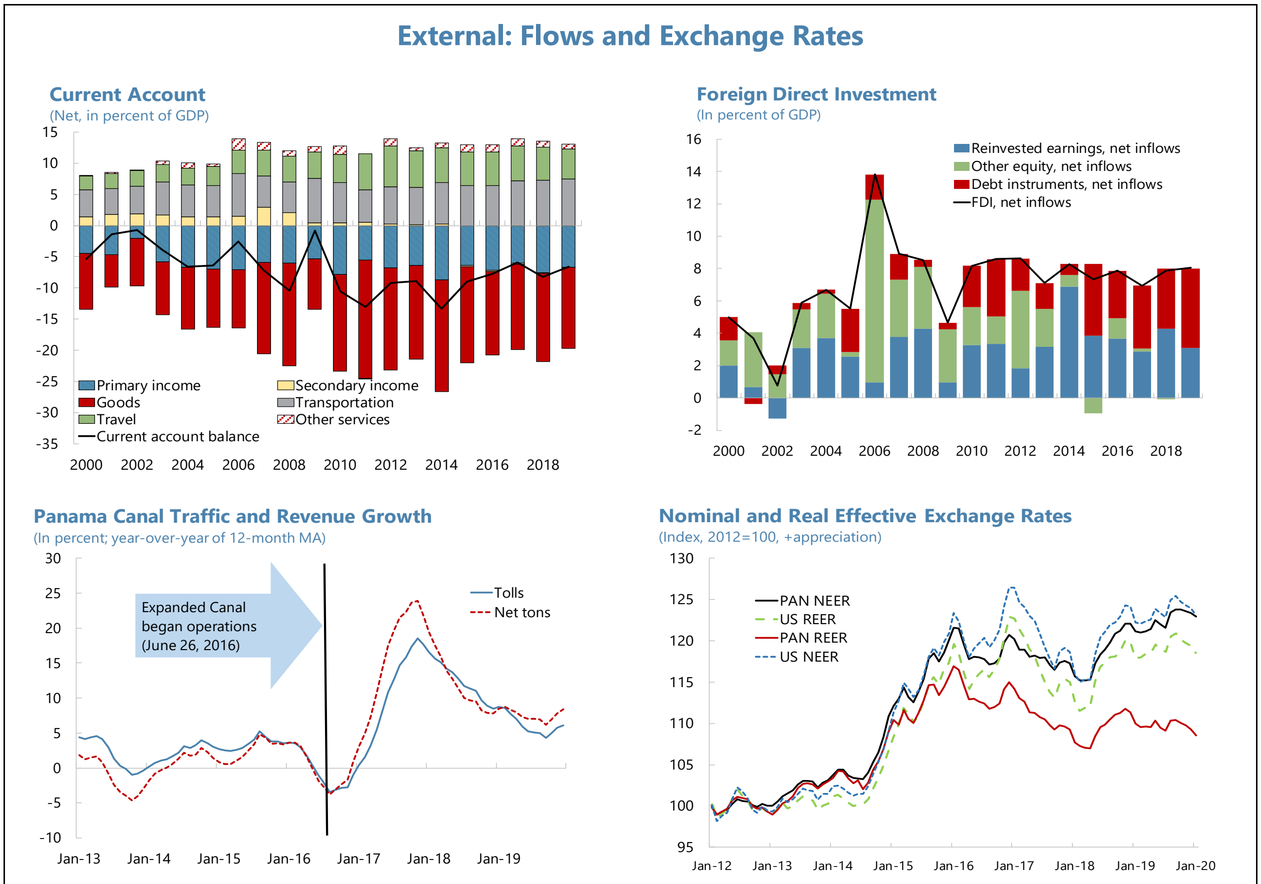
9. Economic activity is projected to recover in 2020. Output growth is projected to rebound to 4.8 percent in 2020, supported by full-scale copper production and robust private investment. Over the medium term, growth is expected to stabilize at its potential annual rate of 5 percent. Inflation is expected to pick up to 1 percent y/y in 2020 amid accelerating economic activity and stabilize at 2 percent y/y in the medium term. Meanwhile, the external position is projected to continually improve, reducing the current account deficit to 5 percent of GDP by 2023. The fiscal balance is also expected to gradually improve—in line with the amended fiscal rule—with the non-financial public sector (NFPS) deficit converging to 2 percent of GDP by 2022.

10. The balance of risks is tilted to the downside. Main domestic risks to growth are related to setbacks in exiting the FATF grey list and complying with SFRL deficit ceilings, both of which could expose Panama to reputational damage and potential pressures on correspondent banking relationships. Continued oversupply in the domestic property market could adversely impact financial stability and the real economy through a price correction and rising NPLs. Social tensions could disrupt economic activity and cause policy missteps. Among external risks, the most notable ones are a slowdown in Canal activity, weaker-than-expected global growth, escalating trade tensions, the spread of coronavirus as well as an erosion in competitiveness due to U.S. dollar appreciation. Other risks include a sharp tightening of global financial conditions leading to rising domestic interest rates which drive up debt service and refinancing costs. Cyberattacks can bring significant disruptions to digital infrastructure, while climate-change related weather events can adversely affect Canal activity, agriculture and tourism (see Annex II).

Medium-Term Macroeconomic Outlook

				Est.	Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					(In percent)					
Macroeconomic Developments										
Real GDP growth	5.0	5.6	3.7	3.5	4.8	5.0	5.0	5.0	5.0	5.0
Output gap	-0.1	0.7	0.0	-0.9	-0.5	-0.2	0.0	0.0	0.0	0.0
CPI inflation (average)	0.7	0.9	0.8	-0.4	0.5	1.5	2.0	2.0	2.0	2.0
Private credit growth	8.4	6.5	4.5	3.1	5.4	6.6	7.1	7.1	7.1	7.1
					(In percent of GDP)					
Fiscal Accounts										
Overall balance	-2.0	-2.2	-3.2	-3.1	-2.7	-2.5	-2.0	-2.0	-2.0	-2.0
Structural primary balance	-0.3	-0.7	-1.5	-1.3	-0.8	-0.6	-0.1	-0.2	-0.3	-0.4
Public debt (gross) 1/	34.8	34.8	36.8	40.8	41.5	41.5	40.7	40.0	39.4	38.7
Public debt (net) 2/	20.3	22.9	25.8	28.0	29.3	29.9	29.8	29.8	29.7	29.6
External Sector										
Current account balance	-7.8	-5.9	-8.2	-6.6	-6.4	-6.2	-5.9	-5.3	-4.8	-4.8
Foreign direct investment	-7.9	-6.9	-7.9	-8.0	-7.3	-7.1	-6.9	-6.6	-6.6	-6.6

Sources: Ministry of Economy and Finance; INEC; SBP; and IMF staff calculations.
1/ Non-Financial Public Sector (NFPS) as defined in Law 31 of 2011.
2/ NFPS gross debt minus deposits at the National Bank (BNP) and financial assets at Panama's Savings Fund.



Sources: INEC and IMF staff calculations.

Authorities' Views

11. **The authorities broadly agreed with staff's views on the outlook and risks**. They were optimistic about the outlook for 2020 and medium-term growth prospects given the copper mine activity and a recovery in private investment. They remain mindful of reputational costs of remaining on the FATF grey list and of postponing fiscal consolidation. The authorities emphasized the importance of risks stemming from trade tensions, weak growth prospects in key trade partners, the coronavirus outbreak, and climate-change related extreme weather events. They agreed with staff's assessment of public debt sustainability and external stability.

POLICY DISCUSSIONS

A. Turning Around Fiscal Policy

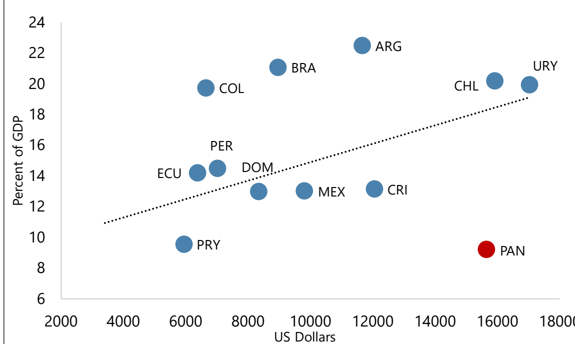
Addressing Fiscal Imbalances

12. **A gradual fiscal consolidation effort is needed given the relatively large fiscal imbalances and the weak economy.** A strong adjustment runs the risk of weakening the economy, when the main source of the imbalance is lower tax revenues mostly related to slow growth. The

policy response was delayed due to the change in government in July 2019. As the slowdown persisted, still-low revenues widened the deficit further in the second half of 2019. In addition, unrecorded arrears from previous years of over 2 percent of GDP were uncovered (and already paid), adding to public debt. Panama's ample access to international capital markets allows for a gradual adjustment, while continued fiscal discipline needs to prevent debt from rising further. To avoid an abrupt fiscal tightening, the government modified the deficit ceiling again to 3½ percent of GDP in 2019 with a gradual adjustment to 2 percent of GDP by 2022. Debt of the Central Administration reached about 46 percent of GDP at the end of 2019, a 4½-percentage point increase compared to 2018, but still below historical averages. These debt levels are higher than previously estimated but are significantly lower on a net basis and sustainable under the baseline and alternative more adverse scenarios (see Annex IV).

13. The revenue underperformance is cyclical as well as structural, limiting resources needed to reach the Sustainable Development Goals. Despite high and sustained receipts from the Panama Canal Authority, NFPS revenue fell by about 1½ percent of GDP in 2019. Tax revenue—already among the lowest in the region—showed the largest shortfall (1 percent of GDP), which is partly due to the tax system that amplifies the cyclicality of tax revenues. Direct taxes are paid on expected profits and incomes at the beginning of each year. Consequently, the lower-than-expected growth in 2018 increased the tax credits used in 2019, accounting for a significant part of the fall. Moreover, the prospect of a tax amnesty as the new administration took office may have lowered tax compliance. Indirect taxes continued to suffer from depressed demand throughout 2019. However, the decline in revenue is not just due to the slowdown—tax revenues have failed to keep up with GDP growth for some years—but also linked to lower tax pressure in some of the more dynamic sectors of the economy (due to tax exemptions).[5] Non-tax revenues are mainly contributions from the Canal which depend on world trade and will decrease over time as a share of GDP as the effect of the expansion fades while the Panamanian economy continues growing at a faster rate than the world economy and international trade, putting further pressure to rely on tax revenues (see Annex VI).

Tax Revenues vs GDP Per Capita
(In percent of GDP and US dollars, in 2018)



Sources: World Economic Outlook database and IMF staff calculations.

14. The downward trend in revenue collection calls for stronger efforts in tax and customs administrations, including strengthening their governance. Numerous tax exemptions and shortcomings in customs and tax administrations already place Panama's tax revenues significantly below countries with similar income levels. Improving the institutional capacity of tax and customs administrations will be crucial to boost tax collection and allow the government to achieve social objectives. Reforms should enhance human resources, limit discretionary powers, reform control

[5] Tax collections have fallen by about 3 percentage points of GDP over the last decade.

processes, and improve data collection and management. To this end, FAD and the Regional Technical Assistance Center for Central America, Panama and the Dominican Republic (CAPTAC-DR) are providing technical assistance. If these reforms are insufficient to boost revenues, it may be necessary to revisit tax exemptions and tax policy to counteract the erosion of the tax base. While tax revenues from the copper mine are expected to be small, the legal uncertainty created by the Supreme Court ruling in 2018 should be addressed (see Annex V).

15. Current expenditure growth needs to be contained to make room for public investment while being mindful of social spending. As revenue measures will not have an immediate effect, expenditure will have to bear the brunt of the fiscal adjustment in the short run. Over the medium term, expenditure cannot outpace revenue growth if the fiscal rule is to be observed. Any additional current spending takes away resources from capital expenditure. While public investment has been high in the last years, further improvements (especially in water and transport infrastructure) are needed. A new law on public-private partnership (PPP) promises to leverage private finance for public investment, but so far, no concrete projects have been announced. Rebalancing current expenditure towards social spending, especially education, and improving the effectiveness of social spending will be crucial to reduce inequality and achieve inclusive growth. Similarly, capital spending needs to be reviewed regularly to ensure its effectiveness and high quality.

16. The pension system may need reforms to strengthen its sustainability over the medium term and prevent undue pressure on the public accounts. The mixed scheme introduced by the 2005 pension reform has combined enough reserves to supplement contribution revenues until 2035. Reforms will need to align contributions with the expected payouts, either by limiting pension benefits or through increasing total contributions. Undertaking gradual reforms early on will avoid a necessary larger adjustment if it is postponed until the longer term.

Strengthening the Fiscal Framework

17. After several modifications of the fiscal rule, the authorities need to demonstrate commitment to fiscal discipline and strengthen policy credibility. In the absence of independent monetary policy, fiscal policy is Panama's main macroeconomic stabilization tool. However, in practice, fiscal policy is limited by the deficit ceiling under the SFRL which serves as an anchor and imposes fiscal discipline, but also limits the scope for countercyclical policy. While the SFRL has helped to create a track record of fiscal discipline, the recent imbalances highlight the need to continue strengthening the fiscal framework. The conduct of fiscal policy could be adapted while minimizing procyclicality. To this end, fiscal policy could be designed to improve its effectiveness in macro-stabilization by using a "shadow" structural fiscal rule that could build fiscal buffers in the future. For example, the deficit could be set below the ceiling after 2022 in upturns to create buffers (while near the ceiling in downturns, using the buffers).[6] In addition, appointing the

[6] The primary surplus under the modified SFRL for 2022 is ¼ percent of GDP which coincides with the structural primary surplus. While the SFRL keeps the overall balance fixed at 2 percent of GDP after 2022, the structural primary balance is de facto relaxed as the interest payments decline. The authorities could consider adhering to a structural

(continued)

members of the fiscal council will allow it to take on its role in monitoring fiscal policy and informing the public debate about the goals and result of policy measures.[7]

18. Strengthening transparency and recording of fiscal accounts will give clarity on the fiscal stance, facilitate analysis of liabilities, and reduce vulnerabilities to corruption. The use of turnkey projects and deferred payment contracts separates the timing of construction, the recording of public accounts and the recognition of corresponding liabilities. The authorities should migrate towards accrual accounting of budgetary expenditures. With sizeable projects, unclear recording can distort the actual fiscal stance which complicates policy decisions. In addition, the authorities need to prevent future accumulation of unrecorded arrears by strengthening budgetary execution rules and penalties, and monitor fiscal risks from contingent liabilities, also when using PPP contracts. Transparent execution of the budget process, salient measures of spending and debt, and clear consequences of misuse of public funds would be supportive of this strategy.

Authorities' Views

19. The authorities are committed to fiscal discipline but see a need for supporting the still-weak economy. The modified deficit ceiling of the fiscal rule permits a gradual adjustment, which will consist of revenue and expenditure measures. The authorities prioritized tax and customs administration reforms which they expect to show some results this year. The 2020 budget foresees a reduction in current expenditure compared to the previous year's budget to contain current primary spending. The authorities have paid the identified arrears to the private sector and are discussing measures to prevent the accumulation of unrecorded arrears in the future. The recording of fiscal accounts is being strengthened, while the process of appointment of the fiscal council members is ongoing.

B. Bolstering Financial Integrity and Tax Transparency

20. Despite notable progress on technical compliance, Panama was placed on the FATF grey list for shortcomings in the effectiveness of its AML/CFT regime and its legal framework. Despite scaling up compliance with FATF's technical recommendations (from 8 to 87 percent in four years), Panama underperforms in many outcomes on regulatory effectiveness (see 2018 SIP). The FATF has called for action in four areas: (i) enhancing Panama's national AML/CFT policy by better understanding national and sectoral money laundering and terrorist financing risks (ML/TF); (ii) enforcing legal action against AML/CFT violations, identifying unlicensed money remitters and enhancing supervision of Designated Nonfinancial Businesses and Professions (DNFBP); (iii) verifying and updating beneficial ownership information; and (iv) demonstrating the ability to investigate and prosecute cases of money laundering involving foreign tax crimes and to provide constructive and timely international cooperation.

primary surplus of ¼ percent of GDP after 2022 while observing the SFRL, avoiding a fiscal relaxation and accumulating fiscal buffers. This implies targeting an overall fiscal deficit of 1½ percent of GDP in 2023 and thereafter (rather than 2 percent).

[7] The Law to create an independent fiscal council was approved by the National Assembly in October 2018, but no members have been appointed yet.

21. Tackling the issues included in the FATF action plan should be prioritized. Panama implemented important measures to strengthen its financial integrity strategy in 2019 by criminalizing tax evasion and improving due diligence to detect fiscal crimes in banking transactions. More recently adopted regulations, including: (i) creating the Superintendency of Non-financial Subjects (formerly an intendency); (ii) introducing criminal penalties for unlicensed money remitters; (iii) creating a single registry for final beneficiaries of offshore entities; (iv) amending the tax evasion legislation; (v) suspending 381,000 dormant entities from the public registry; and (vi) creating a working group with France to cooperate on fiscal and financial transparency and AML/CFT measures are steps in the right direction to exit the FATF watchlist and strengthen Panama's attractiveness for foreign investors and its position as a regional financial center. Creating a roadmap for the undertaking of necessary reforms is urgent. In the absence of policy action, correspondent bank relationships risk being severed, which in turn would dry up domestic liquidity and stifle growth (see 2020 Selected Issues Paper, SIP).

22. The OECD Global Forum upgraded Panama to "partially compliant" with its global tax-transparency standard while the European Union (EU) put Panama on its blacklist of tax havens. The Global Forum recognized measures taken by the authorities to address its legal recommendations (since its last review in 2016) during the November 2019 review. The document noted some remaining challenges, however, including the availability of accounting documentation for dormant entities and slow response to exchange-of-information requests. The EU, on the other hand, added Panama to its list of non-cooperative tax jurisdictions in February 2019 citing lack of progress on relevant reforms.

Authorities' Views

23. Exiting the FATF grey list is a top priority for the Panamanian authorities. With this goal in mind, they are advancing the reform agenda outlined in the list of FATF's recommendations. They are optimistic that a number of recently approved legislative initiatives will enhance Panama's AML/CFT regulatory framework and provide the basis for successfully prosecuting cases involving money laundering and foreign tax crimes. The authorities highlighted progress made since Latin America Anti-Money Laundering Group (GAFILAT)'s latest review, namely in criminalizing tax evasion, enhancing due diligence requirements in banking transactions, and raising public awareness of money laundering activities. They noted that technical assistance from the Fund has been very valuable in advancing initiatives in these areas.

C. Reinforcing Financial System Resilience

24. The financial system remains sound. Although the recent deceleration in credit growth has exacerbated the (small) negative credit gap, private credit remained elevated at above 80 percent of GDP, well above the regional average. Financial soundness indicators suggest that Panama's onshore banking system remained resilient.[8] In particular, loss-absorbing buffers are

[8] The offshore banking system is about 14 percent of the overall banking system and has no linkages to the domestic economy (see SIP 2017).

adequate with capital exceeding regulatory requirements, banks remain profitable, and asset quality is sound. Following a small increase in 2018, the gross NPL ratio has stabilized at around 2 percent and remains well-provisioned. Nonetheless, liquidity buffers could be strengthened as liquid assets cover only one third of short-term liabilities. To address this, the authorities adopted Basel III-related liquidity rules in 2018, with the liquidity coverage ratio (LCR) to be phased-in by 2022. Staff welcomes the publication of the Financial Stability Report, which increases transparency.

25. While macrofinancial risks appear limited, remaining pockets of vulnerability need to be closely monitored. Banks have adhered to a conservative lending strategy to contain NPLs, which were concentrated in construction, commerce and the Colon Free Zone (CFZ). While oversupply in some property segments, especially in the high-end market persists, prices have weakened only moderately (see 2020 SIP). Risks to banks (whose loans are well-collateralized) are contained as the authorities had enforced sectoral capital requirements on loans to households and corporations since 2016. However, a sharp contraction in prices could trigger adverse macrofinancial spillovers, which could increase NPLs. The extension of the preferential interest rate to real estate valued under US$180,000, for which demand remains high, contributes to growing mortgage loans but with limited risk to banks as the subsidy on the interest rate is covered by the government. Nonetheless, credit to households—the main driver of banks' credit—warrants careful monitoring due to rising household indebtedness. Staff welcomes the authorities' surveillance of the housing market and recommends developing formal price indices for all residential and commercial properties, in addition to the recently developed price index of new housing (VNPI). While risks in the cooperative financial sector are not well known, they appear limited (representing about 2 percent of the overall financial system).

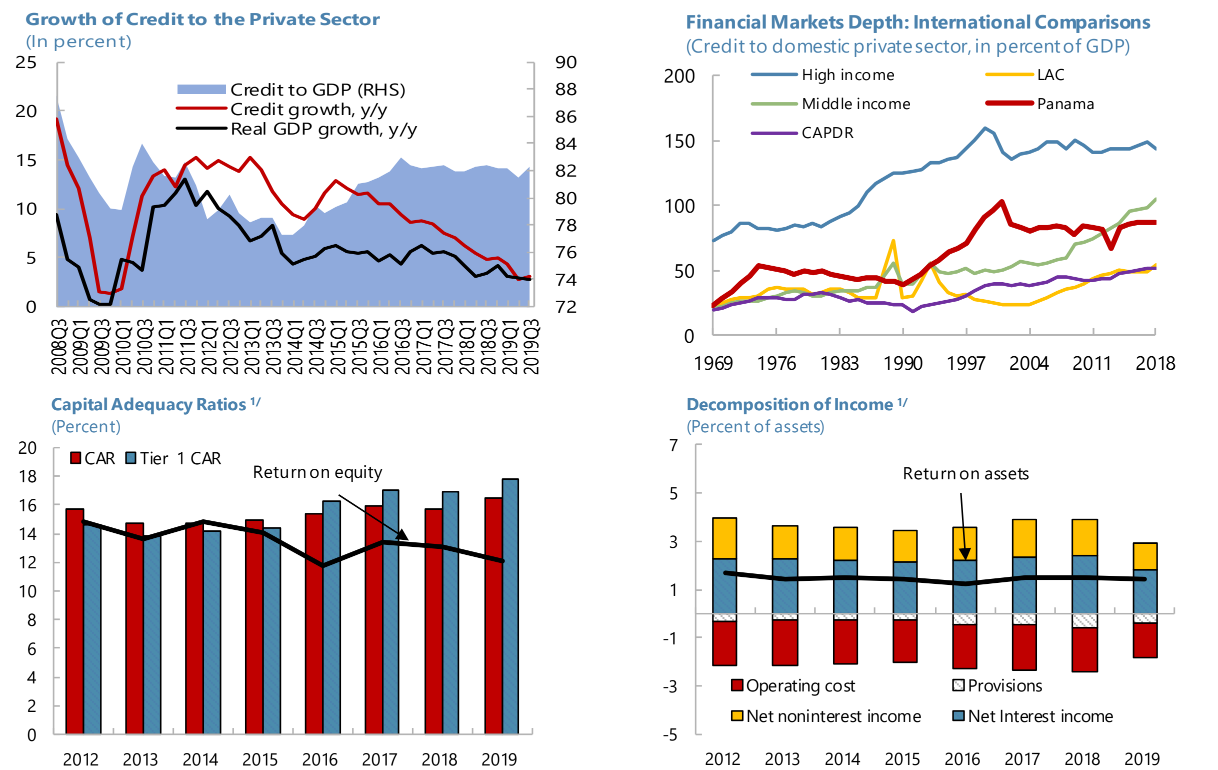
26. The authorities should continue strengthening the financial system through improved oversight. The transition to Basel III standards is well advanced and continues to make progress with the gradual implementation of the LCR. The Panama's Superintendency of Banks (SBP) continues to preside the Financial Coordination Council, participate in joint supervision of financial conglomerates, and conduct risk-based supervision and stress tests of the banking system. In 2019, the SBP intervened, first taking control, and subsequently enforcing liquidation of All-bank (with no discernable consequences for financial stability).[9] Adoption of the International Financial Reporting Standard (IFRS-9) in January 2018 resulted in improved provisioning coverage. CAPTAC-DR is providing technical assistance in several areas related to financial oversight.

27. Developing macroprudential tools and further upgrading the regulatory framework are needed to prevent the buildup of vulnerabilities. In the absence of a central bank (which traditionally serves as the lender of last resort), banks self-insure against shocks by holding high levels of liquidity (almost 60 percent of deposits). While the current system reduces moral hazard, it

[9] All-bank was a small bank with only 0.4 percent of total deposits in the system. The SBP had taken administrative and operational control of All-bank in September 2019, following intervention of the Banco del Orinoco, NV, a bank controlled by the same group in Curaçao by the local regulator. All-bank had a quarter of its liquid assets in Banco del Orinoco, NV, which also managed a third of its investments in securities.

is not optimal as the additional liquidity is costly and limits the supply of credit, creating pressures on interest rates. To mitigate systemic liquidity risk and strengthen confidence, the authorities could introduce an emergency liquidity facility and a limited deposit insurance scheme. Prompt adoption of the draft law on the bank resolution framework can help to broaden the resolution toolkit. To fortify financial stability, the authorities could formalize a crisis management plan, implement capital conservation buffers, introduce additional capital requirements for systemically-important banks, implement the net stable funding ratio (NSFR, in line with Basel III), and expand the macroprudential policy toolkit by establishing a limit on the household's debt-service-to-income ratio.

Financial System Indicators



Sources: INEC, SBP, and IMF staff calculations.
1/ Data for 2019 corresponds to 3rd quarter 2019.

28. Promotion of fintech has potential to modernize Panama's financial system, improve intermediation and enhance financial inclusion. Located close to a digital interconnection of submarine cables, Panama has access to internet bandwidth higher than most OECD countries. Strong internet connectivity and bandwidth, along with relatively high mobile phone usage (77 percent of adults), places Panama as a potential fintech hub. With adequate regulatory safeguards, fintech activity can reduce intermediation costs, and improve access to financial products. Staff encourages the authorities to put in place robust cybersecurity and fintech regulatory frameworks to mitigate risks.

Financial Soundness Indicators[1]

	2017				2018				2019		
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Overall Financial Sector Rating	M	M	M	L	L	M	L	L	L	L	L
Credit cycle	L	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	0.7	0.3	-0.5	-0.4	-0.2	0.0	0.0	0.2	0.2	-0.8	-0.1
Growth of credit / GDP (%, annual)	0.9	0.4	-0.6	-0.4	-0.2	0.0	0.0	0.3	0.2	-0.9	-0.1
Credit-to-GDP gap (st. dev)	-0.4	-0.9	-1.6	-2.1	-1.9	-1.5	-1.3	-1.3	-1.1	-1.4	-0.4
Balance Sheet Soundness	M	M	M	L	L	M	L	L	L	L	L
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L	L
Total deposits-to-total loans ratio[2]	112.6	112.8	110.2	110.5	109.3	107.1	104.5	106.3	105.9	106.4	107.0
Balance Sheet Buffers	M	M	M	L	L	M	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	11.0	11.3	11.6	11.4	11.3	11.5	11.6	11.3	11.7	12.0	12.2
Profitability	L	L	L	L	L	L	L	L	L	L	L
ROA	1.4	1.5	1.5	1.5	1.6	1.6	1.5	1.5	1.5	1.5	1.4
ROE	13.2	13.6	13.1	13.5	13.9	13.7	12.7	12.8	13.0	12.4	12.2
Asset quality	H	H	H	M	M	H	M	M	M	L	L
NPL ratio	1.5	1.5	1.7	1.4	1.7	1.8	1.9	1.7	1.8	1.8	1.9
NPL ratio change (%, annual)	30.5	39.4	28.5	14.0	11.5	21.6	12.2	18.8	6.4	-1.6	-2.5

Source: National authorities and IMF staff calculations.
1/ The indicator-specific thresholds are determined based on analytical findings of the GFSR (Fall 2011, Ch.3), Dell'Arricia et al. (2012), Key Aspects of Macroprudential Policy (2013), Staff Guidance Notes on Macroprudential Policies (2014), Basel III, and MCM's expert judgement based on FPAS experiences.
2/ Total deposits include interbank funding.

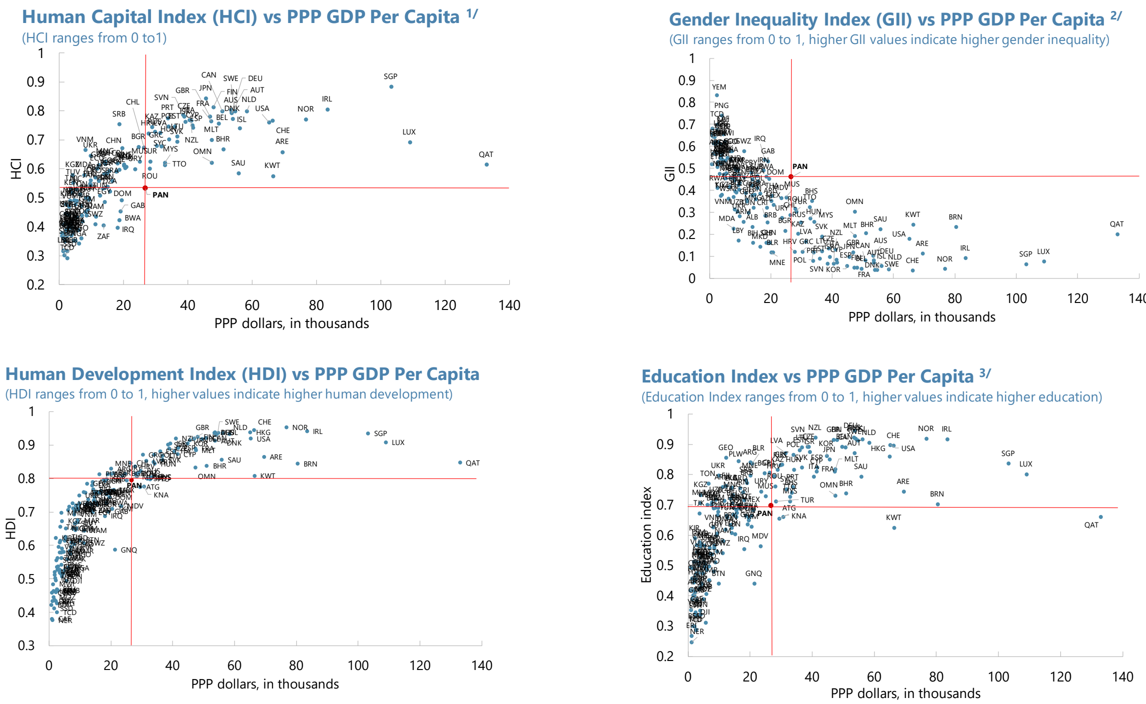
Authorities' Views

29. The authorities concurred on the soundness of the financial system and remain committed to continue fortifying its regulatory oversight. A five-year masterplan on regulatory reforms is underway with the appointment of a new Bank Superintendent. The authorities are aware of the risks related to the real estate market and are actively monitoring developments. Concerns on confidentiality will need to be addressed before macroprudential limits on household debt could be introduced. The authorities are considering adoption of the Basel standards on capital conservation buffers for all banks, capital surcharge for domestic systemically important banks, and strengthening the stress-testing framework for banks. A quantitative impact study will be conducted before the NSFR is considered as the implementation of the LCR is still in progress. A bank resolution law is currently being drafted. A regulatory sandbox is also underway for developing fintech.

D. Supporting Sustainable and Inclusive Growth

30. While remarkable growth performance has contributed to significant reductions in poverty and inequality, further efforts are needed. Panama has been the fastest-growing economy in the region over the last two decades and one of the most dynamic economies in the world. However, it lags the peers in its income group in many aspects of social policy, such as education, health, gender equality and social inclusion. Specifically: (i) educational enrollment and academic outcomes are among the lowest in the region; (ii) rural poverty rates remain high, and are particularly elevated and persistent in the *comarcas* (territories inhabited by indigenous peoples); (iii) gender inequality persists, represented by the relatively high labor force participation gap, very high rates of adolescent births, elevated maternal mortality rates compared to peers, and political underrepresentation for women; and (iv) social protection programs need to improve their effectiveness (see 2020 SIP).

Social: World Comparisons



Sources: WEO, Human Development Report, World Bank and IMF staff calculations.
Note: 2019 data for PPP GDP Per Capita, 2018 data for GII, HDI and Education Index and 2017 data for HCI.
1/ HCI measures the amount of human capital that a child born today can expect to attain by age 18 given the risks of poor health and education.
2/ GII is a composite measure reflecting inequality in achievement between women and men in three dimensions: reproductive health, empowerment and the labour market.
3/ Education Index is a component indicator from the HDI. It is an average of mean years of schooling and expected years of schooling.

31. A strong reform agenda is urgently needed to sustain high economic growth and close the gap with advanced economies. The high growth observed over the last decade was driven mostly by investment, while total factor productivity was negative (see Annex VII). Future growth will increasingly rely on productivity improvements as investment rates are expected to fall to more sustainable levels while population growth will moderate (see 2020 SIP).

- ***Labor inadequacies***. Panama needs to improve the functioning of its labor market and the quality of its labor supply. Panama ranks among the lowest 20 countries in the world (according to the Global Competitiveness Index) when it comes to hiring and firing practices, while restrictions on the employment of foreign workers also limit labor market flexibility. Education reform should be a priority to improve the quality of schooling and boost the low rates of enrollment in secondary education and beyond, which will improve the quality of the labor force over the medium term.

- ***Investment climate***. While Panama's investment rate is the highest in the region, it is likely to moderate as some big projects are being completed. To improve its attractiveness as a business destination, Panama needs to address deficiencies in governance and institutions—including through reforms to strengthen fiscal governance and the AML/CFT framework. The authorities should reduce red tape, continue professionalizing the public administration, resolve weaknesses in the insolvency framework, and improve the judicial system, particularly with respect to contract enforcement and property rights in rural areas.

- ***Technology and innovation***. Panama's ability to maintain high growth crucially depends on its innovative capacity. This rests on the continued attractiveness to FDI, the expansion into high value-added sectors and a skilled workforce to absorb knowledge spillovers. Existing policies attract knowledge-intensive industries and research activities to special economic zones, but positive spillovers to the rest of the economy are limited. The authorities should invest in research and development, while making better use of Panama's proximity to high speed internet connections to attract technologically sophisticated businesses.

Growth Accounting

(Contributions to growth, percent)

	2000-09	2010-19	Proj. 2020-25
Labor	1.7	0.8	0.7
Human Capital	0.3	0.2	0.2
Capital	2.9	7.2	4.6
TFP	0.7	-2.0	-0.5
GDP	**5.6**	**6.2**	**5.0**

Source: PWT and IMF staff calculations.

32. Stronger social policies are needed to sustain high economic growth and expand its potential output. In light of the recently emerged social tensions in the region, the authorities need to be particularly mindful of: (i) enhancing their social policy program; and (ii) mitigating the impact of structural reforms on the vulnerable segments of the population. Revamping social policies would involve eliminating gaps in coverage and improving the efficiency of support programs for the poor, enhancing economic opportunities for women and the indigenous groups, and better provision of basic infrastructure and public services to rural areas, among others. This will require a multi-year policy strategy, a sustainable investment plan (amid the state's limited capacity to shoulder all the needed spending given its low revenue base), and some degree of support from experts in the field (see 2020 SIP).

33. Although Panama's contributions to global greenhouse gas emissions are low, adherence to its climate-change mitigation policies is important.[10] In order to pursue a low-carbon growth model and fulfill its Sustainable Development Goals (SDG), Panama must adhere to its Doha commitment to meet the growing electricity demand with mostly renewable energy, capitalizing on its endowment of hydroelectric resources. In addition to "green" energy provision, the country has committed to: (i) promote the use of new technologies for improving the efficiency, generation, storage, transmission and distribution of energy; (ii) sustainably manage its forest resources, including through reforestation and agroforestry; and (iii) protect its water resources.

34. Weak water infrastructure and volatile rainfall demand policy action to ensure water security. The artificial lakes Gatun and Alajuela supply the Panama Canal and around half of Panama's population with fresh water. In recent years, *El Niño*-induced droughts already forced the Canal administration to limit cargo, which could happen more often if no policy actions are taken. Despite Panama's abundance of rainfall, water losses are high due to lack of investment in water infrastructure. Around one-half of drinking water is currently lost before reaching the consumer. At

[10] Panama ratified the Kyoto Protocol in 1999 and, in 2015, the Doha Amendment on the reduction of greenhouse gas emissions by December 31, 2020. Furthermore, the authorities ratified the Paris Agreement on climate change in 2016 and pledged to ratify the Kigali Amendment to the Montreal Protocol in September 2018.

the same time demand is rising, especially from the expanded Canal and a growing population. Water has been on the authorities' reform agenda starting with the 2015 National Water Plan. However, more policy actions, such as investment in water infrastructure and water management, are crucial to secure water supply for human consumption, agricultural needs, and sustainable functioning of the Canal.

Authorities' Views

35. The authorities remain committed to ensure the inclusivity and sustainability of Panama's long-term growth prospects. They highlighted progress achieved over the years in reducing poverty rates and boosting the standards of living. However, they agreed with the staff's assessment of certain deficiencies in the social policy framework, including the urgent need to upgrade the educational system and address high structural poverty rates in the *comarcas*. They stressed the need for continued assistance on social policy reform from experts in the field, including the World Bank and other development partners. The authorities agreed with staff on the importance of enhancing water resource management and adhering to Panama's Doha commitments in light of the country's vulnerability to extreme weather events.

E. Enhancing Data Reporting Standards

36. Enhancing the autonomy and capacity of the Statistics Institute is crucial to bringing data quality in line with the economy's per capita income. The new government prioritized making the National Institute of Statistics and Census (INEC) independent from the Comptroller's Office and included the issue in the initial constitutional reform package. While data are broadly adequate for surveillance purposes, policymakers would benefit from more timely and accurate expenditure-side data for national accounts, more frequent labor market indicators, and closing data gaps on housing prices and private indebtedness. Since October 2018, Panama is a subscriber to the enhanced General Data Dissemination System (e-GDDS) and has published macroeconomic data through a National Summary Data Page (NSDP). To align its statistical framework with best practices, Panama needs to transition to the Special Data Dissemination Standard (SDSS). To this end, STA and CAPTAC-DR are providing technical assistance on an update of the Report on the Observance of Standards and Codes (ROSCs), and other relevant issues.

STAFF APPRAISAL

37. Growth is expected to rebound in 2020. Economic activity is projected to recover after a slowdown in 2018–19, supported by full-scale copper production and robust private investment. Growth over the medium-term is expected to remain at its potential. Key risks relate to setbacks in exiting the FATF grey list and complying with SFRL deficit ceilings as well as a slowdown in Canal traffic amid escalating trade tensions, weak growth in key trade partner countries, and the coronavirus outbreak. While external imbalances are expected to decline over the medium-term, the external position is moderately weaker than fundamentals and desirable policy settings.

38. Sustained fiscal discipline is required for fiscal policy credibility and to keep public debt on a downward trajectory. Amid a relatively high deficit exacerbated by newly discovered unrecorded arrears, Central Administration debt reached 46.2 percent of GDP in 2019. The modified gradual adjustment of the deficit ceiling under the SFRL is appropriate to smooth the pace of necessary fiscal consolidation. In addition, the authorities should consider using a "shadow" structural rule in the future to build fiscal buffers.

39. A realignment of fiscal revenue and expenditures is imperative to sustain growth. In addition to improving the capacity of tax and customs administrations, action is required to review Panama's complex tax exemptions that continually erode the tax base. On the expenditure side, realigning current spending with social needs—including by investing more in education—and improving the effectiveness of social spending will be crucial to achieve sustainable and inclusive growth. Capital projects need to be carefully assessed and prioritized going forward.

40. The pension system needs to be strengthened. Faced with slowing population growth, the authorities need to gradually align pension contributions with expected payouts, to avoid creating an undue burden to the public finances in the long run. Given the politically sensitive nature of such adjustments, a slow-paced approach is recommended.

41. Strengthening the fiscal framework is essential to improving the macroeconomic policy toolkit. The emergence of sizable unrecorded arrears highlights the need to strengthen budgetary execution rules and misuse penalties as well as to streamline the recording of fiscal accounts by limiting the use of turnkey projects and deferred payment contracts in public investment projects.

42. Exiting the FATF grey list must remain a priority. Building on the momentum of recent legislative action, the authorities should continue addressing the deficiencies in Panama's AML/CFT regime and legal framework identified by the FATF. In addition, the authorities should address the shortcomings identified in the 2019 Global Forum review on global tax transparency, including by responding to exchange-of-information requests in a timely manner.

43. The financial sector remains robust, but macrofinancial risks warrant continued monitoring. Addressing data gaps with respect to household and corporate balance sheets and property prices remains a priority. Specifically, improving housing price indices would facilitate financial-sector surveillance.

44. The alignment of prudential regulations with Basel III is welcome. The authorities should focus on macroprudential tools and further upgrading the regulatory toolkit. It will also be important to put in place robust frameworks for crisis management, including by adequate liquidity support for banks and enhancing the range of resolution tools available to failed banks.

45. The fintech sector holds potential in the presence of an appropriate regulatory framework. Adopting cybersecurity and fintech regulatory frameworks while capitalizing on Panama's digital and mobile connectivity could place the country as a regional fintech hub, enhancing financial inclusion, and lowering intermediation costs.

46. A reinforcement of the structural reform agenda will be necessary to maintain high potential growth. Sustaining high rates of growth will require continued improvements in productivity and competitiveness, a strengthening of policies related to labor mobility, governance and institutional capacity, and enhancing the innovation and technological sophistication in key industries. To remain an attractive destination for doing business, Panama needs to upgrade the skill level of its workforce, streamline the insolvency framework and improve the functioning of the judicial system.

47. Addressing social inequities is urgent. Revamping social policies is imperative to maintain broad-based and inclusive growth and requires strategic policy action in the areas of education, gender equality, social protection programs, and poverty reduction in the *comarcas*.

48. Panama's climate change mitigation strategy and commitments are welcome. Beyond "green" energy provision, the authorities should be mindful of natural resource preservation, especially in view of the country's susceptibility to extreme weather events. Most notably, the pressure for better water management is mounting both from the expanded Canal operations and a growing population.

49. Staff propose that the next Article IV consultation takes place on the standard 12-month cycle.

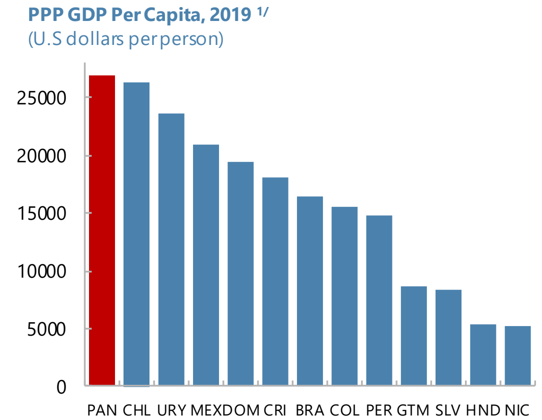
Proposed Decision

The Executive Board endorses the thrust of the staff appraisal in the report for the 2020 Article IV consultation with Panama (SM/20/64, 3/10/20).

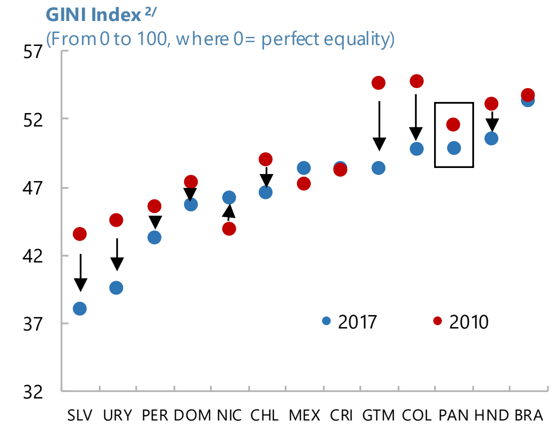
It is expected that the next Article IV consultation with Panama will take place on the standard 12-month cycle.

Figure 1. Panama: Socio-Economic Indicators

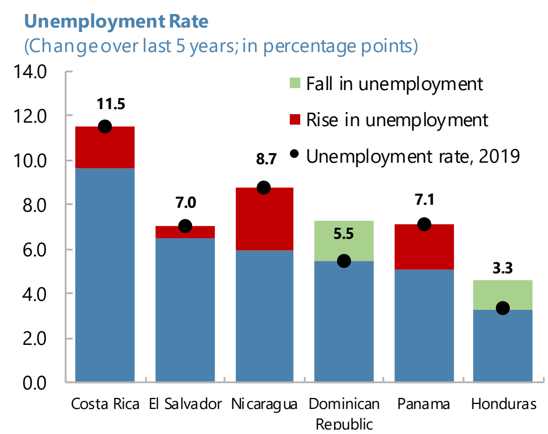
Per capita income is the highest in Latin America...



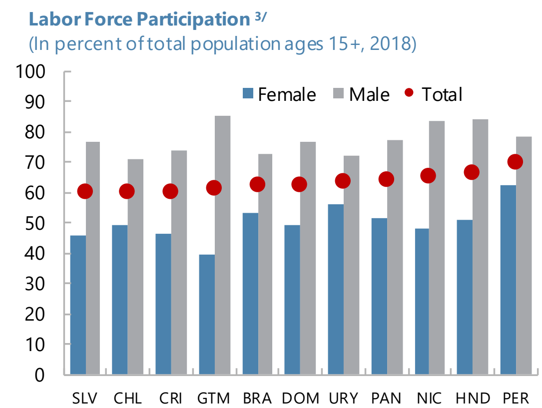
...but inequality remains high relative to regional peers.



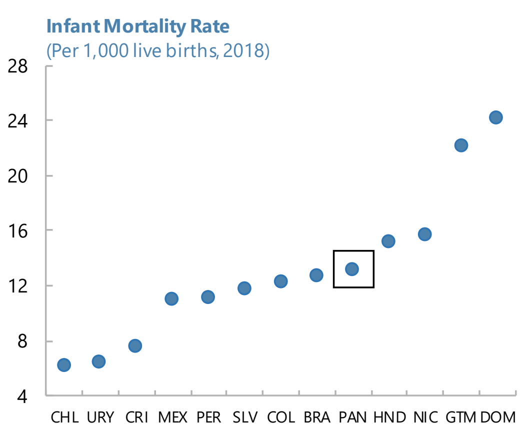
Unemployment has increased but remains comparable to regional peers.



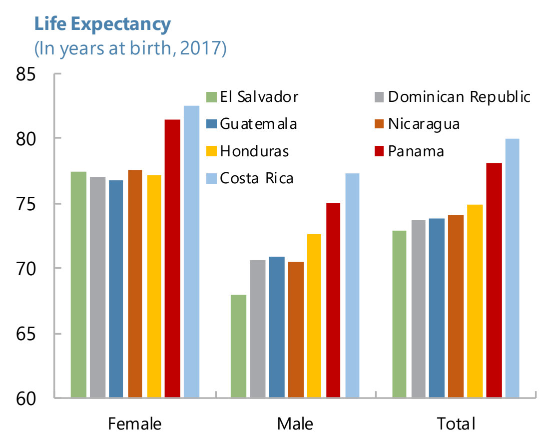
Labor force participation rates are in line with regional peers.



Infant mortality is comparable to regional peers, but...



...life expectancy is higher than in most regional peers.

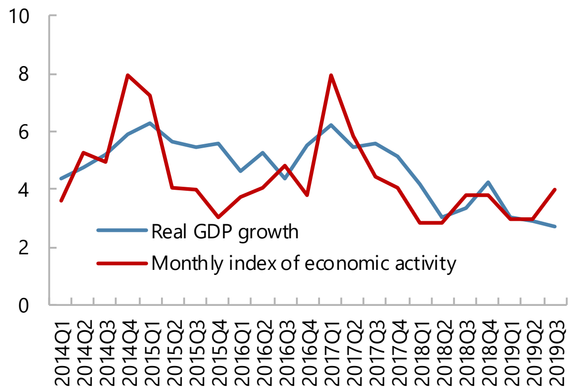


Sources: WEO, October 2019; World Bank, World Development Indicators, and IMF staff calculations.
1/ LA6 (Brazil (BRA), Chile (CHL), Colombia (COL), Mexico (MEX), Peru (PER) and Uruguay (URY)) and CAPDR (Costa Rica (CRI), Honduras (HND), Nicaragua (NIC), El Salvador (SLV), Dominican Republic (DOM), Guatemala (GTM), and Panama (PAN).
2/ For 2010, data for NIC, CHL and BRA is from 2009 and GTM is from2006. For 2017, NIC and GTM is from 2014, and for DOM and MEX to 2016.
3/ Data for DOM and GTM are from 2017 and for NIC is from 2014.

Figure 2. Panama: Real Sector Developments

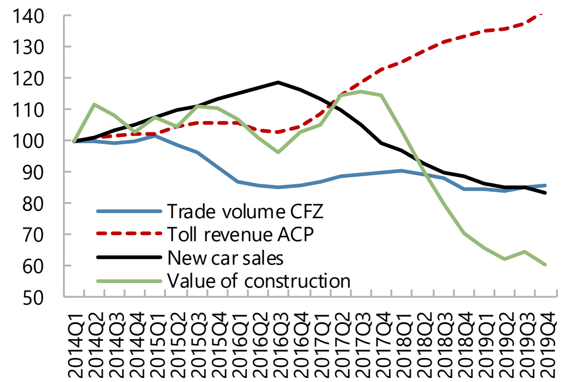
Economic slowdown persists for over a year...

Economic Activity
(Percent; year-over-year)



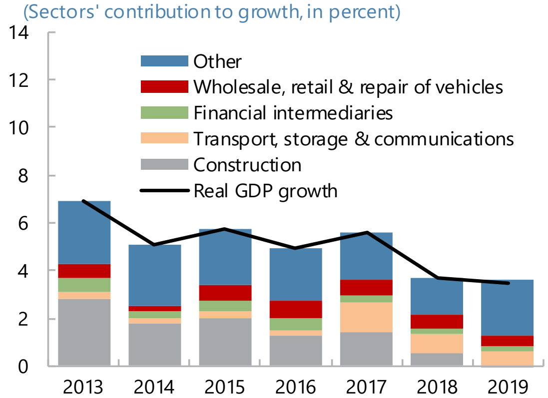
...due to a plummeting construction sector and continued weakness in the CFZ.

High-Frequency Indicators 1/
(Index 2014Q1=100)



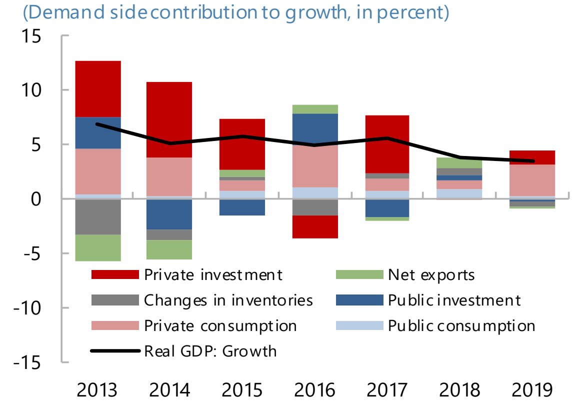
Transport and communication remain healthy and support economic activity...

Real GDP Growth
(Sectors' contribution to growth, in percent)



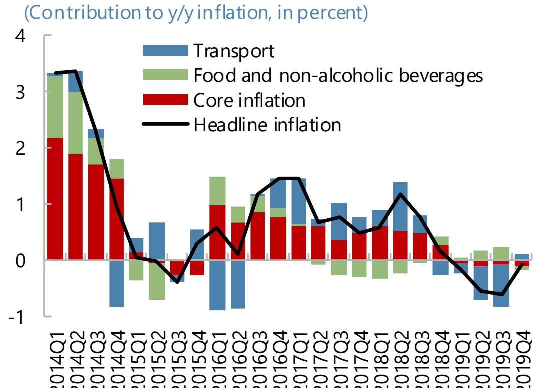
...together with strong consumption, while declining investment drags economic growth down.

Real GDP Growth
(Demand side contribution to growth, in percent)



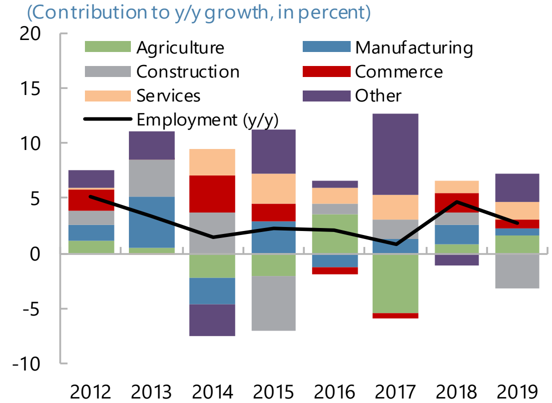
Prices are on declining path, reaching negative inflation in mid-2019, reflecting weak demand.

Inflation
(Contribution to y/y inflation, in percent)



Aggregate employment growth has slowed, with divergent dynamics across economic sectors.

Employment Growth
(Contribution to y/y growth, in percent)

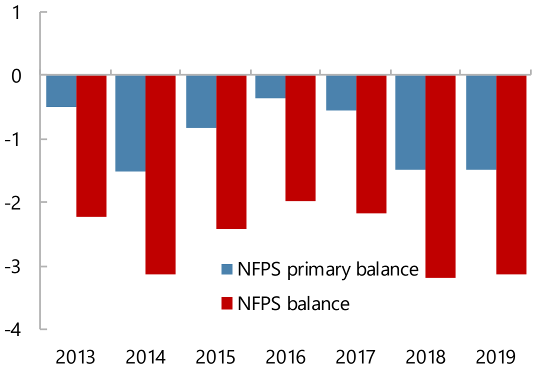


Sources: National authorities and IMF staff calculations.
1/ 4-quarter moving averages. Colon Free Zone (CFZ) measured in gross metric tons.

Figure 3. Panama: Fiscal Developments

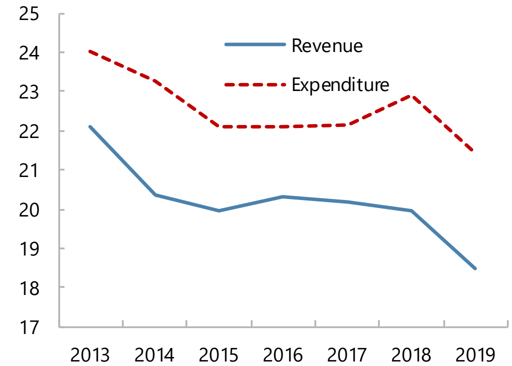
The fiscal deficit remained stable in 2019 …

Fiscal Balances 1/
(In percent of GDP)



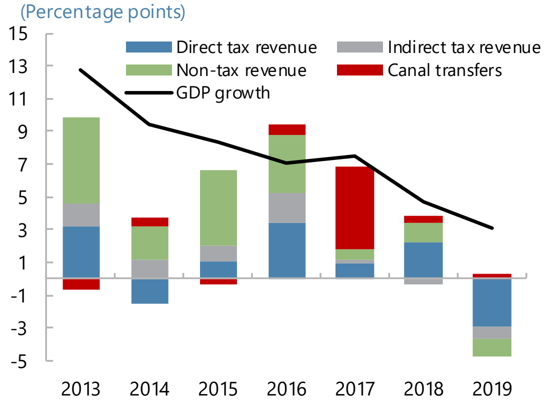
… despite a fall in revenue due to the combination of cyclical and structural factors.

Revenue and Expenditure 1/
(In percent of GDP)



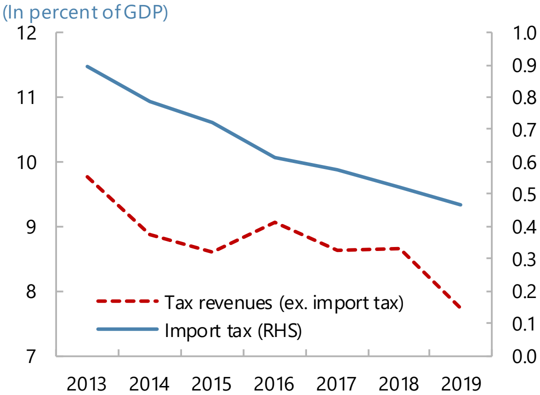
Low tax revenue explains most of the revenue decline…

Revenue Contribution 2/
(Percentage points)



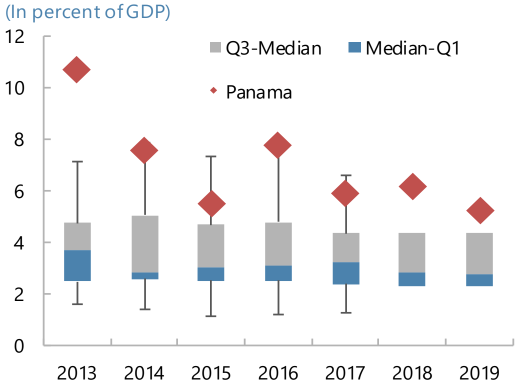
…and challenges in tax and customs administration, and tax exceptions continue to affect tax and tariff collection.

Tax Revenues
(In percent of GDP)



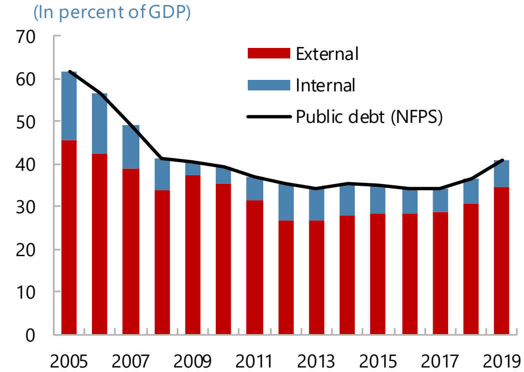
Public investment has fallen after the completion of several large infrastructure projects.

Public Gross Fixed Capital Formation 3/
(In percent of GDP)



Public debt increased by over 6 percent of GDP in the past three years.

Public Debt
(In percent of GDP)

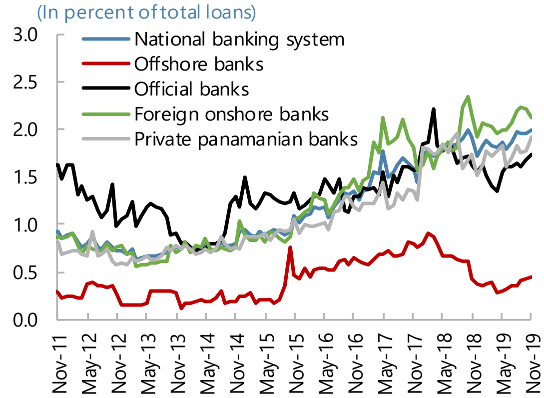


Sources: National Authorities, WEO and IMF staff calculations.
1/ Non-Financial Public Sector.
2/ Data refer to the Central Government.
3/ Countries in the chart are CAPDR (Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica, Panama and Dominican Republic and LA6 (Brazil, Chile, Colombia, Mexico, Peru, and Uruguay).

Figure 4. Panama: Banking Sector Soundness

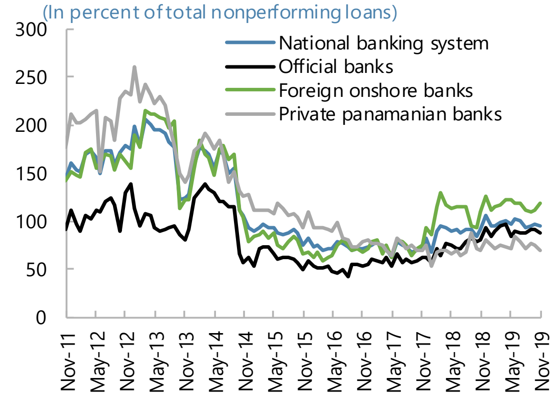
NPLs remain relatively low but have doubled in recent years…

Nonperforming Loans
(In percent of total loans)



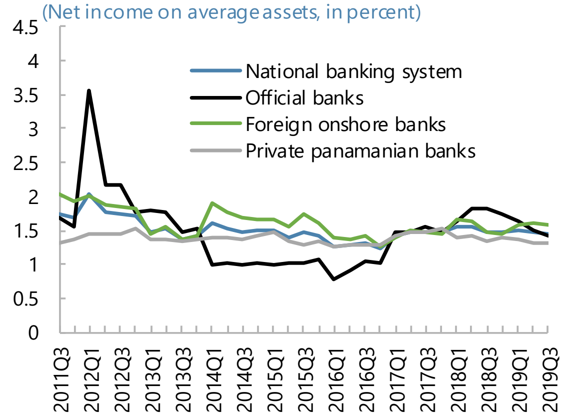
…while provisioning coverage improved in 2018 with the adoption of stricter provisioning requirements.

Provisioning
(In percent of total nonperforming loans)



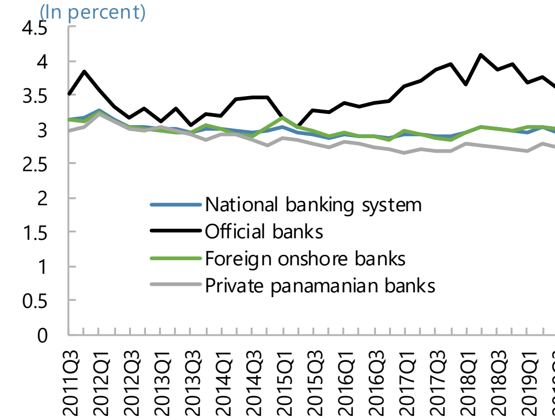
Banks' profitability has remained stable as rising funding costs have been offset by higher returns on liquid assets…

Return on Assets
(Net income on average assets, in percent)



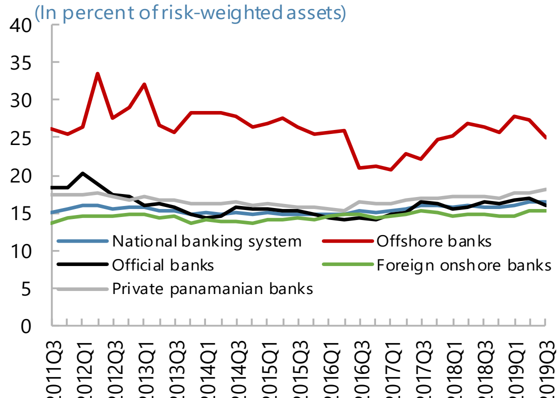
…and net interest margins have remained broadly stable.

Net Interest Margin
(In percent)



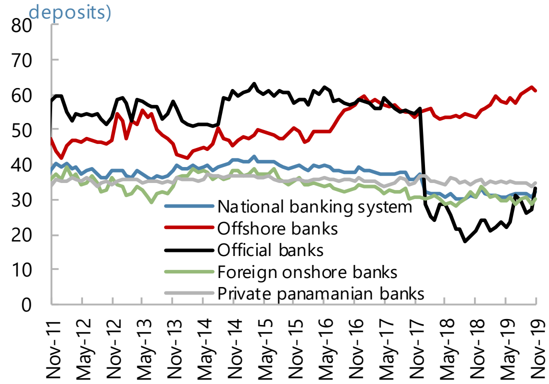
Banks' capital adequacy remains well in excess of regulatory minimum.

Capital Adequacy Ratio
(In percent of risk-weighted assets)



Banks' liquidity has remained ample and broadly stable.

Bank Liquidity
(Ratio of liquid assets plus marketable securities to total deposits)

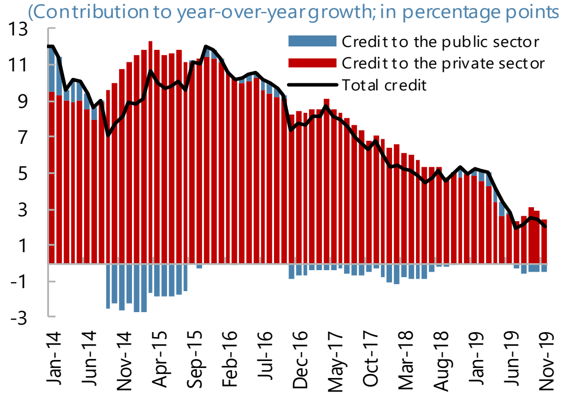


Sources: SBP and IMF staff calculations.

Figure 5. Panama: Macrofinancial Developments

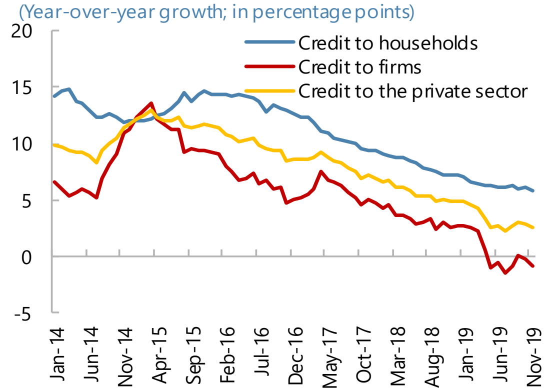
Credit growth slowed further in 2019, driven mostly by weak private sector borrowing…

Credit Growth: Public vs. Private Sector
(Contribution to year-over-year growth; in percentage points



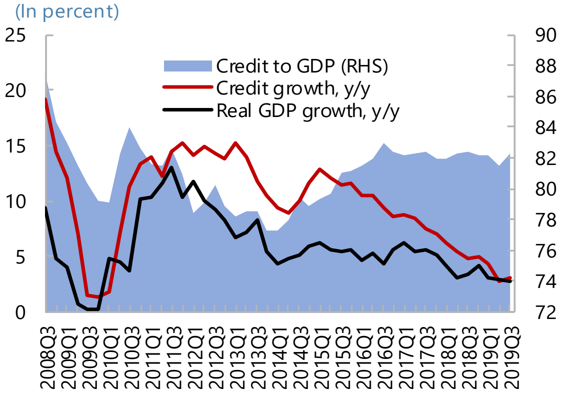
…while its composition continued shifting from firms to households.

Private Sector Credit Growth
(Year-over-year growth; in percentage points)



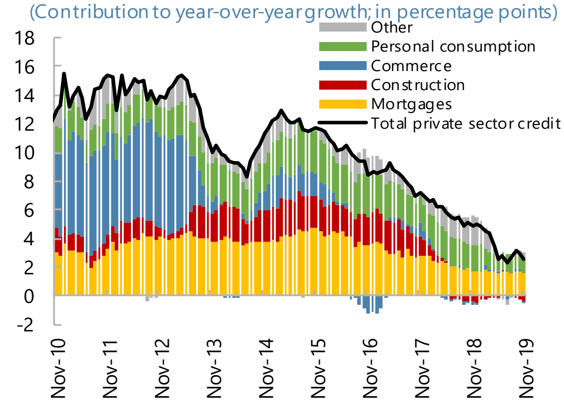
Private sector credit evolves in line with economic activity…

Growth of Credit to the Private Sector
(In percent)



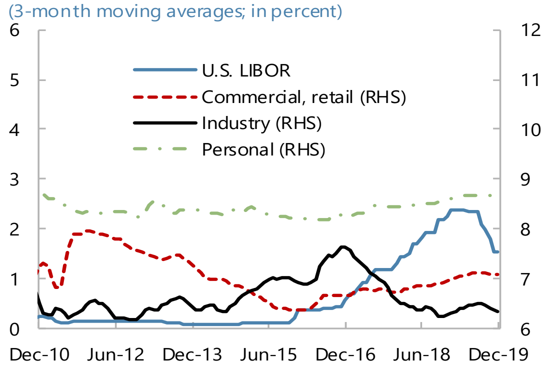
…it decelerated further in 2019 driven by mortgages and personal consumption.

Credit to the Private Sector
(Contribution to year-over-year growth; in percentage points)



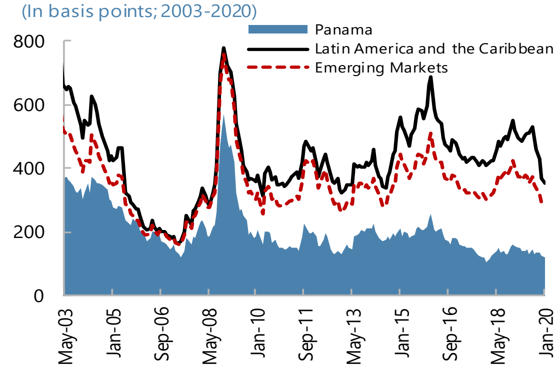
Domestic interest rates have been relatively stable…

Interest Rates
(3-month moving averages; in percent)



…while sovereign spreads remain among the lowest in a region.

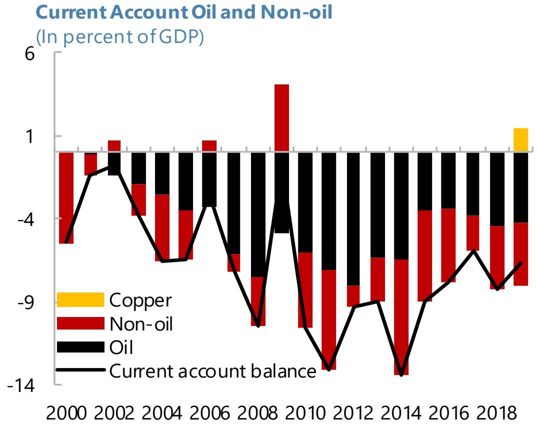
EMBIG Spreads
(In basis points; 2003-2020)



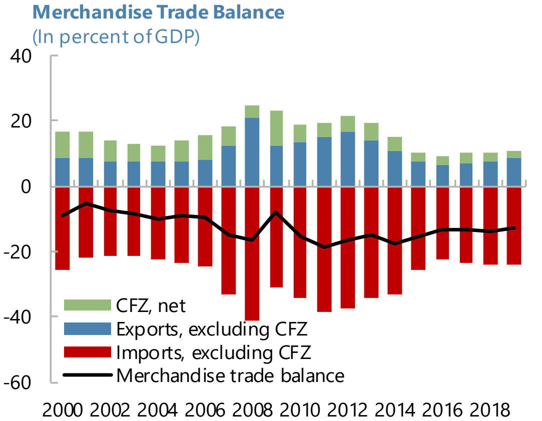
Sources: SBP, INEC, U.S. Federal Reserve, Bloomberg and IMF staff calculations.

Figure 6. Panama: External Sector Developments

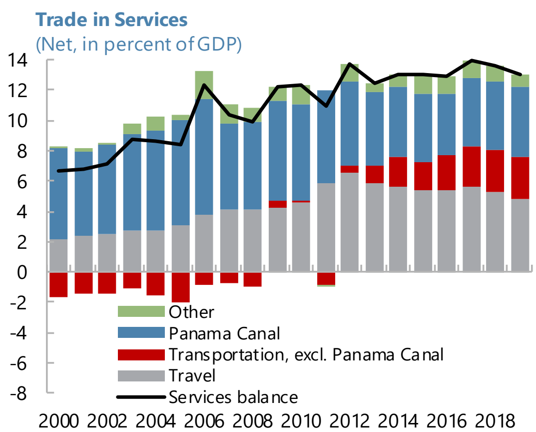
The current account deficit has improved, as copper exports started and oil prices fell…



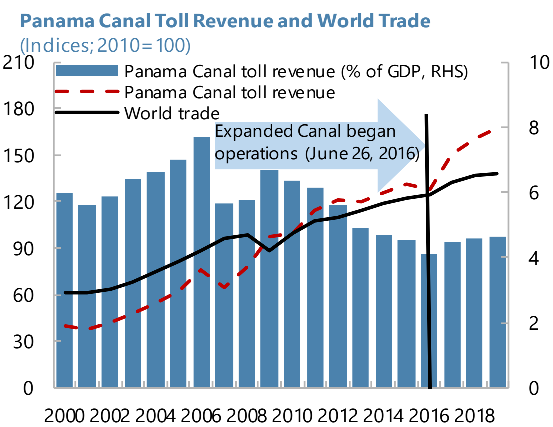
…which reduced the merchandise trade deficit.



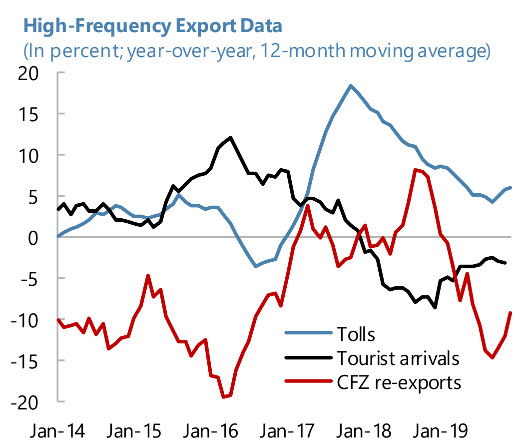
Weak tourism exports reduced service exports…



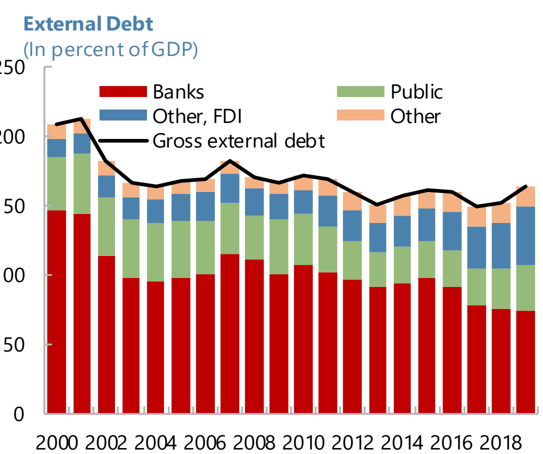
… but revenues from the Panama Canal continue to grow, albeit at a slower rate.



CFZ and tourism are recovering slowly, while canal toll revenue remains strong.



External debt ticked up amid strong FDI inflows and high public external debt.



Sources: IMF WEO; INEC and IMF staff calculations.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2018)	4.2	Poverty line (percent, 2017)	20.7
Population growth rate (percent, 2018)	1.6	Adult literacy rate (percent, 2018)	95.4
Life expectancy at birth (years, 2017)	78.1	GDP per capita (US$, 2018)	15,507
Total unemployment rate (August, 2019)	7.1	IMF Quota (SDR, million)	376.8

					Est.	Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					(Percent change)						
Production and prices											
Real GDP (2007 prices)	**5.7**	**5.0**	**5.6**	**3.7**	**3.5**	**4.8**	**5.0**	**5.0**	**5.0**	**5.0**	**5.0**
Consumer price index (average)	0.1	0.7	0.9	0.8	-0.4	0.5	1.5	2.0	2.0	2.0	2.0
Consumer price index (end-of-year)	0.3	1.5	0.5	0.2	-0.1	1.0	2.0	2.0	2.0	2.0	2.0
Output gap (% of potential)	0.1	-0.1	0.7	0.0	-0.9	-0.5	-0.2	0.0	0.0	0.0	0.0
Demand components (at constant prices)											
Public consumption	**7.6**	**10.1**	**6.5**	**7.5**	**8.6**	**2.2**	**5.7**	**4.8**	**4.1**	**4.0**	**5.3**
Private consumption	2.8	7.1	3.1	2.3	3.4	3.9	5.0	5.0	5.0	5.5	5.5
Public investment 1/	-20.4	49.0	-20.7	7.0	-5.2	1.2	4.6	-5.4	4.4	5.3	3.1
Private investment	12.6	-5.5	14.9	-0.1	1.4	1.8	3.8	5.1	3.0	2.2	4.0
Exports	0.9	-4.3	5.0	5.0	-0.4	7.9	5.3	5.1	6.3	4.6	4.9
Imports	-0.1	-4.8	4.7	2.8	-0.4	4.2	4.6	4.2	4.9	3.3	4.6
Financial sector											
Private sector credit	**11.4**	**8.4**	**6.5**	**4.5**	**3.1**	**5.4**	**6.6**	**7.1**	**7.1**	**7.1**	**7.1**
Broad money	5.5	4.1	5.2	2.8	3.1	5.4	6.6	7.1	7.1	7.1	7.1
Average deposit rate (1-year)	2.7	2.7	2.7	3.5	3.9	...	...	...	...	...	...
Average lending rate (1-year)	3.3	3.5	3.5	4.3	4.7	...	...	...	...	...	...
					(In percent of GDP)						
Saving-investment balance											
Gross domestic investment	**42.8**	**40.5**	**41.7**	**41.3**	**39.8**	**39.1**	**38.7**	**38.2**	**37.6**	**36.8**	**36.5**
Public sector	5.5	7.8	5.9	6.1	5.2	5.0	5.0	4.5	4.5	4.5	4.4
Private sector	37.2	32.7	35.8	35.2	34.6	34.0	33.7	33.7	33.1	32.3	32.0
Gross national saving	33.8	32.7	35.8	33.1	33.2	32.7	32.5	32.4	32.3	32.0	31.7
Public sector	3.0	3.9	4.2	4.2	2.4	2.6	2.9	2.9	2.9	2.9	2.8
Private sector	30.8	28.8	31.5	28.9	30.8	30.1	29.6	29.5	29.5	29.1	28.8
Public finances 1/											
Revenue and grants	**22.7**	**22.6**	**22.0**	**21.9**	**20.7**	**20.4**	**20.5**	**20.5**	**20.3**	**20.2**	**20.0**
Expenditure	25.9	24.8	24.2	24.8	23.4	22.9	22.7	22.2	22.0	21.9	21.7
Current, including interest	16.8	16.7	17.0	17.1	17.8	17.5	17.4	17.4	17.3	17.2	17.0
Capital	9.0	8.0	6.9	6.5	5.5	5.3	5.3	4.8	4.8	4.8	4.7
Overall balance, including ACP	-3.2	-2.2	-2.2	-2.9	-2.7	-2.5	-2.2	-1.7	-1.7	-1.7	-1.7
Overall balance, excluding ACP	-2.4	-2.0	-2.2	-3.2	-3.1	-2.7	-2.5	-2.0	-2.0	-2.0	-2.0
Total public debt											
Debt of Non-Financial Public Sector 2/	**35.5**	**34.8**	**34.8**	**36.8**	**40.8**	**41.5**	**41.5**	**40.7**	**40.0**	**39.4**	**38.7**
External	28.2	28.5	28.7	30.5	34.7	34.8	34.2	33.6	32.9	32.3	31.8
Domestic	7.3	6.3	6.1	6.2	6.1	6.7	7.3	7.2	7.1	7.0	6.9
Debt of ACP	5.1	4.7	4.4	4.2	3.8	3.2	2.7	2.3	1.8	1.5	1.1
Other 3/	3.1	3.8	3.4	4.2	4.1	3.9	3.6	3.4	3.2	3.0	2.8
External sector											
Current account	**-9.0**	**-7.8**	**-5.9**	**-8.2**	**-6.6**	**-6.4**	**-6.2**	**-5.9**	**-5.3**	**-4.8**	**-4.8**
Net exports from Colon Free Zone	2.7	2.9	3.0	2.5	2.3	2.3	2.3	2.4	2.5	2.5	2.5
Net oil imports	3.5	3.4	3.8	4.4	4.2	3.9	3.7	3.6	3.5	3.5	3.5
Net foreign direct investment inflows	7.3	7.9	6.9	7.9	8.0	7.3	7.1	6.9	6.6	6.6	6.6
External Debt	161.3	159.9	149.6	151.8	163.1	166.3	166.2	164.7	163.6	162.2	161.0
Memorandum items:											
GDP (in millions of US$)	54,092	57,908	62,219	65,128	67,145	70,750	75,403	80,756	86,490	92,631	99,208

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.
1/ Includes Panama Canal Authority (ACP). Includes Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.
2/ Non-Financial Public Sector according to the definition in Law 31 of 2011.
3/ Includes debt of public enterprises outside the national definition of NFPS (ENA, ETESA, and AITSA) and non-consolidated agencies.

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

	2015	2016	2017	2018	Est. 2019	Projections 2020	2021	2022	2023	2024	2025
					Non-Financial Public Sector						
Revenues	**19.7**	**20.1**	**20.0**	**19.7**	**18.3**	**18.3**	**18.5**	**18.5**	**18.4**	**18.3**	**18.1**
Current revenue	19.6	20.1	20.0	19.7	18.3	18.3	18.6	18.5	18.4	18.3	18.2
Tax revenue	9.3	9.7	9.2	9.2	8.2	8.2	8.6	8.5	8.5	8.4	8.4
Nontax revenue	3.7	3.4	4.5	4.4	4.1	4.2	4.1	4.1	4.0	4.0	3.9
o/w: Panama Canal fees and dividends	1.8	1.8	2.6	2.6	2.6	2.6	2.4	2.4	2.4	2.3	2.3
Social security agency	5.6	5.8	5.7	5.6	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Public enterprises' operating balance	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other [2/]	0.7	1.0	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Capital revenue	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**22.1**	**22.1**	**22.2**	**22.9**	**21.4**	**21.0**	**21.0**	**20.5**	**20.4**	**20.3**	**20.1**
Current primary expenditure	13.6	13.5	13.6	13.7	14.2	13.8	13.8	13.8	13.8	13.8	13.8
Central government [3/]	8.1	7.9	8.0	8.0	8.3	8.0	8.0	8.0	8.0	8.0	8.0
Rest of the general government	5.5	5.6	5.6	5.6	5.9	5.9	5.9	5.9	5.9	5.9	5.9
Social security agency	5.0	5.1	5.2	5.2	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Decentralized agencies	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Interest	1.7	1.7	1.7	1.8	1.9	2.1	2.1	2.0	1.9	1.8	1.7
Capital	6.6	6.7	6.5	6.3	5.3	5.1	5.1	4.6	4.6	4.6	4.5
Accrued spending [4/]	0.2	0.2	0.3	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance [5/]	**-2.4**	**-2.0**	**-2.2**	**-3.2**	**-3.1**	**-2.7**	**-2.5**	**-2.0**	**-2.0**	**-2.0**	**-2.0**
Net financing [6/]	**2.3**	**1.7**	**2.3**	**3.5**	**3.2**	**2.7**	**2.5**	**2.0**	**2.0**	**2.0**	**2.0**
External	2.4	2.1	2.1	3.1	5.1	1.9	1.5	1.6	1.6	1.6	1.6
Domestic	-0.1	-0.5	0.2	0.4	-1.9	0.9	1.0	0.3	0.4	0.4	0.4
					Panama Canal Authority (ACP)						
Revenue	**4.8**	**4.3**	**4.6**	**4.8**	**5.0**	**4.7**	**4.4**	**4.5**	**4.4**	**4.3**	**4.1**
Expenditure	**5.6**	**4.6**	**4.7**	**4.5**	**4.5**	**4.4**	**4.1**	**4.1**	**4.0**	**4.0**	**3.8**
Current primary expenditure	1.4	1.4	1.5	1.5	1.6	1.5	1.4	1.5	1.4	1.4	1.4
Transfers to the government	1.8	1.8	2.6	2.6	2.6	2.6	2.4	2.4	2.4	2.3	2.3
Interest payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Capital expenditure	2.4	1.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Overall balance	**-0.8**	**-0.3**	**-0.1**	**0.3**	**0.5**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
					Consolidated Non-Financial Public Sector						
Overall balance (incl. ACP)	**-3.2**	**-2.2**	**-2.2**	**-2.9**	**-2.7**	**-2.5**	**-2.2**	**-1.7**	**-1.7**	**-1.7**	**-1.7**
Memorandum items:											
Primary balance (excl. ACP)	-0.8	-0.4	-0.5	-1.5	-1.5	-0.9	-0.6	-0.1	-0.2	-0.3	-0.4
Structural primary balance (excl. ACP) [7/]	-0.9	-0.3	-0.7	-1.5	-1.3	-0.8	-0.6	-0.1	-0.2	-0.3	-0.4
Primary balance (incl. ACP)	-1.5	-0.4	-0.4	-1.0	-0.7	-0.3	-0.1	0.4	0.3	0.2	0.1

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/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.
5/ For 2015 - 2017, includes spending allowed under Article 34 of Law 38 of 2012.
6/ Includes staff adjustment for net financing through the change in obligations related to unrecorded expenditure for 2015-2019. For 2019, also accounts for deposits accumulated in pre-financing operations.
7/ Primary balance adjusted for the output gap.

Table 3. Panama: Summary Operations of the Central Government [1]

(In percent of GDP)

					Est.	Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenues and grants	**13.4**	**13.3**	**13.9**	**13.8**	**12.5**	**12.7**	**12.9**	**12.9**	**12.7**	**12.7**	**12.5**
Current revenue	13.2	13.3	13.9	13.8	12.5	12.7	12.9	12.9	12.7	12.7	12.5
Taxes	9.3	9.7	9.2	9.2	8.2	8.2	8.6	8.5	8.5	8.4	8.4
Direct taxes	4.8	5.1	4.9	5.1	4.4	4.4	4.7	4.7	4.6	4.6	4.5
Income tax	4.3	4.6	4.4	4.6	4.0	4.0	4.3	4.3	4.2	4.2	4.1
Tax on wealth	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Indirect taxes	4.5	4.6	4.3	4.1	3.8	3.8	3.8	3.8	3.8	3.8	3.8
Import tax	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
ITBMS	2.4	2.6	2.5	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Petroleum products	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other tax on domestic transactions	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Nontax revenue	3.9	3.6	4.7	4.6	4.3	4.5	4.3	4.3	4.3	4.2	4.2
Dividends	1.6	1.5	2.3	2.3	2.2	2.2	2.1	2.1	2.1	2.1	2.0
Of which : Panama Canal Authority	1.1	1.2	1.9	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.6
Panama Canal Authority: fees per ton [1/]	0.7	0.7	0.7	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Transfers from decentralized agencies	0.5	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Other	1.1	0.9	1.2	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Capital revenue	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	**17.4**	**17.5**	**17.5**	**17.5**	**16.7**	**15.9**	**16.0**	**15.5**	**15.4**	**15.3**	**15.2**
Current	11.1	10.7	10.9	10.9	11.5	11.2	11.3	11.2	11.2	11.1	11.1
Wages and salaries	4.0	4.3	4.6	4.7	4.8	4.6	4.6	4.6	4.6	4.6	4.6
Goods and services	1.4	1.3	1.3	1.2	1.2	1.0	1.0	1.0	1.0	1.0	1.0
Current expenditure of CSS	0.7	0.5	0.6	0.6	0.7	0.6	0.6	0.5	0.5	0.4	0.4
Transfers to public and private entities	3.2	2.8	2.7	2.7	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Interest	1.7	1.7	1.7	1.8	1.9	2.1	2.1	2.2	2.1	2.0	2.1
Domestic	0.3	0.3	0.4	0.3	0.4	0.4	0.5	0.5	0.4	0.4	0.4
External	1.4	1.4	1.4	1.4	1.5	1.7	1.7	1.7	1.7	1.6	1.7
Capital	6.0	6.5	6.1	5.7	5.2	4.7	4.7	4.2	4.2	4.2	4.2
Accrued spending [2/]	0.3	0.3	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings [3/]	2.2	2.6	3.0	2.9	1.0	1.5	1.7	1.6	1.6	1.6	1.4
Overall balance [4/]	**-4.1**	**-4.1**	**-3.6**	**-3.6**	**-4.1**	**-3.3**	**-3.1**	**-2.6**	**-2.6**	**-2.6**	**-2.7**
Financing (net) [5/]	4.4	2.6	3.3	4.3	2.6	3.3	3.1	2.6	2.6	2.6	2.7
External	2.4	2.1	2.4	3.3	5.4	1.9	1.5	1.6	1.6	1.6	1.6
Domestic	2.0	0.5	0.9	1.0	-2.8	1.4	1.6	0.9	1.0	1.0	1.1
Memorandum items:											
Primary balance	-2.4	-2.4	-1.8	-1.9	-2.2	-1.2	-0.9	-0.4	-0.5	-0.6	-0.6
GDP (in millions of US$)	54,092	57,908	62,219	65,128	67,145	70,750	75,403	80,756	86,490	92,631	99,208

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

1/ Includes public service fees.

2/ Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18.

3/ Current revenues and grants less current expenditure.

4/ For 2015 - 2017, includes spending allowed under Article 34 of Law 38 of 2012.

5/ Includes staff adjustment for net financing through the change in obligations related to unrecorded expenditure for 2015-2019. For 2019, also accounts for deposits accumulated in pre-financing operations.

Table 4. Panama: Public Debt

(In percent of GDP)

	2015	2016	2017	2018	Est. 2019	Projections 2020	2021	2022	2023	2024	2025
Central Government											
Gross debt [1/]	38.3	38.5	39.2	41.8	46.2	46.6	46.3	45.2	44.2	43.3	42.4
of which: held by social security (CSS)	2.5	3.2	3.7	4.8	5.4	5.1	4.8	4.5	4.2	3.9	3.6
Domestic	9.4	9.3	9.6	10.2	10.1	10.5	10.9	10.5	10.2	9.9	9.7
of which: previously unrecorded	1.0	1.2	1.6	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	28.9	29.2	29.6	31.6	36.1	36.1	35.4	34.7	34.0	33.3	32.7
Financial assets	6.8	5.6	4.0	3.8	6.0	5.9	5.6	5.3	5.0	4.8	4.5
Deposits [2/]	4.5	3.4	1.9	1.9	3.9	3.7	3.5	3.2	3.0	2.8	2.6
Sovereign Wealth Fund	2.3	2.2	2.1	2.0	2.1	2.2	2.1	2.0	2.0	1.9	1.9
Net debt	31.6	32.9	35.2	38.0	40.2	40.8	40.7	39.9	39.2	38.5	37.9
Non-Financial Public Sector											
Gross debt [1/]	35.5	34.8	34.8	36.8	40.8	41.5	41.5	40.7	40.0	39.4	38.7
of which: previously unrecorded	0.6	0.7	1.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial assets	15.3	14.5	11.9	11.0	12.8	12.3	11.6	10.9	10.3	9.7	9.1
Central government	6.8	5.6	4.0	3.8	6.0	5.9	5.6	5.3	5.0	4.8	4.5
Decentralized institutions (incl. CSS) [2/]	8.5	8.9	7.9	7.1	6.8	6.4	6.0	5.6	5.3	4.9	4.6
Net debt	20.2	20.3	22.9	25.8	28.0	29.3	29.9	29.8	29.8	29.7	29.6
Memorandum items:											
Net Debt as defined under SFRL [3/]	36.1	36.4	37.1	39.8	44.1	44.5	44.2	43.2	42.2	41.3	40.5

Source: Ministry of Finance and IMF staff calculations.

1/ Includes staff adjustment for accumulated obligations related to unrecorded expenditure in 2015-2018.

2/ Deposits at the National Bank (BNP).

3/ Central Government gross debt minus assets of the Sovereign Wealth Fund (FAP).

Table 5. Panama: Summary Accounts of the Banking System[1]

(In millions of U.S. dollars, unless otherwise stated)

					Est.	Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	(in millions of balboa at end of period)										
Net foreign assets	**5,021**	**3,974**	**1,752**	**544**	**654**	**716**	**750**	**770**	**793**	**820**	**850**
Short-term foreign assets, net	5,021	3,974	1,752	544	654	716	750	770	793	820	850
National Bank of Panama	3,678	4,331	2,957	2,218	2,288	2,414	2,576	2,762	2,961	3,175	3,404
Rest of banking system	1,343	-356	-1,204	-1,674	-1,634	-1,698	-1,826	-1,992	-2,168	-2,355	-2,554
Long-term foreign liabilities	0	0	0	0	0	0	0	0	0	0	0
Net domestic assets	**31,582**	**34,323**	**38,414**	**40,820**	**42,258**	**44,500**	**47,440**	**50,841**	**54,482**	**58,380**	**62,553**
Public sector (net credit)	-7,046	-8,099	-7,425	-6,929	-6,923	-6,923	-6,923	-6,923	-6,923	-6,923	-6,923
Central government (net credit)	-1,112	-1,209	-505	-305	-299	-299	-299	-299	-299	-299	-299
Rest of the public sector (net credit)	-5,934	-6,890	-6,920	-6,624	-6,624	-6,624	-6,624	-6,624	-6,624	-6,624	-6,624
Private sector credit	44,439	48,161	51,310	53,628	55,288	58,257	62,088	66,496	71,217	76,274	81,689
Private capital and surplus	-8,872	-9,597	-10,390	-10,694	-11,025	-11,617	-12,381	-13,260	-14,202	-15,210	-16,290
Other assets (net)	3,061	3,858	4,919	4,816	4,918	4,783	4,656	4,528	4,389	4,239	4,077
Liabilities to private sector	**36,937**	**38,468**	**40,478**	**41,623**	**42,912**	**45,216**	**48,189**	**51,611**	**55,275**	**59,200**	**63,403**
Total deposits	36,616	38,264	40,324	41,408	42,690	44,982	47,940	51,344	54,989	58,894	63,075
Demand deposits	8,114	8,148	8,250	8,642	8,910	9,389	10,006	10,716	11,477	12,292	13,165
Time deposits	19,135	20,493	21,796	22,368	23,060	24,299	25,896	27,735	29,704	31,813	34,072
Savings deposits	9,367	9,622	10,278	10,398	10,720	11,295	12,038	12,893	13,808	14,788	15,838
Bonds	321	204	155	215	222	234	249	267	286	306	328
Deposit as % of private sector credit	82.4	79.4	78.6	77.2	77.2	77.2	77.2	77.2	77.2	77.2	77.2
	(12-month change in relation to liabilities to the private sector at the beginning of the period)										
Net foreign assets	-3.0	-2.8	-5.8	-3.0	0.3	0.1	0.1	0.0	0.0	0.0	0.0
Net domestic assets	9.0	7.4	10.6	5.9	3.5	5.2	6.5	7.1	7.1	7.1	7.1
Public sector credit (net)	-2.8	-2.9	1.8	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	13.0	10.1	8.2	5.7	4.0	6.9	8.5	9.1	9.1	9.1	9.1
Private capital and surplus	2.2	2.0	2.1	0.8	0.8	1.4	1.7	1.8	1.8	1.8	1.8
Other assets (net)	1.0	2.2	2.8	-0.3	0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Liabilities to the private sector	5.5	4.1	5.2	2.8	3.1	5.4	6.6	7.1	7.1	7.1	7.1
	(12-month percent change)										
Memorandum items:											
M2 1/	5.5	4.1	5.2	2.8	3.1	5.4	6.6	7.1	7.1	7.1	7.1
Net domestic assets	11.1	8.7	11.9	6.3	3.5	5.3	6.6	7.2	7.2	7.2	7.1
Public sector credit (gross)	-6.1	-37.3	-10.1	21.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector credit	11.4	8.4	6.5	4.5	3.1	5.4	6.6	7.1	7.1	7.1	7.1
Share of demand deposits in total deposits (in percent)	22.2	21.3	20.5	20.9	20.9	20.9	20.9	20.9	20.9	20.9	20.9
	(In percent of GDP)										
Total deposits	67.7	66.1	64.8	63.6	63.6	63.6	63.6	63.6	63.6	63.6	63.6
Credit to private sector	82.2	83.2	82.5	82.3	82.3	82.3	82.3	82.3	82.3	82.3	82.3

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and IMF staff calculations.

1/ M2 comprises bank deposits; estimates of U.S. currency in circulation are not available.

Table 6. Panama: Financial Soundness Indicators [1]

(In percent, end-of-period)

	2013	2014	2015	2016	2017	2018	2019 [1/]
				(In percent)			
Core indicators							
Regulatory capital to risk weighted assets	14.8	14.7	14.9	15.3	16.0	15.7	16.5
Regulatory Tier 1 capital to risk-weighted assets	13.9	14.1	14.3	16.3	17.0	16.9	17.8
Non-performing loans net of provisions to capital	-3.4	0.5	1.4	1.3	1.4	0.0	0.4
Non-performing loans to total gross loans	0.7	0.9	1.0	1.3	1.4	1.7	2.0
Return on assets	1.4	1.5	1.4	1.2	1.5	1.5	1.4
Return on equity	13.7	14.8	14.0	11.8	13.4	13.1	12.1
Interest margin to gross income	53.5	55.3	55.3	53.9	52.5	50.6	47.8
Non-interest expenses to gross income	51.4	49.9	50.1	50.0	46.9	46.4	47.9
Liquid assets to total assets	16.6	17.7	16.0	15.7	12.8	12.1	11.3
Liquid assets to short-term liabilities	42.5	42.3	39.9	39.3	33.9	34.8	33.8
Net open position in FX to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sectoral distribution of loans							
Domestic residents	75.7	74.2	74.6	77.5	80.7	81.2	82.2
Deposit takers	0.7	0.7	1.0	1.0	0.9	1.2	1.2
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.6	2.2	2.2	2.8	2.6	2.8	2.6
General government	3.2	1.5	1.5	1.7	1.1	1.1	1.1
Nonfinancial corporations	36.8	37.2	36.4	36.3	37.8	36.7	36.5
Households	32.5	32.7	33.5	35.7	38.3	39.5	40.9
Nonresidents	24.3	25.8	25.4	22.5	19.3	18.8	17.8
Additional indicators							
Capital to assets (leverage ratio)	9.8	10.0	10.2	11.4	12.5	12.5	13.1
Large exposures to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross assets position in derivatives to capital	0.3	0.2	0.1	0.1	0.2	0.1	0.2
Gross liabilities position in derivatives to capital	0.4	1.0	0.8	1.3	0.9	0.7	0.4
Trading income to total income	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Personnel expenses to total income	45.5	47.0	46.7	46.2	46.8	46.4	46.3
Customer deposits to total non-interbank loans	84.5	82.3	78.9	78.1	78.0	76.1	76.1
FX loans to total loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FX liabilities to total liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: IMF Financial Soundness Indicators.

1/ Data for 2019 corresponds to 3rd quarter 2019.

Table 7. Panama: Summary Balance of Payments
(In percent of GDP; unless otherwise stated)

					Est.	Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					(In percent of GDP)						
Current account	**-9.0**	**-7.8**	**-5.9**	**-8.2**	**-6.6**	**-6.4**	**-6.2**	**-5.9**	**-5.3**	**-4.8**	**-4.8**
Merchandise trade excluding Colón Free Zone, net	-18.1	-16.3	-16.6	-16.6	-15.3	-14.1	-13.9	-13.6	-13.1	-12.6	-12.7
Exports, f.o.b.	7.5	6.3	7.2	7.7	8.7	9.4	9.3	9.0	9.5	9.1	8.7
Of which: Copper	0.0	0.0	0.0	0.0	1.3	2.4	2.4	2.3	2.8	2.5	2.2
Of which: Gold	0.0	0.0	0.0	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Imports, f.o.b.	25.6	22.5	23.7	24.3	23.9	23.5	23.2	22.7	22.6	21.7	21.4
Of which: Oil	6.0	5.4	6.8	8.1	7.5	6.7	6.3	6.1	5.9	5.8	5.7
Merchandise trade from Colón Free Zone, net	2.7	2.9	3.0	2.5	2.3	2.3	2.3	2.4	2.5	2.5	2.5
Re-exports, f.o.b.	18.8	16.1	15.0	15.0	13.0	12.9	12.9	13.0	13.1	13.1	13.2
Imports, f.o.b.	16.1	13.2	12.1	12.5	10.7	10.6	10.6	10.6	10.6	10.6	10.7
Services, net	13.0	12.9	13.9	13.6	13.1	13.4	13.6	13.6	13.7	13.9	14.0
Travel, net	5.3	5.3	5.6	5.3	4.8	5.0	5.0	5.1	5.1	5.1	5.1
Transportation, net	6.4	6.5	7.2	7.3	7.5	7.6	7.6	7.6	7.6	7.6	7.6
Of which: Canal	4.5	4.1	4.5	4.6	4.6	4.6	4.4	4.3	4.2	4.1	4.0
Other services, net	1.2	1.2	1.1	1.0	0.8	0.9	1.0	1.0	1.1	1.2	1.2
Income, net	-6.6	-7.3	-6.2	-7.7	-6.7	-8.1	-8.2	-8.3	-8.4	-8.5	-8.6
Primary, net	-6.4	-7.1	-6.0	-7.6	-6.7	-8.0	-8.1	-8.2	-8.4	-8.5	-8.5
Of which: Direct investment	-5.0	-5.7	-4.5	-5.8	-4.8	-5.8	-5.9	-5.9	-6.0	-6.0	-6.1
Secondary, net	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Of which: Workers' remittances	-0.7	-0.7	-0.6	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6
Capital account	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**-12.0**	**-13.3**	**-9.3**	**-9.8**	**-8.6**	**-6.4**	**-6.2**	**-5.8**	**-5.3**	**-4.8**	**-4.8**
Foreign direct investment, net	-7.3	-7.9	-6.9	-7.9	-8.0	-7.3	-7.1	-6.9	-6.6	-6.6	-6.6
Of which: Reinvested earnings	-3.9	-3.7	-2.9	-4.3	-3.1	-3.2	-3.1	-3.3	-3.3	-3.2	-3.3
Portfolio investment, net	-0.6	-0.2	-1.1	-0.6	-3.5	0.5	-0.4	-0.8	-0.7	-0.2	-0.3
Financial derivatives, net	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-3.8	-6.1	0.3	-0.4	1.9	0.2	1.1	1.6	1.8	1.8	1.8
Reserve assets, net	-0.1	1.1	-1.6	-1.0	1.0	0.2	0.2	0.2	0.2	0.2	0.2
Net errors and omissions	**-3.1**	**-5.5**	**-3.4**	**-1.6**	**-2.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:											
Exports of goods and services (annual percent change)	-7.8	-3.3	7.7	5.1	-0.2	7.8	6.4	6.8	8.6	6.4	6.6
Imports of goods and services (annual percent change)	-10.9	-6.9	5.8	7.2	-1.7	4.0	5.7	5.7	6.8	4.7	6.4
Oil trade balance (percent of GDP)	-3.5	-3.4	-3.8	-4.4	-4.2	-3.9	-3.7	-3.6	-3.5	-3.5	-3.5
Gross international reserves (in millions of U.S. dollars)	4143	4745	3788	3149	3834	3960	4121	4308	4507	4721	4950
Net international investment position (in percent of GDP)	-76.3	-84.3	-87.6	-93.5	-99.3	-100.7	-100.7	-99.9	-98.6	-96.9	-95.2
Gross external debt (percent of GDP)	161.3	159.9	149.6	151.8	163.1	166.3	166.2	164.7	163.6	162.2	161.0

Sources: INEC; and IMF staff calculations.

Table 8. Panama: External Vulnerability Indicators
(In percent, unless otherwise specified

	2015	2016	2017	2018	Est. 2019	Projections 2020	2021
Financial indicators							
Broad money (12-month percent change)	5.5	4.1	5.2	2.8	3.1	5.4	6.6
Private sector credit (12-month percent change)	11.4	8.4	6.5	4.5	3.1	5.4	6.6
Deposit rate (6-month; in percent) 1/	1.8	1.7	1.8	2.6	3.0	…	…
External indicators							
Merchandise exports (12-month percent change)	-15.6	-9.0	6.8	6.8	-1.3	8.5	5.8
Merchandise imports (12-month percent change)	-12.6	-8.2	7.7	7.5	-2.9	3.7	5.6
Current account balance (in percent of GDP)	-9.0	-7.8	-5.9	-8.2	-6.6	-6.4	-6.2
Capital account balance (in percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (in percent of GDP)	-12.0	-13.3	-9.3	-9.8	-8.6	-6.4	-6.2
Of which : direct investment	-8.0	-7.3	-7.1	-6.9	-6.6	-6.6	-6.6
Non-Financial Public Sector external debt (in percent of GDP)	28.2	28.5	28.7	30.5	34.7	34.8	34.2
In percent of exports of goods and services 2/	58.5	65.5	65.7	69.7	81.8	80.2	78.9
External interest payments							
In percent of exports of goods and services 2/	8.5	9.2	9.7	10.1	8.9	7.7	7.3
External amortization payments							
In percent of exports of goods and services 2/	164.1	186.1	173.3	146.9	149.5	142.3	131.8
REER, percent change (average) 6/	-1.7	-8.3	-7.6	-1.2	1.0	…	…
Gross international reserves at end of period							
In millions of U.S. dollars 3/	4,143	4,745	3,788	3,149	3,834	3,960	4,121
In months of imports of goods and services	2.0	2.1	1.6	1.3	1.6	1.5	1.5
In percent of broad money 4/	11.2	12.3	9.4	7.6	8.9	8.8	8.6
In percent of short-term external debt 5/	9.4	10.9	9.8	8.1	9.9	10.2	10.7
Memorandum items:							
Nominal GDP	54,092	57,908	62,219	65,128	67,145	70,750	75,403
Exports of goods and services 2/	26,074	25,210	27,143	28,539	28,489	30,718	32,683
Imports of goods and services 2/	27,366	25,475	26,951	28,902	28,397	29,536	31,209

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.
6/ Negative sign indicates depreciation.

Annex I. Implementation of Past IMF Policy Advice

The authorities' macroeconomic and financial policies remained broadly in line with past Fund advice in 2019. In particular, the authorities strengthened the fiscal framework by approving the fiscal council law and strengthened the AML/CFT framework by approving a law that criminalized tax evasion. However, more needs to be done to strengthen tax collections, expenditure controls, fiscal transparency, and the effectiveness of the AML/CFT framework.

1. Executive Directors' views. During the 2018 Article IV consultation (concluded on December 12), Directors stressed the importance of continuing to enhance Panama's financial integrity through effective implementation of its AML/CFT framework and measures to strengthen tax transparency. They also emphasized the need to further strengthen the fiscal framework through a fiscal council and enhanced assessment and management of fiscal risks, as well as improvements in tax and customs administrations. Directors also urged the authorities to strengthen financial sector oversight, macroprudential policy and crisis management, including by aligning prudential regulations with Basel III and by putting in place robust frameworks for crisis management and bank resolution. Finally, Directors called for reinforcing the structural reform agenda, namely with stronger social policies and improvements to the business climate.

2. Fiscal Policy: Fiscal policy remains anchored on the SFRL, which was streamlined and modified in October 2018. A bill also created the fiscal council—an independent committee tasked with providing technical analysis of fiscal policy—following staff recommendations. However, a collapse in tax collections in 2019 led to an unexpected deterioration in the fiscal position that required another modification to the SFRL. Similarly, members of the Council remain to be appointed, and measures to monitor fiscal risks and contingent liabilities are still in their early stages. The pace of reform in revenue administration, particularly in tax and customs, is short of expectations.

3. Financial Integrity and Tax Transparency: The authorities continue addressing the gaps identified in Panama's AML/CFT framework by the FATF and GAFILAT, its regional body for Latin America. Importantly, Panama criminalized tax evasion in January 2019, in line with staff advice and FATF requirements, and strengthened its legal code to more effectively penalize repeat tax evaders in September. Furthermore, the authorities created the Superintendency of Nonfinancial Subjects and introduced criminal penalties for unlicensed money remitters in 2019. In addition, they further enhanced Panama's legislative framework in 2020 (see SIP for details). However, Panama needs to demonstrate the effectiveness of these legal actions by investigating and prosecuting money laundering cases and tackle other items on the FATF action plan.

4. Financial Sector Reforms: Prudential regulation has been largely aligned to Basel III with the gradual implementation of the LCR. Draft legislation to strengthen the banking resolution framework developed in line with IMF technical advice remains under consideration.

5. **Structural Reforms**: Amid 2019 general elections, reform implementation has been delayed by the political cycle, including in the areas of education, labor market flexibility, social safety nets, and infrastructure development.

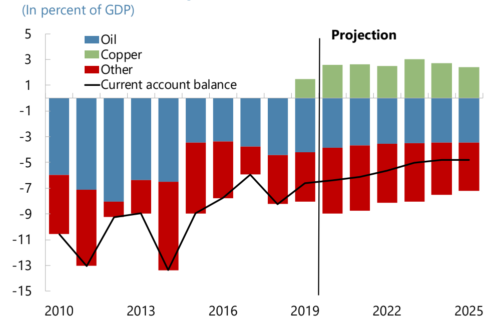
Annex II. Prospects and Risk Assessment[1]

1. **Growth will recover, and Panama will remain among the most dynamic economies in Latin America.** Assuming adherence to the SFRL and the authorities' plan to exit the grey list, growth is projected to increase to 4.8 percent in 2020 and 5 percent in 2021 (its estimated potential), helped by the full-year impact of copper production, a recovery in construction, commerce, and services sectors and a rebound in exports and private investment. As the economy regain momentum, the demand for credit is expected to recover, with banks intermediating the funds (having ample access to external capital markets) and making the credit available to continue supporting the recovery. Over the medium term, the economy is expected to continue expanding at 5 percent as positive spillovers from recently-completed large-scale investment projects are realized (including the Canal expansion, the large copper mine, and the new airport terminal) and the projected growth recovery of the global and regional economies supports higher growth in Panama. Inflation is expected to pick up to 1 percent in 2020 and to gradually converge toward 2 percent over the medium term.

2. **The fiscal balance is expected to improve in line with the limits established under the amended fiscal rule, returning public debt to its downward trajectory.** Although some of the revenue shortfall is structural, tax revenue is expected to rebound somewhat in 2020 as economic conditions improve. Nevertheless, in the absence of tax measures, expenditure cuts (on non-priority current and capital expenditures) will contain the NFPS deficit at 2¾ percent of GDP in 2020. The negative impact of fiscal tightening on growth will be more than offset by higher copper exports in 2020. By 2022 the deficit should converge to 2 percent of GDP as expenditures are expected to be contained. Although public debt remains sustainable, the fiscal deficit, pre-financing operations and payment of arrears increased the gross NFPS debt levels to 40.2 percent of GDP in 2019, but the trend reverses to a downward trajectory falling below 38 percent of GDP by 2025 (see Annex IV).

3. **The external position is projected to improve over the medium term.** Copper exports will continue to boost the trade balance and add another 1½ percent of GDP to exports by 2023, reducing the current account deficit below 5 percent of GDP. Panama will continue to attract substantial amounts of FDI in the medium term as it further expands its sea and air-transportation hubs as well as tourism.

Current Account Impact of Commodities
(In percent of GDP)



Sources: INEC and IMF staff calculations.

[1] The Risk Assessment Matrix (RAM) shows events that could materially affect the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability of below 10 percent, "medium" a probability of between 10 and 30 percent, and "high" a probability of 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. ST and MT stand for the "short-term" and "medium-term", indicating that the risk could materialize within 1 year and 3 years, respectively.

4. **The balance of risks is tilted to the downside** (See RAM below).

- ***Domestic risks.*** Setbacks in improving the AML/CFT and tax transparency frameworks and addressing the FATF recommendations could reduce Panama's competitiveness as a regional financial center and impair the country's attractiveness for FDI. In case of some losses of correspondent banking relationships, the drying up of foreign credit could affect domestic lending and real activity, which would squeeze bank margins and increase credit risk, which in turn would dampen economic activity. Continued oversupply in some segments of the property market could trigger a correction in prices, negatively affecting financial stability through higher NPLs and lower systemic liquidity. Setbacks in fiscal consolidation necessary to return to the SFRL limits could hamper the credibility of fiscal policy, reducing market confidence and leading to higher borrowing costs. Weaker spillovers from recently completed large projects (to the rest of the economy) could lead to lower potential growth. Social tensions could disrupt economic activity and cause policy missteps. On the positive side, a stronger recovery supported by copper exports could lead to higher growth in 2020.

- ***External risks*.** Escalating trade tensions, weaker-than-expected global growth and the spread of the coronavirus could affect exports and dampen government revenue, if traffic through the Panama Canal falls (see Annex VI). Pressures from real U.S. dollar appreciation could harm external competitiveness. A sharp rise in risk premia and further buildup of financial vulnerabilities in systemic economies would further increase domestic interest rates, leading to higher debt service and refinancing risks. Cyberattacks could trigger systemic disruptions in infrastructure, affecting the activity of the financial and logistics sectors. Natural disasters and extreme climatic events could be disruptive to Canal activity, agriculture and tourism.

Risk Assessment Matrix

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact		Policy Response
External Risks					
Rising Protectionism and Retreat from Multilateralism	High	ST, MT	High	Escalating and unpredictable protectionists actions and inoperative WTO dispute resolution framework imperil the global trade system. Additional actions or the threat thereof, including investment restrictions, reduce growth directly and through adverse confidence effects. In the medium term, geopolitical competition, protracted tensions, and fraying consensus about the benefits of globalization leads to further fragmentation, with adverse effects on investment, productivity, growth, and stability. Spreading isolationism would directly affect Panama through lower exports, FDI, and growth as slower growth or a decline in world trade would directly lower transits through the Panama Canal and associated fiscal revenue and lower growth in key trading partners would directly lower exports. Increased uncertainty about growth triggered by escalating trade tensions could lead to increased financial market volatility, with the negative consequences for growth potentially exacerbated by increased uncertainty and lower investment.	Continue efforts to diversify key export markets. Advance structural reforms to improve productivity and strengthen competitiveness.
Coronavirus Outbreak	Medium	ST	Medium	Coronavirus outbreak may cause widespread and prolonged disruptions to economic activity and global spillovers through tourism, supply chains, containment costs, and confidence effects on financial markets and investment. It could reduce transits through the Panama Canal, affecting domestic output and fiscal revenue.	Build liquidity and fiscal buffers to safeguard macroeconomic stability
Weaker-than-expected Global Growth	High	ST, MT	Medium	Weaker consumption and investment in the USA (due to lower confidence) and Europe (due to weak foreign demand and/or an unanticipated Brexit outcome) along with lower growth prospects in China (due to a coronavirus outbreak and/or escalating trade tensions) and lower growth in large emerging economies (caused by the policy missteps, idiosyncratic shocks, and/or contagion) could slower global growth, especially if concentrated in the USA and/or China, two of Panama's most important trading partners, This would lead to an immediate decline in Panamanian output, directly through lower exports and Panama Canal activity and value-added activities associated with the canal, including the Colon Free Zone re-exports. Slower Canal activity may also indirectly affect the broader economy as lower canal-related income may lead to lower consumer spending and dampen government canal revenue.	Build external and fiscal buffers to safeguard macroeconomic stability; advance structural reforms to improve competitiveness.
Sharp Rise in Risk Premia That Exposes Vulnerabilities	Medium	ST	Medium	An abrupt reassessment of market fundamentals triggers widespread risk-off events that expose financial vulnerabilities that have been building in a period of low interest rates and a search for yield. Sharp decline in asset prices could lead to significant losses in major financial institutions could lead to sudden increases in global interest rates, putting pressure on sovereign financing costs and Panamanian interest rates, leading to higher debt service and refinancing risks, principally for households whose indebtedness has increased. Should rising U.S. interest rates put appreciation pressure on the U.S. dollar, Panama's REER would also face appreciation pressures, potentially eroding Panama's external competitiveness and exports.	Continue to deepen domestic financial markets and rebalance public sector financing to domestic sources. Consolidate public finances to avoid a sudden, sharp increase in domestic rates and possible crowding out of private investment. Current account to adjust automatically through lower imports. Enhance crisis preparedness of Panama's regional financial center.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact		Policy Response
Intensified Geopolitical Tensions and Security Risks	High	ST	Medium	Deteriorating situations in Venezuela and Nicaragua could bring inflows of asylum seekers to Panama and neighboring countries, exacerbating social tensions and causing negative economic spillovers.	Develop migration policy to deal with asylum seekers and facilitate their absorption into domestic economy
Large Swings in Energy Prices	High	ST, MT	Medium	In the near term, uncertainty surrounding the shocks elevates price volatility, complicating economic management. As shocks materialize, they cause large and persistent price swings. Sharp rise in oil prices due to a negative supply shock could lead to a deterioration of the trade balance and current account deficit. On the other hand, a significant drop in oil prices due to materialization of downside risks to growth, or positive supply shocks, would improve the current account.	Advance structural reforms to lower oil dependence, improve productivity and strengthen competitiveness. Current account to adjust automatically through higher or lower imports.
Cyber-attacks on Critical Global Financial Systems, Infrastructure and Institutions	Low	ST, MT	Medium	Breach of critical financial and commercial digital infrastructure as well as broader private and public institutions can trigger systemic financial instability or widespread disruptions in socioeconomic activities, affecting activity of Panama's financial system, logistics infrastructure and shipments through the Canal.	Improve legal, institutional and strategic frameworks, devise a centralized plan and common rules to combat cyberattacks more effectively.
Higher Frequency and Severity of Natural Disasters	Low	ST, MT	Medium	Extreme weather events to which the region is prone, especially resulting in floods and draughts, may be disruptive to the Canal activity, tourism inflows, agricultural production, and can result in destruction of infrastructure and loss of human lives. A sequence of severe events hits key infrastructure and large economies, which disrupts trade, reduces global GDP, and prompts a recalculation of risk and growth prospects.	Develop a comprehensive water management plan and disaster financing framework, invest in resilient infrastructure.
Domestic Risks					
Setbacks in Improving the AML/CFT and Tax Transparency Frameworks	Medium	ST	High	Slowdown in implementing the FATF action plan or setbacks in the tax information exchange could lead to reputational damage, reduced external funding and access to international financial services, higher borrowing costs, and increased scrutiny of Panamanian entities.	Promptly implement the FATF action plan on AML/CFT and the OECD tax transparency recommendations
Sharp Correction in Residential and Commercial Property Markets	Low	ST, MT	Medium	A sharp correction in prices could trigger adverse macro-financial spillovers in the economy, which could increase banks' NPLs.	Strengthen monitoring of systemic risk. Develop macroprudential policy framework and strengthen financial sector crisis preparedness.
Setbacks in Fiscal Consolidation Necessary to Return to the SFRL Limits	Low	MT	Medium	Should fiscal imbalances continue (due to not recovering revenues, increasing expenditure needs, or deficiencies in the tax and custom administration), the credibility of fiscal policy could deteriorate, damaging reputation, reducing market confidence, and leading to higher borrowing costs, impacting debt sustainability.	Build fiscal buffers and commit to fiscal targets below the SFRL ceilings. Reform tax and customs administration.
Social Discontent that Causes Economic Disruption and Policy Missteps	Low	ST, MT	Medium	Social tensions and protests could disrupt economy and adversely affect confidence, paralyze reforms, and cause policy missteps reducing medium-term growth	Develop clear communication and engagement strategy with communities affected by the planned policy reforms, and consider their direct and indirect distributional effects.

Annex III. External Sector Assessment

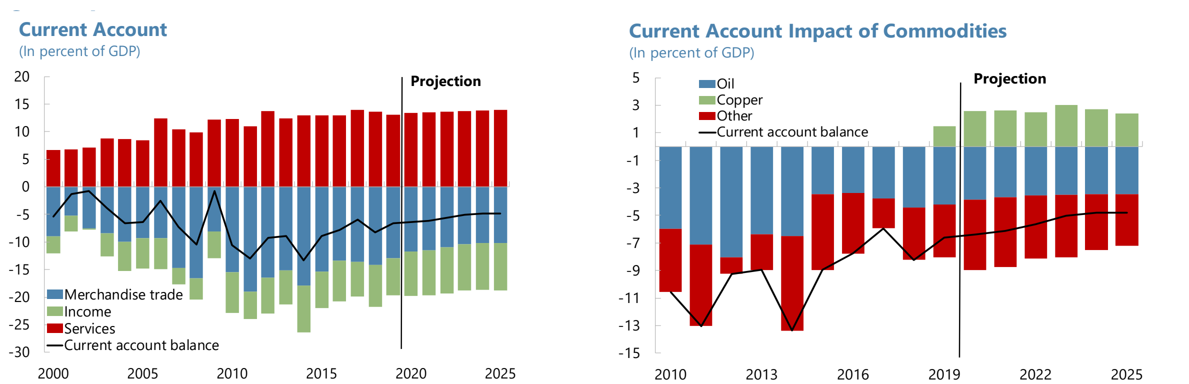
The external position in 2019 was moderately weaker than fundamentals and desired policy settings. The current account deficit—fully covered by FDI inflows— is estimated to have improved to 6.6 percent of GDP in 2019 (from 8.2 percent in 2018), but remains relatively large, mainly due to high investment rates. Despite the positive real exchange rate gap, market-share and survey-based indicators of competitiveness suggest that Panama remains highly competitive, particularly amongst its LAC peers. Panama's external stability remains closely dependent on continued financial stability and the global economic environment, particularly developments in global interest rates and world trade. Policy efforts should continue to focus on enhancing Panama's resilience to these risks by reducing vulnerabilities and building policy buffers.

A. Current Account

Background

1. **The current account deficit declined in 2019 and is projected to converge to 4.8 percent of GDP by 2024.** In 2019 the deficit narrowed to 6.6 percent of GDP, after it had widened to 8.2 percent in 2018. The start of copper production by a new mine in the second half of 2019, lower interest rates which improved the income balance and healthy growth of Canal revenues all helped to improve the external balance. Copper and gold exports from the new mine are expected to add another 1.7 percent of GDP to exports by 2023. Near term negative impacts came from slowing tourism receipts and the CFZ that is still grappling with economic challenges in its main export markets (e.g. Venezuela) and an ongoing trade dispute with Colombia. High investment rates were the main driver of the external deficit in the past ten years. In the medium term, the external balance is expected to improve as investment rates fall to more sustainable levels while contributions from the CFZ increase on the back of initiatives that enhance the zone as a hub for regional distribution of IT and pharmaceutical products.

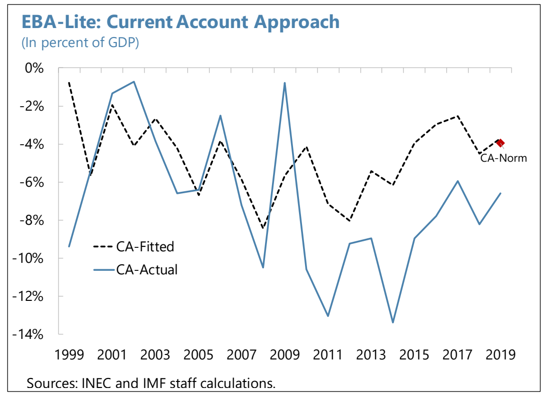
Current Account



Sources: INEC and IMF staff calculations.

Assessment

2. The external position is moderately weaker than fundamentals and desirable policy settings.



- ***The External Stability Approach*** estimates the external position to be moderately weaker than fundamentals if the NIIP is stabilized at its 2018 level. Stabilization would require a real depreciation of 4.4 percent to close the external gap, implying a current account gap of -1.4 percent of GDP.

- ***The EBA-Lite methodology*** using the current account approach suggests an underlying current account gap in 2019 of -2.7 percent and an overvaluation of the real exchange of 8.7 percent. The policy gap is positive, mostly due to favorable external factors that more than offset the expansive domestic fiscal policy.

- ***In summary,*** while both methodologies point to weaknesses in the external position of Panama, the External Sustainability Approach appears more relevant given the importance of the large external debtor position of Panama (derived from the large and sustained FDI), and this approach suggests a mild overvaluation of the real exchange rate between 5 and 6 percent.

Table 1. Panama: EBA-Lite Current Account Panel Regression

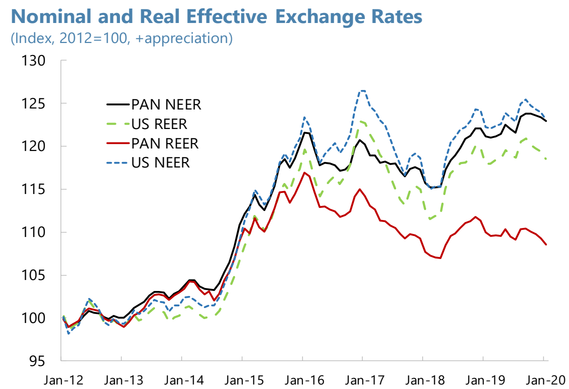
		% GDP			Total	o/w Domestic
(a)	**Actual current account**	-6.6%	(b)	**Fitted current account**		-3.7%
				Residual (a)-(b)		-2.9%
(c)	**Current account norm (b)-(d)-(f)**	-3.9%	(d)	**Multilateral adjustement[1]**		-0.7%
(e)	**Current account gap (a)-(c)**	**-2.7%**			Total	o/w Domestic
(g)	Real exchange rate elasticity	-31%	(f)	**Policy gap**	1.0%	-0.3%
				Fiscal policy	0.6%	-0.5%
	Real exchange rate gap (e)/(g)	**8.7%**		Public Health Expenditure	0.0%	0.0%
				Change in GIR	0.0%	0.0%
				Private Credit	-0.1%	0.2%
				Capital Control	0.5%	0.0%

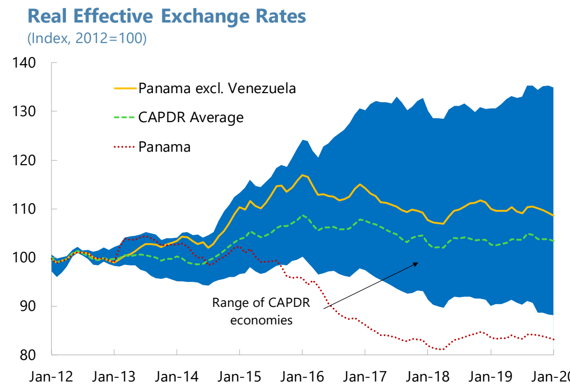
1/ Adjusts for natural disasters and conflict, and multilateral consistency

B. Real Effective Exchange Rate

3. The real effective exchange rate (REER) returned to its downward trajectory. Panama faced appreciation pressures in the second half of 2018. Given dollarization, strong U.S. growth and rising interest rates in the second half of 2018 were the main reason for the appreciation pressures. By end-2019, the real exchange rate had depreciated again by 1.9 percent relative to the year before, returning to the downward trend. With slowing U.S. growth and the halt in monetary tightening, the risks of further appreciation eroding Panama's competitiveness are limited. However, the assessment of the REER continues to be hampered by the use of bilateral goods trade data to determine the relative weights in the REER given that services account for about 70 percent of exports outside of the CFZ. To the extent that the markets for Panama's service exports differ from those of its goods exports, the REER may not accurately capture movements in Panama's price competitiveness relative to its trading partners.

Real Exchange Rate





Sources: INS and IMF staff calculations.
Note: Panama's NEER and REER exclude Venezuela.

C. Capital and Financial Flows

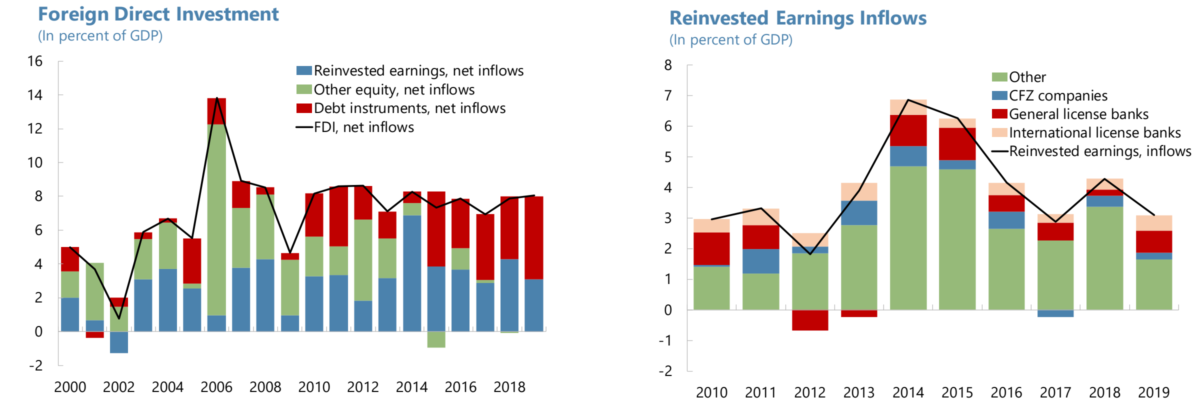
Background

4. **The dominance of FDI in financing of the current account deficit has been supportive of external stability.** In 2019, Panama is estimated to have received 8.0 percent of GDP in FDI, similar to 2018. An important part of FDI is in equity instruments which include reinvested earnings of large multinational companies (rather than new investment). Reinvested earnings reached 2.9 percent of GDP in 2019, representing almost 2/3 of foreign entities' profits. The sustainability of the current account deficit continues to rely on the profitability of these multinational firms and their continued reinvestment. Portfolio flows play a less important role in Panama.

Assessment

5. **Over the medium term, the current account is expected to remain adequately financed by FDI.** Panama's FDI inflows have been relatively stable. In 2018, almost 30 percent of FDI flows originated in Canada, 25 percent in Europe versus 8.7 percent from the U.S., whose share declined. Panama's location as a maritime and air transportation hub as well as its position as a regional financial center paired with macroeconomic stability is expected to continue to attract substantial investment. At the same time, any decline in FDI receipts would likely be offset by a reduction of outflows in the primary income account, limiting the overall impact on Panama's ability to finance imports.

Dynamics in the FDI and Components

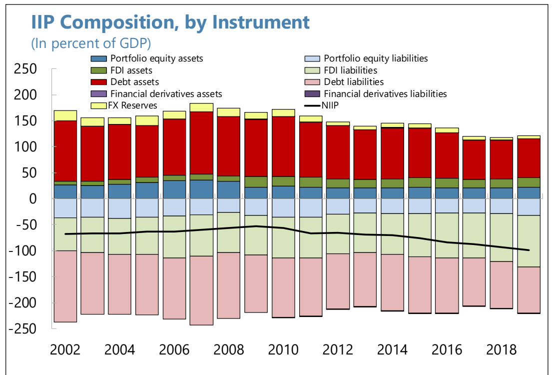


Sources: INEC and IMF staff calculations.

D. Foreign Asset and Liability Position and Trajectory

Background

6. Upward trend in net external liabilities continued. Panama's net liabilities in its net international investment position are expected to have reached 99.5 percent of GDP by the end of 2019. The increase was again driven by strong FDI inflows, but while liabilities continued to be largely equity-related, debt instruments accounted for the latest increase. However, the NIIP is expected to stabilize in the medium term as the current account deficit falls.



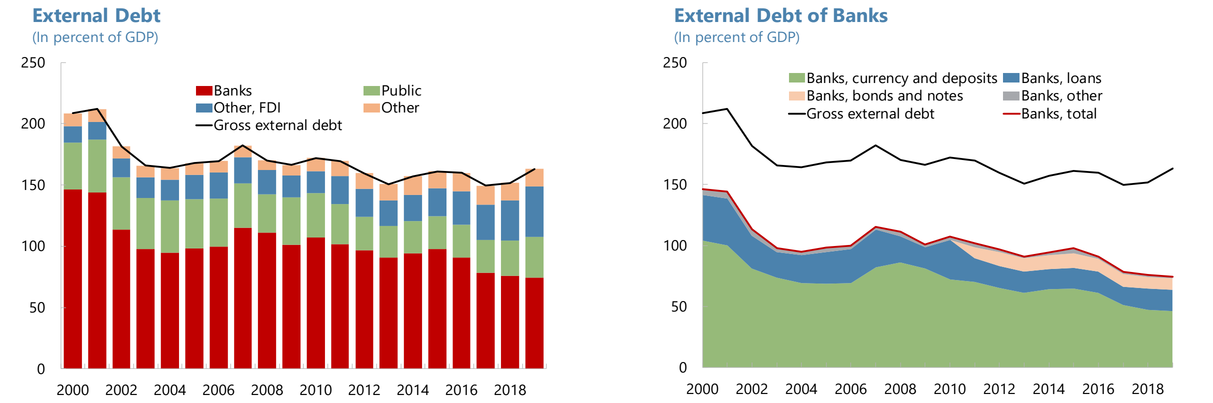
Sources: INEC and IMF staff calculations.

7. External debt increased to over 160 percent of GDP but remained well below the historical average. While external debt remains concentrated in private debt (about ½ is related to the whole banking system, of which about ¼ are the offshore banks), the increase was driven by FDI debt liabilities and public external debt. The decline in non-resident deposits continued, although at a slower pace, reducing the banking sector's foreign liabilities. In 2015, banks' external debt still accounted for over 60 percent of the total, while now its share is 51 percent.

Assessment

8. Overall, external debt is expected to remain relatively high, but stable over the medium term. Deposits from non-residents in the Panamanian banking sector are projected to remain below the historical average, reducing bank liabilities as a share of GDP. With FDI continuing to finance the current account deficit, FDI debt liabilities will gradually increase, making up a larger share of external debt. Public external debt will reach over 30 percent of GDP in 2020 but move to a downward trend as the fiscal deficit returns to comply with the fiscal rule. While external debt will continue to increase in 2020, these counteracting forces will lead to stabilization around 161 percent of GDP in the medium term.

External Debt



Sources: INEC and IMF staff calculations.

F. Other External Competitiveness Indicators

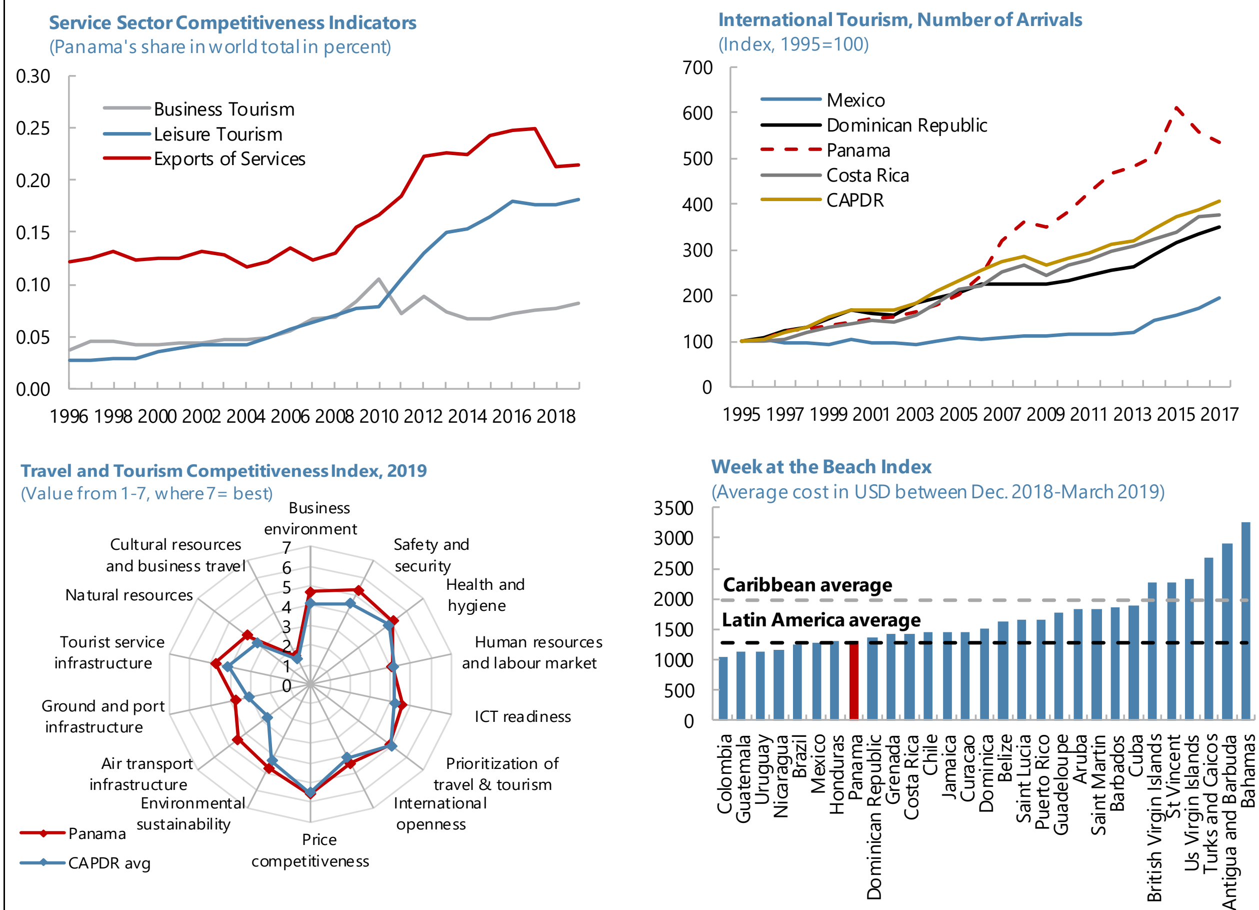
9. **Panama is maintaining its competitiveness in its main exports but has faced some challenges in the past years.** After over a decade of rapid expansion in the tourism sector, tourism receipts have stagnated in the last two years. This reduces Panama's share of service exports in the world, an indicator of external competitiveness. However, thanks to the continued growth in canal traffic and the expansion of Tocumen airport, Panama's exports of transportation services continued to expand. Goods exports have been held back by slow exports from the CFZ which is still suffering from the ongoing trade dispute with Colombia and low demand in its main export markets. But the start of copper exports has largely offset this effect.

10. **While indicators confirm Panama's competitiveness in tourism, the recent performance of the sector has been disappointing.** Tourist arrivals have decreased in the last two years, despite the overall growth in the region. Nevertheless, the Travel and Tourism Competitiveness Index 2019 compiled by the World Economic Forum (WEF) suggests that Panama outperforms the regional average in many categories, especially infrastructure, and can compete in prices with popular destinations in the region such as Mexico or the Dominican Republic. With strong fundamentals, tourism remains a sector with high growth potential, but well-targeted investment in tourism infrastructure and a coordinated tourism strategy may be necessary to reinvigorate the sector.

11. **Perceptions from survey-based competitiveness indicators suggest that competitiveness is holding.** In the latest WEF's Global Competitiveness Index, Panama dropped slightly from 64th to 66th position. Nevertheless, Panama continuous to outperform the average of Latin America and the Caribbean (LAC) in every pillar. Most progress has been made in ICT adoption while skills, product market and labor market show some deterioration in scores compared to 2017. Strengthening institutions, especially judicial independence and budget transparency, ICT adoption, labor markets and innovation capability would improve competitiveness. Results from the World Bank's Doing Business Report 2020 show a small increase in Panama's distance to the frontier (where the frontier is the best performance measured on a given indicator) by 0.3, reducing its score from 66.9 to 66.6. Progress has been made in firms' ability to get credit and resolve insolvency as Panama

adopted a new insolvency law in 2018 and in paying taxes following the introduction of an online system for filing and payment of corporate income tax, value-added tax and real estate tax. However, the regional comparison highlights that further strengthening tax discipline, contract enforcement and the insolvency regime are important to improve the business environment.

Service Export Competitiveness



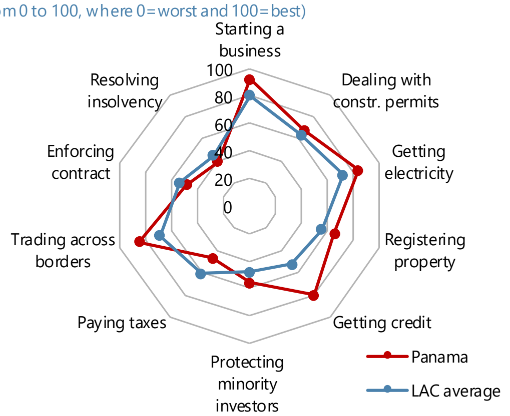
Sources: World Travel and Tourism Council (for chart 1), World Bank, World Tourism Organization (for chart 2), WEF. and Tourism Competitiveness Index 2019 (for chart 3), Week at the Beach index (for chart 4), and IMF staff calculations.

G. Reserve Adequacy Assessment

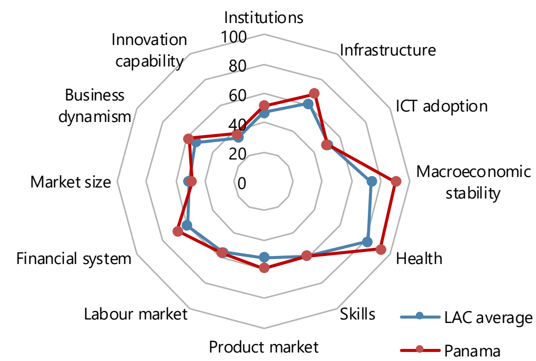
12. Reserve coverage remains below standard metrics, although these are not appropriate for Panama's economy. Panama is fully dollarized and does not have a central bank. Officially reported reserves are mostly the net foreign assets of the largest state-owned bank (the Banco Nacional de Panama), which is the government's bank and has a formal role in operating the payments system, but in the end is just another commercial bank in Panama. As such, Panama's reported reserves are distinct from the concept of international reserves in a country with its own currency. As reported, net international reserves are below both standard reserve adequacy metrics and the IMF's risk-based metric for emerging markets. However, historically Panama has not provided credit or support to the financial system or the private sector, and there is no lender of last resort nor any institution that manages banking system liquidity. Hence, any concept of reserves would only be useful to support the public sector, which currently has liquid assets of over 4 percent of GDP (in addition to the Sovereign Wealth Fund of about 2 percent of GDP), which could be considered adequate to cover the financial needs of a relatively lean government with small deficits.

Survey-Based Competitiveness Indicators

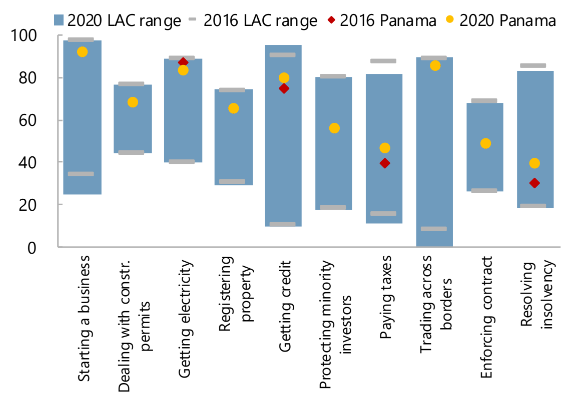
Doing Business Index 2020
(From 0 to 100, where 0=worst and 100=best)



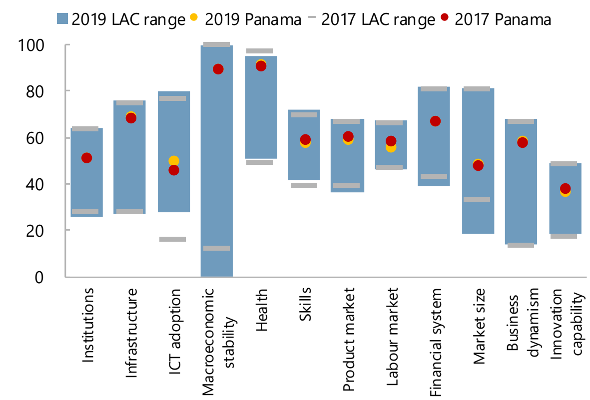
Global Competitiveness Index 2019
(From 0 to 100, where 0=worst and 100=best)



Doing Business Index 2020
(Index, from 0 to 100, where 0= worst and 100= best)



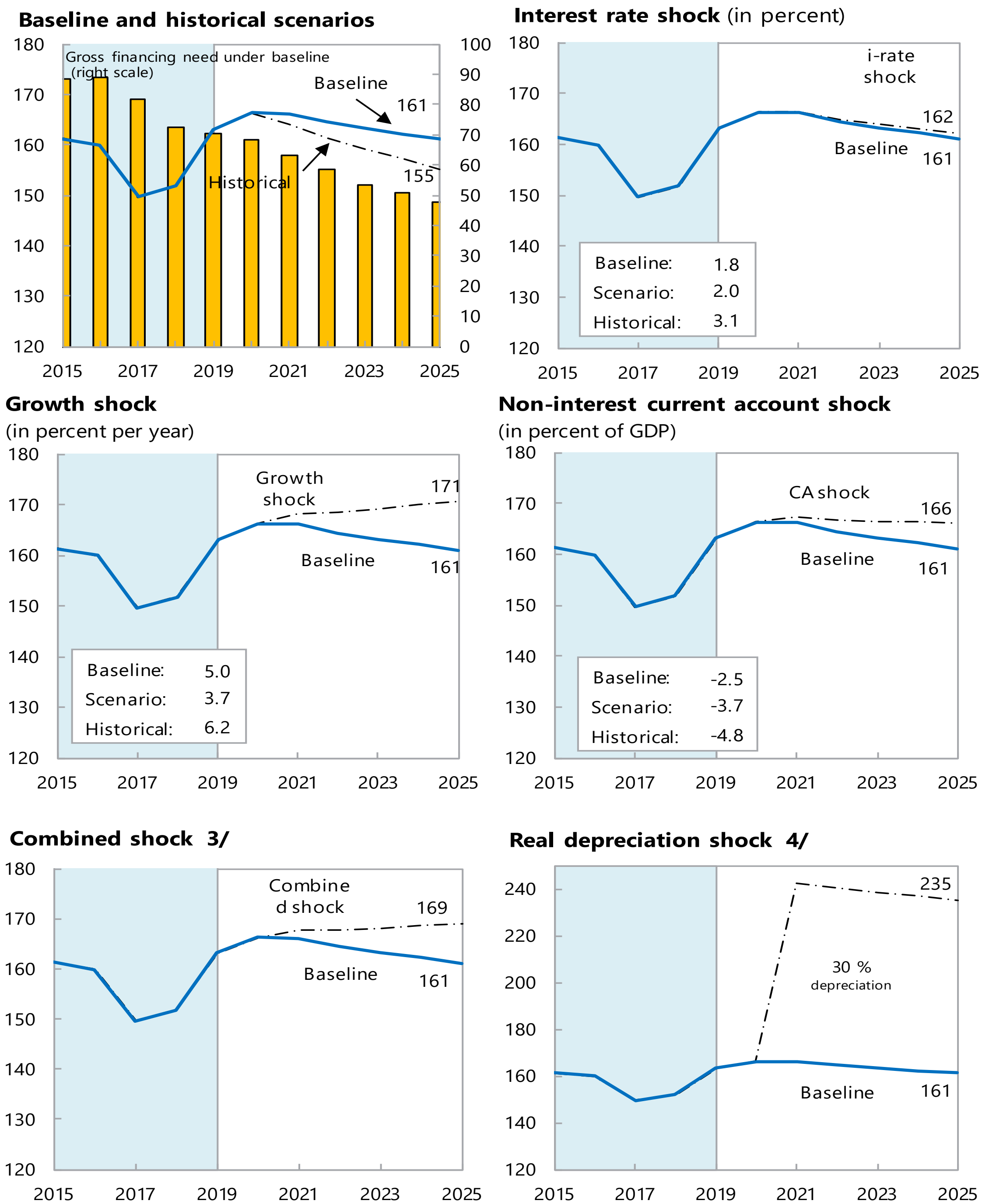
Global Competitiveness Index
(From 0 to 100, where 0= worst and 100= best)



Sources: World Bank Doing Business Index 2020, World Economic Forum GCI 4.0 2019 and IMF staff calculations.

Figure 1. External Debt Sustainability: Bound Tests 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ 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.

Table 2. External Debt Sustainability Framework, 2015–25

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	161.3	159.9	149.6	151.8	163.1			**166.3**	**166.1**	**164.4**	**163.2**	**162.2**	**161.1**	**-15.0**
2 Change in external debt	4.0	-1.4	-10.3	2.2	11.3			3.2	-0.2	-1.7	-1.2	-1.0	-1.1	
3 Identified external debt-creating flows (4+8+9)	-10.5	-10.7	-12.1	-6.3	-6.0			-8.4	-8.8	-9.0	-9.2	-9.4	-9.3	
4 Current account deficit, excluding interest payments	4.9	3.8	1.7	3.8	2.8			3.1	3.0	2.7	2.3	2.2	2.5	
5 Deficit in balance of goods and services	2.4	0.5	-0.3	0.6	-0.1			-1.7	-2.0	-2.6	-3.4	-3.7	-3.8	
6 Exports	48.2	43.5	43.6	43.8	42.4			43.8	43.8	45.0	46.2	46.8	46.6	
7 Imports	50.6	44.0	43.3	44.4	42.3			42.1	41.8	42.4	42.9	43.0	42.8	
8 Net non-debt creating capital inflows (negative)	-7.3	-7.9	-6.9	-7.9	-8.0			-7.3	-7.1	-6.9	-6.6	-6.6	-6.6	
9 Automatic debt dynamics 1/	-8.0	-6.6	-6.9	-2.3	-0.8			-4.1	-4.6	-4.8	-4.9	-5.1	-5.3	
10 Contribution from nominal interest rate	4.1	4.0	4.2	4.4	3.8			3.3	3.2	3.0	2.8	2.5	2.3	
11 Contribution from real GDP growth	-8.3	-7.5	-8.3	-5.3	-5.1			-7.4	-7.8	-7.8	-7.7	-7.6	-7.6	
12 Contribution from price and exchange rate changes 2/	-3.8	-3.2	-2.7	-1.4	0.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	14.5	9.3	1.8	8.6	17.2			11.6	8.6	7.3	8.0	8.4	8.2	
External debt-to-exports ratio (in percent)	334.5	367.2	342.8	346.4	384.3			379.8	379.0	365.1	352.9	346.9	345.8	
Gross external financing need (in billions of US dollars) 4/	47748.3	51592.5	50838.8	47328.4	47089.1			48312.9	47784.0	47097.2	46305.7	47047.4	47174.2	
in percent of GDP	88.3	89.1	81.7	72.7	70.1	10-Year	10-Year	68.3	63.4	58.3	53.5	50.8	47.6	
Scenario with key variables at their historical averages 5/								**166.3**	**164.2**	**161.4**	**159.2**	**157.3**	**155.0**	**-17.1**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	5.7	5.0	5.6	3.7	3.5	6.2	2.5	4.8	5.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	2.5	2.0	1.7	0.9	-0.4	3.1	2.2	0.5	1.5	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.8	2.7	2.8	3.1	2.6	3.1	0.3	2.2	2.0	1.9	1.8	1.7	1.5	
Growth of exports (US dollar terms, in percent)	-7.8	-3.3	7.7	5.1	-0.2	4.9	12.1	8.7	6.7	10.0	10.0	8.3	6.7	
Growth of imports (US dollar terms, in percent)	-10.9	-6.9	5.8	7.2	-1.7	5.8	15.1	4.9	5.8	8.6	8.3	7.5	6.5	
Current account balance, excluding interest payments	-4.9	-3.8	-1.7	-3.8	-2.8	-4.8	2.3	-3.1	-3.0	-2.7	-2.3	-2.2	-2.5	
Net non-debt creating capital inflows	7.3	7.9	6.9	7.9	8.0	7.9	0.6	7.3	7.1	6.9	6.6	6.6	6.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

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

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

5/ 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.

6/ 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.

Annex IV. Debt Sustainability Analysis

Figure 1. Panama: Public Sector DSA – Baseline Scenario

(In percent of GDP unless otherwise indicated)

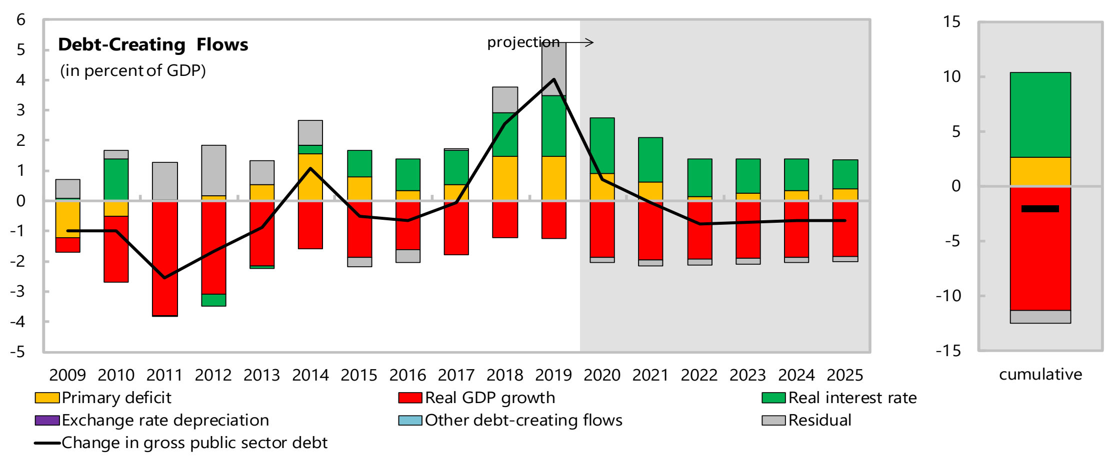
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	36.2	36.8	40.8	41.5	41.5	40.7	40.0	39.4	38.7
Public gross financing needs	6.8	6.2	6.4	5.5	5.3	4.7	4.8	6.8	4.6
Net public debt		25.9	28.0	29.3	29.9	29.8	29.8	29.7	29.6
Real GDP growth (in percent)	6.3	3.7	3.5	4.8	5.0	5.0	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	4.1	0.9	-0.4	0.5	1.5	2.0	2.0	2.0	2.0
Nominal GDP growth (in percent)	10.7	4.7	3.1	5.4	6.6	7.1	7.1	7.1	7.1
Effective interest rate (in percent) [4/]	5.8	5.4	5.3	5.3	5.3	5.3	5.1	4.9	4.7

As of December 31, 2019		
Sovereign Spreads		
EMBIG (bp) 3/	114	
5Y CDS (bp)	42	
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.8	2.6	4.0	0.7	-0.1	-0.7	-0.7	-0.7	-0.6	-2.1	
Identified debt-creating flows	-1.3	1.7	2.3	0.9	0.1	-0.6	-0.5	-0.5	-0.5	-1.0	
Primary deficit	0.3	1.5	1.5	0.9	0.6	0.1	0.2	0.3	0.4	2.7	-0.9
Primary (noninterest) revenue and gr	21.2	19.7	18.1	18.1	18.3	18.3	18.2	18.1	18.0	108.9	
Primary (noninterest) expenditure	21.4	21.1	19.5	19.0	19.0	18.4	18.4	18.4	18.4	111.6	
Automatic debt dynamics [5/]	-1.6	0.2	0.8	0.0	-0.5	-0.7	-0.8	-0.8	-0.9	-3.7	
Interest rate/growth differential [6/]	-1.6	0.2	0.8	0.0	-0.5	-0.7	-0.8	-0.8	-0.9	-3.7	
Of which: real interest rate	0.5	1.5	2.0	1.8	1.5	1.2	1.1	1.0	1.0	7.7	
Of which: real GDP growth	-2.1	-1.2	-1.2	-1.9	-1.9	-1.9	-1.9	-1.9	-1.8	-11.4	
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	
GG: Net privatization proceeds (neg	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	
Please specify (2) (e.g., ESM and Eur	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/]	0.5	0.8	1.8	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBIG.

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

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (1+g) and the real growth contribution as -g.

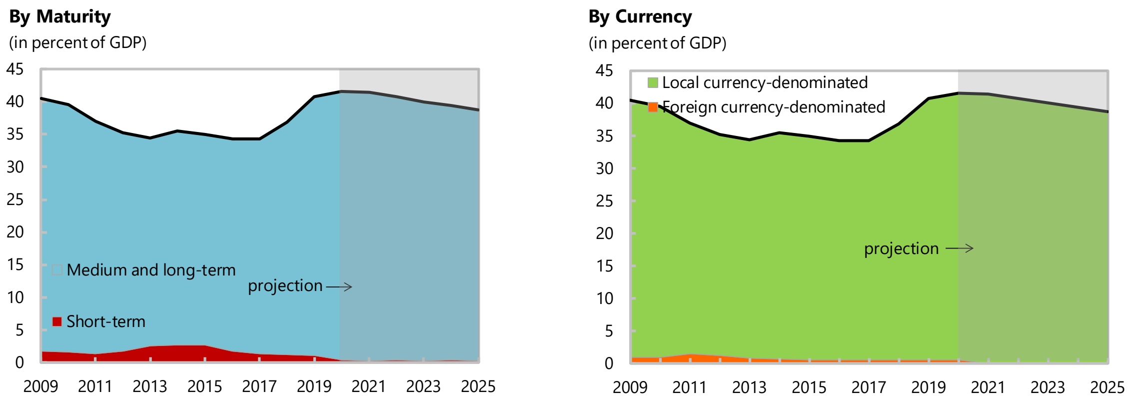
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

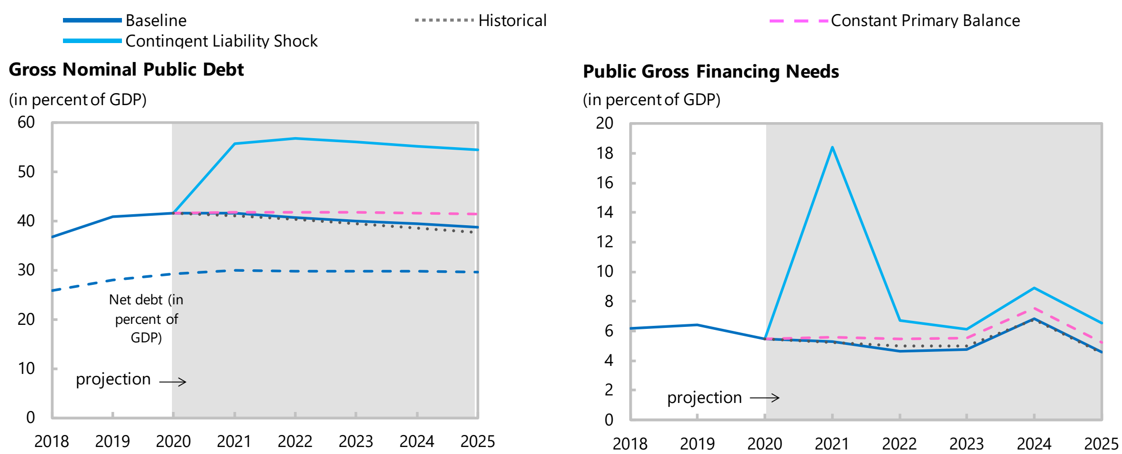
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Panama: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	4.8	5.0	5.0	5.0	5.0	5.0
Inflation	0.5	1.5	2.0	2.0	2.0	2.0
Primary Balance	-0.9	-0.6	-0.1	-0.2	-0.3	-0.4
Effective interest rate	5.3	5.3	5.3	5.1	4.9	4.7
Constant Primary Balance Scenario						
Real GDP growth	4.8	5.0	5.0	5.0	5.0	5.0
Inflation	0.5	1.5	2.0	2.0	2.0	2.0
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	5.3	5.3	5.3	5.0	4.8	4.7

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	4.8	6.2	6.2	6.2	6.2	6.2
Inflation	0.5	1.5	2.0	2.0	2.0	2.0
Primary Balance	-0.9	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	5.3	5.3	5.2	4.9	4.5	4.3
Contingent Liability Shock						
Real GDP growth	4.8	2.5	2.5	5.0	5.0	5.0
Inflation	0.5	0.9	1.4	2.0	2.0	2.0
Primary Balance	-0.9	-13.4	-0.1	-0.2	-0.3	-0.4
Effective interest rate	5.3	6.0	5.8	5.6	5.4	5.2

Source: IMF staff.

Figure 3. Panama: Public DSA Risk Assessment

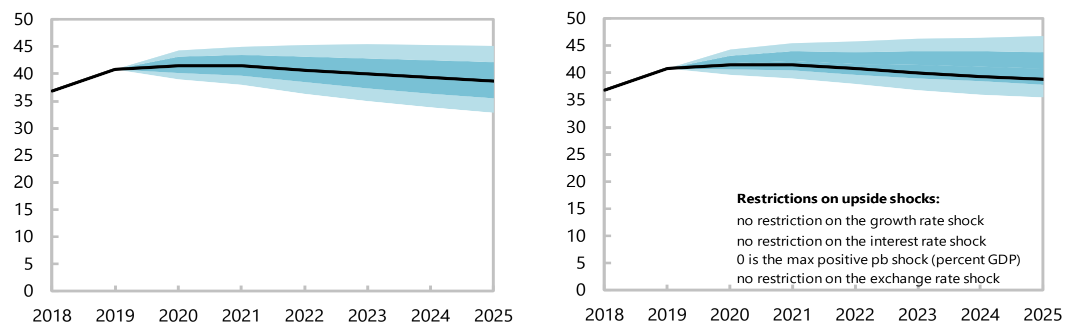
Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

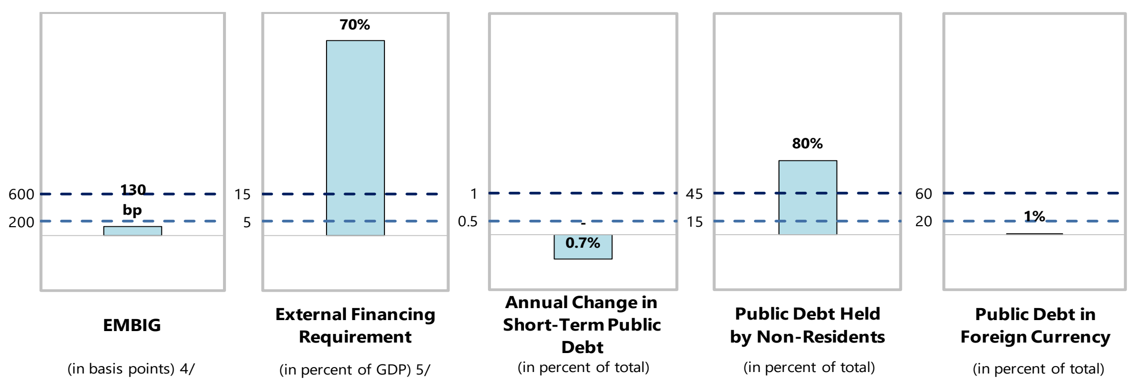
Baseline Percentiles: 10th-25th 25th-75th 75th-90th



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)

Panama Lower early warning Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 02-Oct-19 through 31-Dec-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex V. Economic Impact of Copper Mining[1]

1. *Cobre Panama* is the biggest private investment project in the nation's history, surpassing the Canal expansion. *Cobre Panama* (MPSA) is one of the world's top 15 copper-producing projects.[2] It is majority-owned by the Canadian company First Quantum Minerals (FQM). The cost of this open-pit mine's development totaled approximately US$6.7 billion (10.3 percent of GDP). Copper deposits were first discovered in Panama in 1968. However, the development of the mine was not approved until July 2011, and commercial production started in September 2019. Each year, MPSA expects to produce on average 320,000 tons of copper (peaking at 377,000 tons per annum when at processing capacity), along with 100,000 oz of gold during its lifetime, which is expected at 36 years from 2019 to 2054.[3]

2. *Cobre Panama* is expected to generate exports of around US$2 billion a year during its lifetime, which is equivalent to about 3 percent of GDP. As MPSA's profits get partially reinvested, the economy will benefit from local infrastructure development, including a new access road and electricity supply to over fourteen indigenous communities, and a two-terminal port with spare capacity for non-mining use. The mine has been purchasing a variety of products and services from over 1,000 local suppliers. In addition, MPSA has committed to bring water, sanitation, health, schooling and commercial development programs allowing over 400 families to sell produce from their farms to the mine camps.

3. The mine is expected to provide about 4,000 jobs during its operation phase and training opportunities for local engineers. During the construction phase, it employed about 13,000 workers, mostly low skilled. Currently, MPSA has an estimated 6,000 people working in mining operations and another 1,000 in construction (of whom 91 percent are Panamanian) with an expectation of phasing out the temporary jobs and replacing the expatriate specialists with locals as they acquire the necessary skills. For high-skilled workers (namely mechanical engineers), MPSA provides some scholarships to study mining abroad and traineeships at an FQM mine in Zambia.

4. Fiscal impact from mining activity is expected to be limited. MPSA is required to pay the Government of Panama a 2 percent royalty on its gross production as well as a 25 percent corporate income tax (CIT) on its earnings. The CIT, however, is exempted for the period during which the company has outstanding debt related to the construction and development of the mine

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[1] Prepared by Marina Rousset.

[2] Panama has two of the largest underdeveloped copper deposits in the world, according to a study by Quinn and Pouliot (2014) ("Long-term Monitoring Impact Assessment of Mining Activity in Panama").

[3] The mine is still in the ramp-up process and operates at an estimated 80 percent of capacity. It expects to reach full capacity by 2022-23.

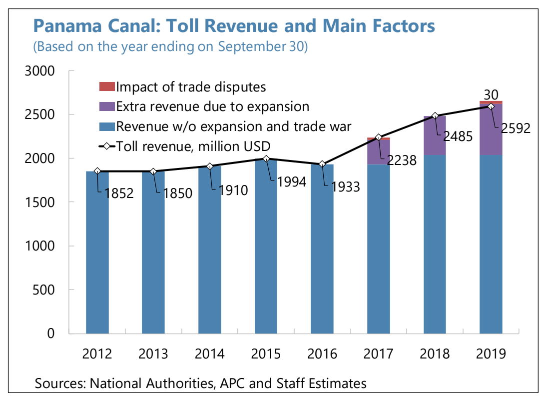
(FQM expects this period to last about 10 years). In addition, MPSA received fiscal benefits, such as a tax credit on development expenses of up to 50 percent (equivalent to a depreciation allowance) and reduced smaller taxes including municipal fees and a land rental tax of US$3.0 per hectare per year.

5. Known risks include legal uncertainty and environmental hazards. Panama's Supreme Court ruled in September 2018 that Law 9, which was used to grant the mining concession to MPSA in 1997, is unconstitutional as it did not follow the correct legal process. The resulting uncertainty puts into question the royalty, tax and tariff structure by which MPSA is bound, and may dampen the appetite for other large-scale foreign investment projects. In addition, despite MPSA's efforts to contain negative environmental externalities, known impacts on the high-biodiversity mining site include deforestation, reduced surface water, groundwater quality and quantity, as well as air contamination and social change associated with the reallocation of some villages.[4] Panama's limited experience in supervising mining activity amplifies these concerns.

[4] According to the March 2019 technical report produced by FQM for listing on the Toronto Stock Exchange.

Annex VI. Challenges in the Management of the Canal[1]

1. Canal expansion, completed in 2016, significantly increased capacity and diverted shipping traffic through Panama. The second set of locks allowed the Panama Canal Authority (ACP) to triple the capacity of ships and capture new markets such as large passenger cruises and liquified natural gas (LNG), as well as to expand the existing markets of liquified petroleum gas (LPG) and container ships. Traffic in the Canal generated revenues of US$2.6 billion in 2019 (about 4½ percent of GDP), of which US$1.8 billion were transferred to the budget. Higher cargo and passenger movement across the Canal have spilled over to the transport and communication sectors.



2. The U.S.-China trade tensions have not had a significant impact on the Canal's overall revenue thus far. While there was a fall in revenue from the US-China traffic, it picked up in other routes, related to increased demand for U.S. LNG from Japan, South Korea and Mexico, and the attraction of new routes (e.g., Brazil began using the Canal for some of its grain exports to China). An agreement reached in the first round of the U.S.-China negotiations is encouraging, but medium-term uncertainty remains heightened.

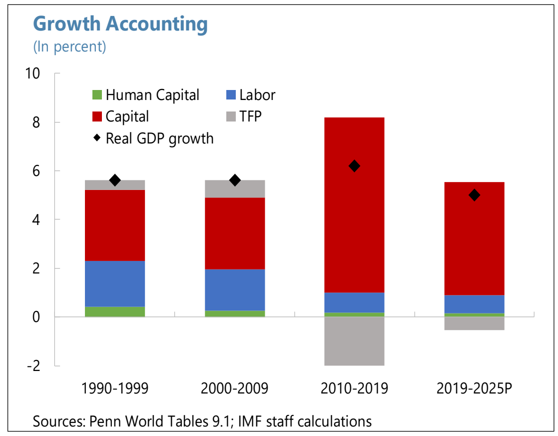
3. Scarcity of water resources presents a significant challenge for the Canal over the medium term. The Panama Canal locks operate using fresh water from the Gatun and Alajuela lakes, which is also used for human consumption. In 2019, a drought lead to historically low water levels in the lakes. To mitigate this impact, the ACP had to limit the use of water for hydroelectric production, and, when necessary, restrict the size of vessels allowed to cross the Canal. To continue meeting the demand for water required for Panama's growth and development, the Canal studies new water sources and measures, like the new water charge for ships.

4. Risks to the Canal from the weaker external environment and climate change are increasing. Supply chain disruptions due to the coronavirus outbreak can weaken global trade. A period of prolonged droughts will further disrupt trade traffic in the future. The Canal is trying to diversify its business, building a shipyard and developing the Canal as a tourist destination, which would attract more cruise ships to use the recently opened Panama Cruise Terminal in Amador as a port of origin.

[1] Prepared by Olga Bespalova.

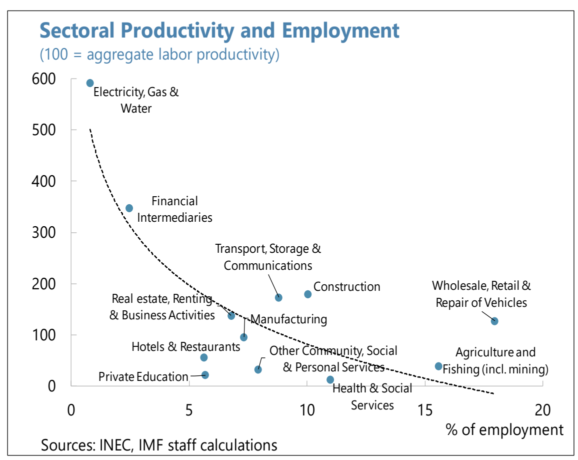
Annex VII. Drivers of Growth[1]

1. Panama's growth over the last decade was fueled by extraordinarily high real investment rates peaking at 45 percent of GDP in 2015. Growth accounting shows that capital accumulation was responsible for the bulk of growth. Large projects such as the Panama Canal expansion or the construction of one of the largest copper mines in the world boosted investment rates. The effect of most of these large projects on economic activity is lagged by a few years, which partially explains the disappointing total productivity growth over the same time period. While some large infrastructure projects such as the fourth bridge over the Canal are still ongoing, the conclusion of many projects will normalize investment rates to below 40 percent of GDP, reducing the contribution of capital to growth. Despite this adjustment, Panama's attractiveness for private investment keeps investment rates high relative to the region.



2. Demographics—as in many countries in the region—are marked by a slowing population growth. Despite positive net migration, this trend is expected to continue, reducing the contribution of labor to growth. The estimated contribution of human capital has been small and investing in a skilled workforce will be important in the future. Gaps in education, also compared to the region, could lead to skilled labor shortages over the medium term (see 2020 SIP).

3. Panama needs to boost productivity to sustain high growth rates over the medium term. As some of the large investment projects reap the gains from years of investment, productivity should expect a boost. But the recent slowdown in productivity growth may also point to some fundamental bottlenecks. While productivity has been exceptionally high in some segments of the economy, relatively unproductive sectors still make up a large share of employment.[2] Fostering labor mobility across sectors and regions, along with further leveraging the strategic location to attract high-growth industries and continually reforming the business climate and governance will be crucial to this agenda.



[1] Prepared by Julia Faltermeier. See SIP (2020) for details.

[2] See R. Hausmann et.al. 2017. "Appraising the Economic Potential of Panama; Policy Recommendations for Sustainable and Inclusive Growth"; CID Working Paper 334, Harvard University, Cambridge MA.

4.

PRESS RELEASE

PR[YY/XX]

IMF Executive Board Concludes 2020 Article IV Consultation with Panama

Appendix I. Draft Press Release

WASHINGTON, DC – **On March 23, 2020,** the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Panama and considered and endorsed the staff appraisal without a meeting.[2]

After a decade of high growth, the economy slowed in 2018–19 and growth is estimated to have reached 3.5 percent in 2019. Inflation slid below zero for most of the year due to soft demand, while credit growth decelerated. The unemployment rate rose slightly to 7.1 percent in August 2019, compared to 6.0 percent the previous year. However, economic activity gained momentum towards the end of 2019, supported by copper exports, which also helped to narrow the external current account deficit to 6.6 percent of GDP. Confronted with a sharp revenue shortfall in mid-2019, the new government decided to revise the fiscal rule widening the deficit ceiling of the non-financial public sector to 3.5 percent of GDP (from 2.0 percent in 2018), and gradually adjusting it in subsequent years. Together with the uncovering of previously unrecorded arrears of over 2 percent of GDP, this increased central government debt to 46.2 percent of GDP, although still below historical levels. For 2020, the deficit is set to decrease to 2.75 percent of GDP. Panama was placed on the FATF grey list in June 2019, with limited impact on the economy and the banking system thus far, and the government has initiated reforms to address the remaining deficiencies in AML/CFT.

The medium-term prospects remain favorable. Panama is expected to remain among the most dynamic economies in the region as it further leverages its role as a transportation and logistics hub and continues to attract high levels of foreign direct investment. Growth is projected to rebound to 4.8 percent this year, with a boost from mining, and remain at its potential growth of 5 percent over the medium term

[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

on the back of strengthened domestic and external demand. Inflation is expected to increase to 1 percent in 2020 and converge to 2 percent in the medium term. Fiscal policy will adjust gradually in line with the deficit ceiling, declining to 2 percent of GDP in 2022, placing public debt on a downward trajectory. However, the balance of risks is tilted to the downside. Domestic risks include delays in addressing fiscal imbalances and compliance with the FATF action plan to exit the grey list. External risks stem from a slowdown in world trade, weak global growth, spillovers from the buildup of financial vulnerabilities in systemic economies and climate change

Executive Board Assessment[3]

In concluding the 2020 Article IV Consultation with Panama, Executive Directors endorsed staff's appraisal, as follows:

Growth is expected to rebound in 2020. Economic activity is projected to recover after a slowdown in 2018-19, supported by full-scale copper production and robust private investment. Growth over the medium-term is expected to remain at its potential. Key risks relate to setbacks in exiting the FATF grey list and complying with SFRL deficit ceilings as well as a slowdown in Canal traffic amid escalating trade tensions, weak growth in key trade partner countries, and the coronavirus outbreak. While external imbalances are expected to decline over the medium-term, the external position is moderately weaker than fundamentals and desirable policy settings.

Sustained fiscal discipline is required for fiscal policy credibility and to keep public debt on a downward trajectory. Amid a relatively high deficit exacerbated by newly discovered unrecorded arrears, Central Administration debt reached 46.2 percent of GDP in 2019. The modified gradual adjustment of the deficit ceiling under the SFRL is appropriate to smooth the pace of necessary fiscal consolidation. In addition, the authorities should consider using a "shadow" structural rule in the future to build fiscal buffers.

A realignment of fiscal revenue and expenditures is imperative to sustain growth. In addition to improving the capacity of tax and customs administrations, action is required to review Panama's complex tax exemptions that continually erode the tax base. On the expenditure side, realigning current spending with social needs—including by investing more in education—and improving the effectiveness of social spending will be crucial to achieve sustainable and inclusive growth. Capital projects need to be carefully assessed and prioritized going forward.

The pension system needs to be strengthened. Faced with slowing population growth, the authorities need to gradually align pension contributions with expected payouts, to avoid creating an undue burden

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

to the public finances in the long run. Given the politically sensitive nature of such adjustments, a slow-paced approach is recommended.

Strengthening the fiscal framework is essential to improving the macroeconomic policy toolkit. The emergence of sizable unrecorded arrears highlights the need to strengthen budgetary execution rules and misuse penalties as well as to streamline the recording of fiscal accounts by limiting the use of turnkey projects and deferred payment contracts in public investment projects.

Exiting the FATF grey list must remain a priority. Building on the momentum of recent legislative action, the authorities should continue addressing the deficiencies in Panama's AML/CFT regime and legal framework identified by the FATF. In addition, the authorities should address the shortcomings identified in the 2019 Global Forum review on global tax transparency, including by responding to exchange-of-information requests in a timely manner.

The financial sector remains robust, but macrofinancial risks warrant continued monitoring. Addressing data gaps with respect to household and corporate balance sheets and property prices remains a priority. Specifically, improving housing price indices would facilitate financial-sector surveillance.

The alignment of prudential regulations with Basel III is welcome. The authorities should focus on macroprudential tools and further upgrading the regulatory toolkit. It will also be important to put in place robust frameworks for crisis management, including by adequate liquidity support for banks and enhancing the range of resolution tools available to failed banks.

The fintech sector holds potential in the presence of an appropriate regulatory framework. Adopting cybersecurity and fintech regulatory frameworks while capitalizing on Panama's digital and mobile connectivity could place the country as a regional fintech hub, enhancing financial inclusion, and lowering intermediation costs.

A reinforcement of the structural reform agenda will be necessary to maintain high potential growth. Sustaining high rates of growth will require continued improvements in productivity and competitiveness, a strengthening of policies related to labor mobility, governance and institutional capacity, and enhancing the innovation and technological sophistication in key industries. To remain an attractive destination for doing business, Panama needs to upgrade the skill level of its workforce, streamline the insolvency framework and improve the functioning of the judicial system.

Addressing social inequities is urgent. Revamping social policies is imperative to maintain broad-based and inclusive growth and requires strategic policy action in the areas of education, gender equality, social protection programs, and poverty reduction in the comarcas.

Panama's climate change mitigation strategy and commitments are welcome. Beyond "green" energy provision, the authorities should be mindful of natural resource preservation, especially in view of the country's susceptibility to extreme weather events. Most notably, the pressure for better water management is mounting both from the expanded Canal operations and a growing population.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2018)	4.2	Poverty line (percent, 2017)	20.7
Population growth rate (percent, 2018)	1.6	Adult literacy rate (percent, 2018)	95.4
Life expectancy at birth (years, 2017)	78.1	GDP per capita (US$, 2018)	15,507
Total unemployment rate (August, 2019)	7.1	IMF Quota (SDR, million)	376.8

				Est.	Projections	
	2016	2017	2018	2019	2020	2021
			(Percent change)			
Production and prices						
Real GDP (2007 prices)	**5.0**	**5.6**	**3.7**	**3.5**	**4.8**	**5.0**
Consumer price index (average)	0.7	0.9	0.8	-0.4	0.5	1.5
Consumer price index (end-of-year)	1.5	0.5	0.2	-0.1	1.0	2.0
Output gap (% of potential)	-0.1	0.7	0.0	-0.9	-0.5	-0.2
Demand components (at constant prices)						
Public consumption	**10.1**	**6.5**	**7.5**	**8.6**	**2.2**	**5.7**
Private consumption	7.1	3.1	2.3	3.4	3.9	5.0
Public investment 1/	49.0	-20.7	7.0	-5.2	1.2	4.6
Private investment	-5.5	14.9	-0.1	1.4	1.8	3.8
Exports	-4.3	5.0	5.0	-0.4	7.9	5.3
Imports	-4.8	4.7	2.8	-0.4	4.2	4.6
Financial sector						
Private sector credit	**8.4**	**6.5**	**4.5**	**3.1**	**5.4**	**6.6**
Broad money	4.1	5.2	2.8	3.1	5.4	6.6
Average deposit rate (1-year)	2.7	2.7	3.5	3.9	…	…
Average lending rate (1-year)	3.5	3.5	4.3	4.7	…	…
			(In percent of GDP)			
Saving-investment balance						
Gross domestic investment	**40.5**	**41.7**	**41.3**	**39.8**	**39.1**	**38.7**
Public sector	7.8	5.9	6.1	5.2	5.0	5.0
Private sector	32.7	35.8	35.2	34.6	34.0	33.7
Gross national saving	32.7	35.8	33.1	33.2	32.7	32.5
Public sector	3.9	4.2	4.2	2.4	2.6	2.9
Private sector	28.8	31.5	28.9	30.8	30.1	29.6
Public finances 1/						
Revenue and grants	**22.6**	**22.0**	**21.9**	**20.7**	**20.4**	**20.5**
Expenditure	24.8	24.2	24.8	23.4	22.9	22.7
Current, including interest	16.7	17.0	17.1	17.8	17.5	17.4
Capital	8.0	6.9	6.5	5.5	5.3	5.3
Overall balance, including ACP	-2.2	-2.2	-2.9	-2.7	-2.5	-2.2
Overall balance, excluding ACP	-2.0	-2.2	-3.2	-3.1	-2.7	-2.5
Total public debt						
Debt of Non-Financial Public Sector 2/	**34.8**	**34.8**	**36.8**	**40.8**	**41.5**	**41.5**
External	28.5	28.7	30.5	34.7	34.8	34.2
Domestic	6.3	6.1	6.2	6.1	6.7	7.3
Debt of ACP	4.7	4.4	4.2	3.8	3.2	2.7
Other 3/	3.8	3.4	4.2	4.1	3.9	3.6
External sector						
Current account	**-7.8**	**-5.9**	**-8.2**	**-6.6**	**-6.4**	**-6.2**
Net exports from Colon Free Zone	2.9	3.0	2.5	2.3	2.3	2.3
Net oil imports	3.4	3.8	4.4	4.2	3.9	3.7
Net foreign direct investment inflows	7.9	6.9	7.9	8.0	7.3	7.1
External Debt	159.9	149.6	151.8	163.1	166.3	166.2
Memorandum items:						
GDP (in millions of US$)	57,908	62,219	65,128	67,145	70,750	75,403

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.
1/ Includes Panama Canal Authority (ACP).
2/ Non-Financial Public Sector according to the definition in Law 31 of 2011.
3/ Includes debt of public enterprises outside the national definition of NFPS (ENA, ETESA, and AITSA) and non-consolidated agencies.