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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/106-2

10:45 a.m., December 12, 2018

2. Panama—2018 Article IV Consultation

Documents: SM/18/279 and Correction 1; and Correction 2; and Supplement 1; SM/18/280

Staff: Santos, WHD; Murgasova, SPR

Length: 49 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	**Alternate Executive Directors**
	Manzi (AE), Temporary
	H. Razafindramanana (AF)
G. Lopetegui (AG)	
N. Ray (AP)	
A. Tombini (BR)	
	H. Ma (CC), Temporary
	A. Del Cid-Bonilla (CE), Temporary
	A. McKiernan (CO)
	C. Just (EC)
	A. Castets (FF)
S. Meyer (GR)	
	M. Siriwardana (IN)
	M. Psalidopoulos (IT)
	Y. Naruse (JA), Temporary
	S. Alavi (MD), Temporary
	M. Merhi (MI), Temporary
	S. Harutyunyan (NE), Temporary
	K. Virolainen (NO)
	S. Potapov (RU), Temporary
	S. Keshava (SA), Temporary
	Anwar (ST), Temporary
P. Inderbinen (SZ)	
	O. Haydon (UK), Temporary
	D. Crane (US), Temporary

H. Al-Atrash, Acting Secretary
S. Maxwell, Summing Up Officer
D. Jiang, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Communications Department: Maria Elena Candia Romano. Corporate Services and Facilities: Echemole Abass. Legal Department: Amira Omar Rasekh Aly, Francisco R. Figueroa, F. Figueroa, Gabriela Rosenberg. Monetary and Capital Markets Department: E. Sonbul Iskender. Strategy, Policy, and Review Department: Z. Murgasova, Zuzana Murgasova. World Bank Group: S. Davies, Simon Davies, Katherine M. Scott. Western

Hemisphere Department: Olga Bespalova, Julia Gabriele Athina Faltermeier, J. Faltermeier, M. Hadzi-Vaskov, Metodij Hadzi-Vaskov, J. Okwuokei, Joel Chiedu Okwuokei, Ruth Miriam Petcoff, Alejandro G. Santos, A. Santos. Alternate Executive Director: P. Fachada (BR). Senior Advisors to Executive Directors: G. Gasasira-Manzi (AE), Z.Mohammed (BR). Advisors to Executive Directors: M. Albert (FF), M. Bangrim Kibassim (AF), L. Cerami (IT), M. Coronel (BR), J. Corvalan (AG), I. Fragin (GR), R. Lopes Varela (AF), A. Maciá (BR), A. Park (AP), A. Srisongkram (ST), M. Sylvester (CO), N. Vaikla (NO), A. Zaborovskiy (EC), K. Hennings (BR).

2. PANAMA—2018 ARTICLE IV CONSULTATION

The staff representative from the Western Hemisphere Department submitted the following statement:

This statement updates developments in Panama since the issuance of the Staff Report, which does not alter the thrust of the Staff Appraisal.

- ***High frequency data point to a slow recovery***. The monthly index on economic activity (IMAE) estimates economic growth at 3.8 percent in September 2018 (y/y), up from 3.4 percent in August 2018 (y/y).

- ***Price pressures remain muted***. Headline inflation edged up to 1.0 percent in October 2018 (y/y), compared to 0.8 percent in September 2018, while core inflation (excluding food and fuel prices) remained stable at 0.7 percent (y/y).

- ***The fiscal position continues to be supportive***. The non-financial public sector (NFPS) deficit reached 3.8 percent of GDP through September 2018 compared to 1.5 percent last year. While revenues were broadly stable in nominal terms compared to last year, acceleration in the pace of budget execution, particularly capital spending, is responsible for the more supportive fiscal position in the first nine months of 2018. The government must adjust spending in the last quarter of 2018 to comply with the new deficit limit of 2.0 percent of GDP under the modified fiscal responsibility law. The authorities have reiterated their commitment to the deficit limits under the fiscal responsibility law.

- ***Minor revisions to the national income accounts***. Recently revised data by the National Statistics Institute (INEC) indicates that real GDP growth for 2017 was 5.3 percent, (or 0.1 percent lower than reported in the Staff Report), whereas nominal GDP growth was 7.5 percent (or 0.6 percent higher than in the Staff Report). However, these marginal changes in GDP estimates do not significantly change the ratios to GDP included in the Staff Report.

Mr. Tombini and Mr. Maciá submitted the following statement:

The Panamanian authorities thank the new mission chief and his team for their productive engagement and policy advice during a comprehensive staff visit in May and the Article IV consultation mission in September. The

authorities broadly agree with the team's assessment and policy recommendations.

Recent Economic Developments

In 2017, Panama's GDP growth was the highest in the Latin American and the Caribbean region at 5.4 percent. A labor strike in construction in April and May – which slashed activity in the sector by 40 percent – and a weak performance in some other economic sectors have reduced growth in 2018 by as much as one percentage point to a projected 4.5 percent. A strong rebound in 2019 is expected, with economic growth projected to hover above 6 percent, supported by a large public infrastructure investment program and the beginning of the production of the copper mine Minera Panamá. The increase in transport and storage facilities, further utilization of the expanded Canal capacity, and continued expansion of the Colon Free Trade Zone (ZLC) activities will also contribute to such recovery. Labor market remains robust, while inflation is expected to climb slightly to 1.2 percent at end-2018.

The authorities continue to support a dynamic public investment program well into the medium term. Public investment budget in 2018 was over US$5.2 billion or about 8.0 percent of GDP, and an equivalent amount has been allocated in the 2019 budget. Large infrastructure projects to be concluded this year and in 2019, totaling over US$ 4.4 billion, encompass the third bridge over the Panama Canal, the city of Colon urban renewal, the Interamerican Highway expansion, the Metro Line 2, and the Tocumen Airport new terminal. Major projects startups in 2019 include the fourth bridge over the Canal and the Metro Line 3 monorail system, totaling about US$ 4.0 billion. Foreign direct investment (FDI) also remains high, comprising among others a liquefied natural gas electricity generation plant completed in August 2018, and a new plant to start construction in 2019. FDI has also supported the expansion of port facilities for larger neopanamax ships in the Canal area and the Minera Panamá, which is expected to start exporting in early 2019. The above represents a total FDI package of about US$9.1 billion.

The current account deficit is projected to increase marginally in 2018. The current account deficit will remain relatively high into the medium term, as government policies continue to support large public infrastructure investments and improve public projects' implementation rate. Also, rising global trade disputes can negatively affect international trade, with clear impact on the Canal revenues. Despite such exogenous risk, the external account is projected to remain well under control in the foreseeable future as

the steady flow of FDI should continue to finance most of the current account deficit.

Recently, the major rating agencies reaffirmed the investment grade for Panama's sovereign debt. In October 2017, Moody's perspective on Panama improved to positive from a previous stable outlook. In February, Fitch reiterated Panama BBB qualification with stable outlook. In July, Standard & Poor's upgraded the outlook to positive based on the country's growth path, stable fiscal policy, and prudent debt management.

Fiscal Stance and Public Financial Management

Panama has maintained a prudent fiscal stance and the Non-Financial Public Sector (NFPS) deficit declined to 1.6 percent of GDP in 2017. The Ministry of Economy and Finance (MEF) estimated the fiscal deficit in mid-year 2018 to have remained at 1.6 percent of GDP. In October, the National Assembly approved MEF's request to increase the 2018 fiscal deficit ceiling to 2.0 percent of GDP to cope with the slack in the economy. At the same time, it provided for a more transparent fiscal rule within the Social and Fiscal Responsibility Law (SFRL). The deficit ceiling will be reduced gradually, and by 2022, it will have converged to 1.5 percent of GDP, supporting a fiscal consolidation approach conducive to continued public debt reduction. In September, NFPS gross debt reached 38.1 percent of GDP and net debt, which excludes the US$ 1.3 billion balance of the sovereign wealth fund (FAP - Fondo de Ahorro de Panamá), stood at 36.1 percent of GDP. On a related note, in a general-elections year, the outgoing administration can only spend 50 percent of the operational budget – i.e., excluding investment outlays – so that the new administration that takes office on July 1st has enough budget to conclude the fiscal year.

The above ruling of the National Assembly also allows the Panama Canal Authority (PCA) to transfer resources to the FAP. Previously, the transfers to FAP were conditioned to PCA's transfers to the treasury surpassing 3.5 percent of GDP. Such ceiling has been reduced to 2.5 percent of GDP for 2018 and 2019, and it will be further reduced to 2.25 percent of GDP after 2020. With the new rule, authorities expect inflows of funds into FAP over the next few years.

Legislative Agenda

The Administration remains heavily involved in efforts to have important bills approved by the National Assembly. Amongst the relevant

bills in parliament, the establishment of the Fiscal Council, an IMF longstanding recommendation, was approved during the last legislative period, while other important initiatives – namely, the adoption of sanctions to fraud against public administration, the criminalization of fiscal fraud, as well as the elimination of the statute-of-limitation on fiscal fraud and corruption – are in different stages of the legislative process. The proposed fintech legislation awaits initial discussion at committee level. The approval of the bill criminalizing fiscal fraud, to be discussed in the upcoming extraordinary legislative sessions, would not only fulfill one of the Financial Action Task Force of Latin America (GAFILAT) main recommendations highlighted in its latest report but reassert the country's commitment to abide to and support international rules and regulations on AML/CFT. The authorities' ability to garner broad political support is both challenging and crucial, especially as a window of opportunity opens with the extraordinary sessions in the last few weeks of the year.

Financial Sector

The banking system has remained stable, well capitalized, profitable and closely supervised. Financial indicators suggest a steady and robust position of the national banking sector. According to the latest banking activity report, the capital adequacy ratio (CAR) was slightly up at 16.0 percent compared to the statutory 8 percent; return on assets (ROA) remained at 1.5 percent; and return on equity (ROE) stood at 13.3 percent. Private sector credit expanded at 5.4 percent year-on-year in July, while personal consumption credit increased 8.9 percent, mostly in the form of housing mortgages, auto loans and credit cards. Non-performing loans (NPL) stood relatively flat at 1.7 percent and local deposits in the banking system increased 1.6 percent in August (yoy).

Panama has made important progress to improve supervision and transition to Basle III. Regulations on capital quality and risk-weighted assets and provisions for market and operational risks have been adopted. Accounting standards transition to IFRS9 has been completed, improving provisioning coverage. The Financial Coordination Council (CCF) has strengthened supervision coordination and the creation of a liquidity fund to reinforce the crisis management and resolution frameworks is being considered.

Transparency Policy and AML/CFT Regulations

Panama has completed in October 2017 the first automatic exchange of information with the United States under the agreement through the Foreign Account Tax Compliance Act (FATCA). It has since ratified the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC) and the Multilateral Competent Authority Agreement (MCAA). Panama was also found "largely compliant" with the Global Forum's exchange of information on request based on common reporting standards (CRS). In January, the country subscribed OECD's Base Erosion and Profit Shifting (BEPS) convention, which calls for exchange of information on rules against tax avoidance with over 70 participating countries. The authorities are aware of the need to upgrade its administrative and legal framework to comply with BEPS's four minimum standards, which are subject to peer monitoring and evaluation.

Under the new AML/CFT legislation, MEF's Intendance of Supervision (IS) oversees activities of designated non-financial business and professions (DNFBP). It enforces reporting requirements in five business sectors including: money transfer agents, casinos, law firms, real estate agents and the ZLC. In 2017, GAFILAT reviewed the effectiveness of the country's regulatory framework determining Panama's considerable progress in the implementation of the FATF 40 technical recommendations since the previous 2012 review. The authorities remain committed to further strengthening GAFILAT recommendations and the effectiveness of the AML/CFT framework.

The Fund's Fiscal Affairs Department (FAD) and Legal Department (LEG) have been fully engaged with Panama on targeted technical assistance in various areas during the term of the current administration. FAD has supported the revenues office (DGI) to strengthen automatic exchange of tax information, while LEG has provided over the past two years technical assistance to the IS, the Financial Intelligence Unit (FIU), the Superintendence of Markets (SMV) and the Superintendence of Insurance (SSRP) on AML/CFT regulations and supervision. LEG has also assisted the IS in enhancing its institutional capacity to deal with GAFILAT's reporting requirements and regulations. Such assistance has targeted strengthening the supervision framework on lawyers, notaries, real estate and construction sector, considered as high-risk areas. New sectors such as precious-metal dealers, armor-carriers and used-car dealers are in the technical assistance agenda for 2019. The authorities highly appreciate the Fund's continued technical assistance, which underlines its trusted engagement with Panama.

Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank staff for the reports and Mr. Tombini and Mr. Maciá for their helpful buff statement.

We welcome Panama's vibrant growth in recent years, which has led the country to exhibit the highest per-capita income in Latin America. Meanwhile, developments in the fiscal and financial areas provide additional signs of a stable economy. Admittedly, the current account deficit is relatively high, but most of it is being financed by foreign direct investment. Notwithstanding Panama's achievements, the report makes it clear that the country has some challenges to face, among which we would like to underline the relatively high inequality, and issues related to weaknesses in the AML/CFT framework and tax transparency.

Indeed, we note from the report that one of the most important risks Panama faces is related to the likelihood that some of the reforms foreseen on AML/CFT could be delayed or even some progress reversed. Lack of additional progress in AML/CFT is particularly important taking into account that, as noted in the staff report, it could entail reputational risks, which may lead to a reduction in access to external funding. In addition, some weaknesses spillover to other member countries, limiting their ability to pursue money laundering, tax evasion, and anti-corruption investigations. Box 2 highlights Panama's advances on technical compliance with FATF recommendations, although it also reveals low effectiveness. We commend staff for a high-quality SIP on Financial Integrity, which describes both progress and remaining challenges. In particular, we advise the authorities to make tax evasion a criminal offence and make tax crimes a predicate offence to money laundering, strengthen transparency to guarantee adequate beneficial ownership information, and increase information sharing with foreign counterparts. We are encouraged by the authorities' commitment to undertake the necessary changes, putting these issues as their top priorities, and by their recognition of the importance of the Fund's technical assistance in these areas.

Despite having increased over the past years, public debt ratios continue to exhibit a relatively low level. Clearly, as noted in the report, Panama's good track record on fiscal issues has been repeatedly rewarded by international capital markets. However, given the fact that fiscal policies constitute the principal anchor of the country's economy, the staff's call for a continuation of fiscal discipline is timely. We would like to have a further

elaboration on the staff's call for strengthening the recording of public investment in the fiscal accounts.

We are encouraged by the staff's assessment on Panama's financial system, noting that it remains profitable, well capitalized and relatively liquid. We welcome the alignment of prudential regulations with Basel III and agree that risk-based supervision of banks and non-banks should be prioritized, while the crisis management and resolution frameworks could be improved.

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

Mr. Meyer and Mr. Fragin submitted the following statement:

We thank staff for the insightful set of papers and Mr. Tombini and Mr. Maciá for their helpful buff statement.

We acknowledge Panama's economic success story, which has resulted in one of the highest per capita incomes in Latin America. Over the course of the last two decades, prudent policies and an ambitious reform agenda have yielded fruit. As staff adequately points out, the key challenge ahead will be to sustain the strong growth performance in the context of a more difficult external environment as well as elevated domestic risks. We broadly concur with the staff appraisal and would like to offer the following remarks:

We share staff's assessment of risks to the outlook and encourage the authorities to further strengthen AML/CFT oversight and tax transparency, not least with a view to implementing the remaining GAFILAT recommendations.

Vigilance also appears warranted in the context of potential over-supply in the real estate market and the presence of strong macro-financial linkages, as highlighted by staff. We therefore agree that the development of a macroprudential framework is essential to address these challenges and would welcome if staff could share its views on the suggested design and implementation of specific macroprudential instruments.

We commend the authorities for their commitment to fiscal discipline. In light of the cyclical downturn projected this year, we see merit in staff's (and the authorities') argument for a mildly expansionary fiscal stance in 2018. At the same time, as the economy strengthens, phasing out the stimulus will be warranted. More broadly, we second staff's call for rebalancing the budget

from current to capital spending in order to sustain Panama's strong growth performance, going forward.

As a precondition for effectively monitoring fiscal and financial sector developments, closing existing data gaps for the real estate market and for the recording of public investment, as well as further strengthening the independence and capacity of the National Institute of Statistics remains of the essence.

The report would have benefitted from a broader discussion of structural policies aiming at further bolstering growth prospects in the medium and longer term. While we take note that the current political context is challenging, we are somewhat surprised that the structural reform agenda – e.g. relating to enhancing productivity and reducing poverty – is missing in the section on policy discussions and finds only brief mentioning in the staff appraisal. Staff's comments would be welcome.

Finally, on a specific point, we would welcome if staff could provide further background on the mentioned large-scale mining project as well as on the related recent Supreme Court ruling.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed report and well written Selected Issues papers, and Mr. Tombini and Mr. Maciá for their informative buff statement. The Panamanian economy has shown stellar growth over recent decades, with a high level of integration into the international trade and finance network. This has contributed to a considerable improvement in socio-economic conditions, with declines in poverty and income inequality. However, growth has weakened recently mainly reflecting the slowdown of construction and tightening financial conditions. While inflation remains subdued, the fiscal position is strong. The current account deficit remains high, but most of it is being financed by FDIs. Economic fundamentals are strong and Panama has the potential to continue as a most dynamic economy in Latin America. The economy is expected to rebound in 2019 and the outlook remains positive. However, this needs careful implementation of policy measures in several areas highlighted in the staff report. We note that staff identifies heightened downside risks, which are largely external. We broadly concur with staff appraisal and would like to limit our remarks to following areas for emphasis.

Strengthening of AML/CFT framework seems a priority. This entails effective and expeditious implementation of remaining GAFILAT

recommendations, which will also help avoid reputational risks. Staff's advice on continued strengthening of supervisory capacity for AML/CFT oversight, enhancing the understanding of AML/CFT risks and addressing outstanding gaps in the legal framework in line with international standards are important to solidify Panama's position as a regional financial center. We note the ongoing actions to further enhance tax transparency which need continued strengthening as recommended in the informative SI paper. Staff report assesses that authorities are behind in implementing some minimum standards on Base Erosion and Profit Shifting (BEPS). Could staff comment on the authorities' plans to upgrade the administrative and legal framework to comply with BEPS's four minimum standards? Staff comments are also welcome on the measures to deal with the characterization of income for tax purposes amidst the spread of digital economy in Panama. We welcome the authorities' new automatic exchange of information standard i.e. the OECD's Common Reporting Standard, implemented since September 2018.

It is encouraging that Panama's financial system remains sound. The banking sector is well capitalized, profitable and closely supervised. However, we concur with staff on the need for further measures to improve the systemic oversight and regulatory system to build resilience. Hence, we welcome the authorities' intension to complete the alignment of prudential regulations for operational risk with Basel III in 2018. We also encourage the strengthening of the bank resolution framework with Fund's TA.

The external sector has been assessed as broadly consistent with fundamentals. However, we note that the REER assessment has been hampered by data issues and hence the REER may not accurately capture the movements in Panama's price competitiveness relative to its trading partners. Could staff comment?

Preserving the track record of fiscal discipline is important to further strengthen fiscal framework and keep public debt on a downward trajectory. We note the revisions to the Social and Fiscal Responsibility Law (SFRL) to simplify and improve the transparency of the fiscal rule, and the plans to reduce the deficit ceiling gradually to converge to 1.5 percent of GDP by 2022 to support public debt reduction. We also welcome the establishment of a Fiscal Council (FC) to promote accountability and fiscal policy debate in Panama. Could staff comment on the level of autonomy of FC on its mandates and the political commitment to the medium-term fiscal goal under the FC? We are supportive of staff's recommendations to improve tax and customs administration, review tax exemptions and rebalance expenditures from current to strategic public investments. Staff comments are welcome on the

allocation of resources to improve access to public services and social assistance programs.

Achieving buoyant growth needs continued improvement in productivity and competitiveness, as highlighted in the interesting SI paper. It is because the contribution from labor and capital could be moderate over the medium-term. Hence, we concur with staff's advice on the need for improving skills, training and education to reduce skills mis-matches in the labor market, attracting foreign talent to knowledge-based sectors, and continued improvement of investment climate. Improving education will also be supportive of Panamanian authorities' agenda on inclusive growth.

An evaluation on the impact of climate change in Panama could have been useful in identifying related risks. We are particularly interested in the potential impact of climate events, including drought-induced water shortages, floods, and destructive storms, on the ship traffic in Panama Canal, which is a key source of economic activity in the country. Could staff comment on the authorities' plans to deal with any climate change and extreme weather related events in Panama in the medium to long-run?

With these remarks, we wish Panamanian authorities all success in their future endeavors.

Mr. Razafindramanana and Mr. Lopes Varela submitted the following statement:

We thank staff for their well-written set of reports and Mr. Tombini and Mr. Maciá for their informative buff statement.

We commend the Panamanian authorities for continued high growth rate and solid fiscal position. These accomplishments are due to resolute policy measures they have implemented over the recent years to promote investment, revitalize services and banking sectors. Good macroeconomic performance has continued through 2018 in spite of the challenging international environment due to the rising of protectionism and tightening of financial conditions. In this context, we encourage the authorities to steadfastly pursue their reform efforts to strengthen the financial sector further, improve the fiscal framework, and implement much needed structural reforms to continue delivering a more robust and inclusive economic growth. We broadly share the staff's appraisal and advice and would wish to offer the following remarks for emphasis.

Additional efforts to address financial sector vulnerabilities will be essential to further enhance Panama‘s role as a regional financial hub. In this regard, we welcome the improvements made to align the AML/CFT framework and laws with international standards to address prevailing vulnerabilities in the system flagged in the evaluation to maintain credibility in Panama’s financial system. We also encourage the authorities to pursue measures that enhance the AML/CFT oversight further as well as transparency, including to adopt the draft bill on tax avoidance quickly. Efforts to raise tax transparency and information exchange, through the strengthening of the revenue administration with the technical assistance from the Fund are welcome. Also, increased implementation of tax transparency actions will be necessary ensure Panama remain compliant with Global Forum rules.

We welcome the resilience and soundness of the banking system. In this regard, a notable improvement has been made in banking supervision and the shift to Basel III. We also welcome the enactment of regulations on capital quality and risk-weighted assets and provisions for market and operational risks, as indicated by Mr. Tombini and Mr. Maciá in their buff statement. Furthermore, close monitoring of risks arising from a potential correction in property prices is warranted to mitigate its adverse spillover in the financial system.

On the publication of the financial stability report, could staff comment on why the authorities have not decided on this.

A stronger fiscal framework is necessary to foster budgetary discipline. We welcome the authorities’ continuous commitment to fiscal discipline, and we see merit on the amendments to the SFR to provide some fiscal stimulus to help sustain higher growth. Still, we concur on the need to continue preserving the hard-won gains from earlier fiscal reforms and agree that the fiscal stimulus should be temporary. We see merit in the submission of the fiscal council rule to the Assembly as it will be helpful in improving the overall fiscal framework efficiency and in satisfying public interest in policymaking.

Containing current expenditure and improving tax administration are essential to support investment and social agenda. While we agree with staff on the need to contain public wages and transfers, we also take note that pressures on wages arise from Education, Health and Security sectors. Would staff comment on measures the authorities could implement to control salaries and transfers without affecting allocations to the education and health services and possible rooms for cuts. Given that despite being the fastest growing

economy, Panama's tax revenue remains the lowest compared to its regional peers, we would have welcomed further staff analysis on this issue. Efforts to pursue reforms aimed at raising more tax revenues and strengthening tax administration to create additional space for the much-needed infrastructure and social spending will be needed to improve Panama's tax revenue. Moreover, the authorities should step their efforts to address capacity constraints, ad hoc exemptions, and tax incentives.

Finally, we welcome significant progress made in reducing poverty and inequality in recent years. Continued implementation of the structural reform agenda is the best path forward to attain these objectives and to pave the way for sustained and inclusive growth. As staff explains in the Selected Issues Paper, increasing competitiveness and productivity by investing further in education and health will support the authorities' efforts. We also encourage them to double their efforts to improve the business environment further.

Mr. Psalidopoulos and Ms. Cerami submitted the following statement:

We thank staff for the detailed and comprehensive set of reports and Mr. Tombini and Mr. Maciá for their informative buff. We broadly agree with staff analysis and recommendations, which rightly continue to prioritize further enhancements on AML/CFT and tax transparency to preserve Panama's position as a regional financial center and an attractive destination for business.

Panama has been among the most dynamic economies in the region for many years and is expected to continue to grow robustly in the medium-term, on the back of large infrastructure investments, the expected start of operation of a new copper mine, and continued expansion of activity related to the Canal and the Colon Free Trade Zone. However, the outlook remains vulnerable to reputational risks arising from possible setbacks in ongoing efforts to strengthen the AML/CFT framework and comply with international standards on tax transparency. We commend the authorities for the significant remedial measures recently taken on both fronts and welcome their commitment, reiterated in the buff, to comply with the remaining FATF recommendations and with Global Forum's standards. We particularly support staff's recommendations to expedite the approval of the criminalization of tax crimes, ensure the availability of beneficial ownership and accounting records of Panamanian entities, and comply with the minimum standards on Base Erosion and Profit Shifting.

We also commend the authorities for the positive track record on fiscal discipline, which has supported favorable bond placements in the international capital markets and the investment rating reaffirmed by the major agencies. The recent simplification of the fiscal rule, complemented by a new expenditure rule, within the amended Social and Fiscal Responsibility Law is expected to improve fiscal transparency and facilitate the gradual consolidation. Staff stresses the need to ensure adequate buffers to mitigate fiscal risks related to unfunded pension liabilities, which had already been flagged in the past. Could staff comment on the perspectives for reforming the pension system, along the parametric reform advocated in the 2016 report?

The financial system remains solid, but the recent deterioration in banks' asset quality, the continued oversupply in the domestic property markets, and the growing non-bank sector call for enhanced vigilance, a robust framework for crisis management and bank resolution, and a strengthened macroprudential framework to mitigate emerging systemic risks. We appreciated the analysis on the interconnections within Panama's regional banking and with foreign banks in the related Selected Issues Paper, which evidenced a broad resilience of the banking sector, although the significant exposures to foreign banks call for strong supervision and reinforce the case for the use of macroprudential policy.

Mr. Just and Mr. Stradal submitted the following statement:

We thank staff for their comprehensive set of papers and Messrs. Tombini and Maciá for their helpful statement. We particularly appreciated the extensive overview of financial integrity in one of the Selected Issues Papers. We welcome the sustained robust growth which significantly elevated the living standards in Panama. Continued productivity gains and addressing the remaining weaknesses in the AML/CFT and tax transparency frameworks are paramount in order to carry the strong growth momentum forward. We broadly concur with the staff assessment and offer the following comments.

We welcome Panama's progress in improving the AML/CFT and tax transparency frameworks. However, a number of outstanding recommendations remain to be addressed and expose Panama to reputational risks which threaten the external stability given the significant current account deficit financed by foreign direct investments. We are encouraged by the authorities' prioritization of this policy area and by the Fund's engagement through technical assistance. We underscore the criminalization of tax evasion and improved transparency of corporate vehicles as essential steps towards

mitigating the elevated money laundering risks. We also encourage the authorities to strengthen AML/CFT supervision through better coordination or consolidation of the involved supervisory agencies, including the AML/CFT data collection and consolidation.

We commend the authorities for their prudent fiscal policy stance which is the key macroeconomic stabilizer in the absence of an independent monetary policy. We welcome the recent simplification and increased transparency of the fiscal rule, as well as the legislative approval of an independent fiscal council, which will further strengthen the fiscal framework. Tax revenues are extremely low compared to Latin American, as well as similar income bracket peers. Strengthening the customs and tax administration capacities and improving its governance and controls, as well as enhancing the tax base by reducing the tax exemptions, is warranted.

We take positive note of the financial sector assessment with banks generally well capitalized, profitable and relatively liquid. The exposures to real estate developers, property markets and mortgages should be closely monitored to mitigate the risks of the property price cycle negatively affecting the banks' balance sheets. More severe stress testing of the banks' asset quality should also be considered. We join staff in encouraging the authorities to better coordinate the assessment of systemic risk among different supervisory agencies and the Ministry of Economy and Finance. We note that the authorities do not intend to introduce deposit insurance. What is staff's view?

Finally, we call on the authorities to urgently address the remaining weaknesses in data provision to bring their quality and timeliness to a level expected from a country which aspires to reach the high-income status.

Mr. Rashkovan, Mr. Tan, Ms. Harutyunyan, and Mr. Srisongkram, submitted the following joint statement:

We thank staff for the comprehensive report and Mr. Tombini and Mr. Maciá for their insightful buff statement. We broadly agree with the thrust of staff's appraisal and would like to make the following comments for emphasis.

We welcome Panama's long-lasting strong economic growth and favorable outlook. We take a positive note that the high growth in Panama has been accompanied by low public debt, subdued inflation and a sound financial sector, underpinned by prudent macroeconomic policies and dynamic

investment programs. Notwithstanding this, we note that the risks are on the downside going forward. In addition, we stress the importance of structural reforms to avoid the “middle-income trap”, and to promote inclusive growth over the long-term period. We also encourage the authorities to consider staff’s advice on strengthening social policies to further reduce poverty and income inequality.

A high standard of financial integrity will be vital in safeguarding Panama’s reputation as a reputable and attractive financial center. We commend the authorities for the significant efforts made in achieving high technical compliance with international AML/CFT standards as recognized in the GAFILAT’s latest assessment. As financial crime typologies and techniques become increasingly complex, further actions are needed to strengthen the effectiveness of Panama’s regime in detecting and deterring money laundering and other illicit activities as outlined in the report. To this end, we are pleased to note that many initiatives are well underway and the authorities are committed to implementing the remaining FATF and tax transparency recommendations in time for the upcoming reviews.

The authorities’ commitment to fiscal discipline and ongoing efforts to enhance the effectiveness and accountability of fiscal policy are welcomed. We commend the authorities’ long-standing commitment to fiscal discipline which has underpinned Panama’s strong fiscal position to date. While the higher deficit ceilings under the amended SFRL will provide needed room for additional stimulus to sustain growth momentum, we welcome the authorities’ intention for this increase to be attributed to capital spending. Looking ahead, we concur with staff that fiscal impulse should be gradually withdrawn as economic activity strengthens to maintain a fiscal consolidation path. In addition, we are encouraged by the buff statement that the bill to establish an independent fiscal council has been approved, paving the way towards a strong fiscal framework.

Systemic risk oversight and prudential regulations should be strengthened to increase resilience of the financial system. While we note that Panama’s banking sector remains sound and well capitalized, the recent deterioration in credit quality is indicative of emerging systemic risks and warrants close monitoring. In the absence of a central bank to act as a lender of last resort, we share staff’s view that it is critical for banks to maintain adequate buffers that are in line with Basel III capital and liquidity standards. On macroprudential oversight and policies, we would appreciate staff’s clarification on the enhanced role of the CCF in systemic risk assessment as proposed in the report. Going forward, we support the authorities’ plans to

create a regulatory sandbox to facilitate FinTech development and consider it as an important step to foster their understanding of new innovation directly from industry players.

With these comments, we wish the authorities every success in their endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports and Mr. Tombini and Mr. Maciá for their helpful buff statement. We are in broad agreement with staff's conclusions and policy recommendations and would limit our remarks to a few issues.

We welcome the continued strong performance of the Panamanian economy but note the challenge of sustaining high growth rates. In this connection, we welcome the analysis in the SIP on avoiding a middle-income trap and on graduating to high-income status. To this end, we agree with staff on the importance of sustaining productivity growth through comprehensive reforms, including improving education quality, attracting talent, and further enhancing the investment climate. Here, we would like to note that education reforms are one of the key priorities in the Government Strategic Plan (2015-19) and would welcome staff elaboration on the progress made, especially on narrowing skills gaps and facilitating the reallocation of labor following completion of large infrastructure projects. We would also welcome staff comments on the plan beyond 2019, especially on issues related to sustaining high growth rates over the medium term.

In light of the fully dollarized economy, we agree that fiscal policy remains the main macroeconomic stabilization tool. In this context, we welcome the authorities' continued prudent fiscal policy stance, which has helped in maintaining fiscal sustainability. This discipline needs to be maintained to keep the public debt ratio on a downward path. Considering the need to generate additional resources for important social objectives such as reducing high poverty levels, we encourage the authorities to step up their efforts to increase revenue collection, especially as tax revenue-to-GDP ratio remains among the lowest in the region and significantly below countries at similar income levels. To this end, the authorities should consider further strengthening revenue administration as well as implementing tax policy measures, especially those related to tax incentives and exemptions.

The authorities should sustain their efforts to further strengthen AML/CFT framework and enhance tax transparency to reinforce Panama's position as a regional financial center. Here, we take note of an important domestic risk identified in the Risk Assessment Matrix related to setbacks in strengthening AML/CFT or improving tax transparency. In this connection, we are reassured by the priority given to these issues by the authorities and their efforts to build on the recent favorable assessment by the FATF-style regional body for Latin America (GAFILAT) by addressing remaining gaps identified in the assessment. We encourage the authorities to continue their efforts to further enhance tax transparency and information exchange.

Finally, we welcome the steps taken in the transition to Basel III and encourage continued vigilance to help reinforce financial resilience. In this connection, we agree with staff on the need for strengthening risk-based supervision of both banks and non-banks, enhancing the role of the Financial Coordination Council in systemic risk assessment, and putting in place strong frameworks for crisis management and bank resolution.

With these remarks, we wish the authorities further success.

Mr. Ray and Mr. Kim submitted the following statement:

We thank staff for their report and Mr. Tombini and Mr. Maciá for their informative buff statement. While Panama's economic growth has slowed this year, this is forecast to be temporary and the rate of growth remains one of the strongest in the region. Public debt is sustainable. Furthermore, the authorities are actively improving the supervision of the banking sector. The key downside risk relates to whether the authorities can effectively implement recent AML/CFT regime changes. We broadly agree with staff's appraisal and add some comments and questions, particularly on Canal revenue, inclusive growth, and the quality of employment.

Given the importance of Canal revenues, we would encourage more analysis on the risks to the forecasts. Staff note that the recent decline in world trade volume is expected to have a negative impact on Canal revenues. But authorities commented that, in their view, there is no evidence of a slowdown in traffic through the Canal. Could staff provide more details on potential negative impacts on Panama's Canal revenue under the WEO scenarios for intensifying trade disputes? In addition, there may be value in investigating how climate change might affect precipitation and Panama Canal operations, similar to staff's analysis of the macroeconomic impact on small island countries. We would welcome staff's views on this issue.

While Panama's rapid growth is welcome, it is time to assess how it could be more inclusive. We appreciate staff's analysis on the relevance of the middle-income trap for Panama and the prospects for maintaining strong growth in the future in their SIPs. We note that Panama's poverty rate has declined remarkably by 10 percentage points over five years, as the unemployment rate has fallen mainly owing to infrastructure construction. Despite this welcome development, inequality remains high relative to regional peers in terms of the Gini coefficient. There would be value in studying how Panama's relatively rapid growth could contribute more to inclusive growth in comparison with other developing countries. We welcome a Selected Issues paper on this issue in the future.

We are aware that Panama's rapid growth has increased the amount of employment and the sectoral makeup of employment is changing. In the last year, employment declined by more than 10 percent in the agricultural sector. This may be affected by an increase in short-term employment associated with infrastructure construction, or it might reflect more fundamental changes in industrial structure associated with urbanization. What is the impact of the changes in employment structures and has the number of daily and temporary workers been increasing and the quality of employment deteriorating?

Mr. Virolainen and Mr. Vaikla submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Tombini and Mr. Maciá for their informative buff statement. We commend the authorities for the strong performance of the Panamanian economy in recent decades. Panama has shown a very strong increase in per capita income and the highest investment ratio in the continent, which has resulted in a significant convergence with advanced economies. While the economic outlook is still positive, growth has begun to slow, NPLs have started to rise and credit growth to weaken. As a trade oriented and a fully dollarized economy with a substantial financial sector, Panama is vulnerable to external risks, such as trade tensions and a tightening of global financial conditions. Furthermore, given Panama's role as a key regional financial and business services provider, financial integrity issues are of critical importance. We agree with the thrust of the staff appraisal and would like to limit our comments to the following points.

The exclusive role of fiscal policy as the main macroeconomic stabilization tool calls for strict fiscal discipline and strengthening of the fiscal framework. We commend the authorities for showing strong commitment to

fiscal discipline in past years. However, we take note of the rapid growth of current expenditures driven by a significant increase in public sector salaries. As the risks to the economy have increased, we urge to limit current expenditure growth, adhere to strict fiscal discipline and build up buffers to provide space for counter-cyclical policy when needed. We commend the authorities for the approval of the bill establishing an independent fiscal council. We concur with staff's advice to strengthen revenue administration, as Panama´s tax revenues are among the lowest in the region, and we also urge the authorities to reform the pension system to address large unfunded liabilities.

We call for further improvements to the oversight of the financial sector. It is encouraging that the financial sector remains sound as the banks are profitable, well capitalized and relatively liquid. We also welcome recent progress in transition to Basel III. However, we note that the weakening of credit growth and the increase of NPLs combined with the anticipated rise in interest rates weighing on property prices, could weaken banks´ balance sheets. In an adverse scenario, these developments could significantly hurt Panama´s sizeable financial sector, representing over 230 percent of GDP. Therefore, we agree with staff that the authorities need to strengthen the systemic risk oversight and put in place a solid framework for bank resolution.

We are pleased to note the high priority which the authorities have assigned to strengthening the AML/CFT framework and improving tax transparency. We note that since 2014 the technical compliance with the FATF recommendations has improved and the reporting of suspicious transactions has increased, while the effectiveness of the AML/CFT system still needs to be strengthened. We fully agree with staff that the authorities need to make tax avoidance a criminal offense and to upgrade the legal framework to comply with BEPS's minimum standards. We also note that despite efforts to improve tax transparency, Panama´s framework for information exchange and its implementation is still considered not to be "compliant" with standards set by the Global Forum. We therefore encourage the authorities to implement required initiatives to successfully meet the Global Forum ´s assessment.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for a set of insightful papers and Mr. Tombini and Mr. Macia for their helpful buff statement. We broadly agree with staff's appraisal and would like to highlight the following points.

Panama's economic performance remains strong. Despite slowing in 2018, the growth rates have been among the highest in the region, at around 6.5 percent over the last decade. Inflation remains under control. The current account deficit has stabilized, and it is largely financed by stable FDI inflows. The fiscal position has continued to improve, supported by higher revenues from the expanded Panama Canal. At the same time, Panama's highly open and fully dollarized economy is exposed to both external and internal downside risks, outlined by staff in the Risk Assessment Matrix (RAM). Escalating trade tensions, the U.S. dollar appreciation, and concerns about the country's financial integrity are among the key risks to the growth outlook. In this context, we welcome the authorities' efforts aimed at strengthening the fiscal framework, as well as increasing transparency of Panama's financial system, and its resilience to shocks.

Maintaining Panama's competitiveness as a regional financial center remains the authorities' key priority. While the recent efforts in enhancing technical compliance with the FATF's standards are commendable, it is paramount to further improve the effectiveness of the AML/CFT framework. The SIP Chapter "Financial Integrity in Panama" provides a very useful analysis of the country's vulnerabilities to ML/FT risks and offers a set of policy recommendations in this area. We welcome the focus on enhancing transparency of corporate vehicles, clarifying the role of resident agents, and reinforcing the fight against money laundering. The SIP chapter appropriately emphasizes that financial integrity includes many aspects, not just the AML/CFT issues. Accordingly, we agree with staff that the authorities need to fight tax evasion and foster tax transparency initiatives towards a successful Global Forum's assessment.

Over the recent years, the authorities have made important progress in strengthening public finances. Fiscal policy has been anchored on the Social and Fiscal Responsibility Law (SFRL), which allowed to reduce fiscal deficit to 1.6 percent of GDP in 2017. According to staff, public debt is sustainable and is projected to gradually decline from 38.5 percent of GDP in 2017 to about 33 percent of GDP over the medium term. The recent modification of the SFRL provides additional fiscal space that the authorities intend to use in 2018-19 to address the transitory weakening of economic activity. While the short-term fiscal impulse seems to be appropriate under the current circumstances, we encourage the authorities to preserve fiscal prudence going forward and advance their efforts in addressing fiscal risks related to contingent and unfunded pension liabilities. Could staff elaborate on the weaknesses in public debt data that require particular attention? Are the authorities considering any parametric pension reforms?

At the same time, the existing fiscal framework has a number of shortcomings and should be further strengthened. The fiscal adjustment over the recent years has been achieved mostly by lower capital expenditures, while current expenditures have increased, and tax revenues remain among the lowest in the region. In this context, we welcome the adoption of the expenditure rule under the modified SFRL and support staff's recommendations to establish an independent fiscal council, improve revenue administration, and implement other measures to further strengthen fiscal policy framework.

Panama‘s banking system remains well-capitalized and resilient to shocks, but further strengthening of supervision and risk monitoring would be advisable in the context of tightening global financial conditions. The recent deterioration in asset quality and the oversupply in property markets pose macro-financial risks to financial stability and the real sector. Addressing data gaps associated with household and corporate balance sheet is a priority. The authorities should develop an institutional framework for macroprudential policy with an adequate toolkit. We also encourage the authorities to create a facility for providing temporary liquidity to banks, introduce a deposit insurance scheme, and put in place a bank resolution framework.

As contributions from labor and capital accumulation are expected to decelerate, Panama's prospects of maintaining high growth rates will increasingly depend on improvements in productivity and human capital. The authorities are well advised to further improve education, address skill mismatches, support knowledge-based economic sectors, and strengthen the business environment. In this context, we would appreciate staff's additional elaborations on the preferred sequencing of structural reforms in Panama.

Mr. Inderbinen and Mr. Danenov submitted the following statement:

We thank staff for the insightful set of papers and Mr. Tombini and Mr. Maciá for their helpful buff statement. We welcome Panama's dynamic economic growth over the last quarter of a century, which has led to one of the highest per-capita incomes in Latin America. Growth is set to continue in the medium term; and, as staff maintain, the immediate challenge is to sustain performance in the context of rising protectionism and tightening financial conditions, as well as the late phase in the political cycle. We encourage the authorities to improve the fiscal framework, strengthen the AML/CFT regime, and implement structural reforms to ensure more inclusive economic growth.

We broadly agree with the staff assessment and have the following comments for emphasis.

Continued efforts are required to strengthen transparency and financial integrity. We thank staff for the comprehensive coverage of integrity issues in the report and the Selected Issues. We welcome the authorities' commitment to further improve the AML/CFT regime, as stated in the buff. We also take good note of the progress to date toward meeting the FATF standard. Going forward, we encourage the authorities to undertake what is necessary to close the remaining gaps in the legal framework, including the transparency of corporate vehicles and the criminalization of predicate tax offenses, in as timely a manner as possible. We note the challenges of ensuring effective oversight of the non-financial businesses and professions sector. Given the large number of corporate entities, as well as the multitude of lawyers and service providers, staff in the SIP recommend developing risk-based tools to prioritize efforts. Could staff specify what will be required of the Intendance of Supervision to effectively fulfill its new mandate of overseeing the DNFBPs?

We commend the authorities' commitment to fiscal discipline. The new expenditure rule and the recent simplification of the fiscal rule in the recently amended Social and Fiscal Responsibility Law will be beneficial both to fiscal transparency and consolidation. We note staff's recommendation to establish a link between the deficit path and a debt target under the rule. Given the absence of monetary policy, would a fiscal rule that balances the budget over the cycle, and hence allows automatic stabilizers to play, be an option in staff's opinion?

We welcome the stability of the financial system. The banking sector is well capitalized, profitable and liquid. However, we concur with staff on the need to further improve prudential regulation and oversight. The lack of a lender of last resort puts a premium on heightened capital and liquidity requirements. In this regard we are encouraged by the authorities' intention to complete the alignment of prudential regulations with Basel III. Also, we take good note of the authorities' doubts about a funded deposit insurance scheme due to moral hazard concerns. Have the authorities considered an ex post funding scheme that – while no longer in accordance with the IADI Core Principles – would recover deposit insurance obligations from the banking system following the failure of an institution?

Mr. Guerra and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for its set of reports and Mr. Tombini and Mr. Macia for their informative buff statement. With the fastest economic growth in Latin America in the last decades, Panama's ambitious stabilization and reform agenda with high capital investment, dynamic financial sector, booming service sector and significant increases in productivity at its core has proven to be a successful one. Per capita income has tripled and is close to move from the middle to the high-income bracket, and poverty has decreased. Inflation remains subdued and the authorities are demonstrating strong commitment to fiscal discipline. We broadly share the thrust of the staff's appraisal and will limit our comments to a few topics.

The authorities need to continue strengthening the fiscal policy framework. We commend the authorities for their efforts to maintain fiscal discipline, being one of the main instruments to preserve macro financial stability in a dollarized country. Additional work to improve tax administration is warranted; during last Art. IV, staff informed the authorities' plans to introduce electronic invoicing and modernize IT systems with this purpose. Has there been any progress in the implementation of these measures? Are there any plans to streamline tax incentives and exemptions? As staff is repeating the same recommendations that in the last Art. IV for customs' administration, we wonder if there are any improvements towards defining an action plan to address the shortcomings identified.

The amendments to the SFRL recently approved by the National Assembly will help to simplify and improve the transparency of the fiscal rule, to contain the growth in current primary spending and to maintain fiscal discipline. However, it is not clear how the fiscal targets set in the law link to the expenditures being excluded from the NFPS accounts, such as the ACP, the Tocumen International Airport, the Electricity Distribution Company and the National Highway; in addition, the recording of public investment is not made on accrual basis. All this complicates to measure the actual stance of fiscal policy. We would like to hear from staff if there is any progress in the compilation and dissemination of timely information on these entities, the liabilities of the turnkey projects and the contingent liabilities of state-owned enterprises. Do the authorities have future plans to move to an accrued basis recording of public investment?

The authorities have made significant progress to enhance financial integrity and tax transparency. Panama was assessed to be largely compliant on the technical elements of the FATF standard; however, challenges remain

regarding the effectiveness of the AML/CFT framework. We commend the authorities for the preparation of an Action Plan to address the shortcomings, with close monitoring from GAFILAT, and encourage them to promptly implement the staff's recommendations outlined in paragraphs 14 and 15 of the report.

The financial sector remains solid and liquid and Basel III regulation has been mostly implemented. We consider three elements are needed to complement this progress to enhance financial sector resilience: i) strengthen systemic risk monitoring and macroprudential policies. There were many recommendations in the 2017 Art. IV to enhance the institutional framework for macroprudential policy and systemic risk monitoring. Staff comments on the stance of the implementation of these recommendations are welcome; ii) elaborate crisis management plans and strengthen the bank resolution framework to reinforce the financial safety net in Panama. Crisis preparedness plans must come from both the banks identified as systemic and the authorities. Is there any roadmap and timeline for the elaboration of these plans? Relative to the bank resolution framework it is encouraging to hear a draft law is under consideration. Is there a timeline for its approval? iii) enhance consolidated financial supervision. The financial sector supervisory framework currently in place poses challenges for consolidated supervision and systemic risk monitoring, even though coordination among the different supervisory bodies has improved. Staff has recommended moving towards a more centralized supervisory structure over the medium term. Are the authorities given any consideration to this?

With these comments, we wish the authorities success in their future endeavors.

Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for their insightful set of papers, as well as Mr. Tombini and Mr. Maciá for their helpful buff statement. We welcome the impressive growth performance of Panama, characterized by the highest per capita income in Latin America. However, inclusive growth remains a challenge in view of the elevated level of income inequalities. Moreover, the country remains highly exposed to international trade through the canal revenues and thus to inward-looking policies. While some progress has been made to enhance the AML/CFT framework, Panama could be put on the grey list of the FATF and financial transparency and fiscal cooperation remain to be strongly enhanced. We therefore encourage the authorities to further their

efforts to that effect. We agree with staff's appraisal and would like to add the following comments:

Outlook and Risks

Panama is projected to perform well in the coming years, but the implementation of inward looking policies could weigh on the economy. Indeed, GDP growth should remain dynamic with the trade channel activity, the beginning of the production of the new copper mine and the financial activity. While the current account deficit is relatively elevated (8 percent of GDP in 2017, 9 percent expected in 2018), it is essentially financed by FDI and staff assesses the external position as broadly consistent with fundamentals and desired policy settings. Nonetheless, we concur with staff that protectionism and tighter credit are the most important ones (with a high likelihood and a high impact according to the RAM). Moreover, the correction in property markets is seen as a medium risk which could affect financial stability: even if credit growth has decelerated, mortgage and construction represent 44 percent of total credit to the private sector. Could staff give a quantitative assessment of the impact of a sharp price decrease both on GDP and banking sector?

Fiscal Stance

The authorities have maintained fiscal discipline over the past years, even in a context of negative output gap. We concur with staff that a mildly expansionary stand was appropriate in 2017 and encourage them to optimize tax revenues to address the significant social needs going forward. Tax revenue and social security contributions levels are low in Panama and remain under the Latin America average. The fiscal space generated by this improvement should help to increase spending towards social fields, as public investment is planned to pick-up after five years of subsequent decline. Could staff explain the significant drop and volatility in public investment since 2015? On the legislative aspects, we welcome the amendments to the Social and Fiscal Responsibility Law which helps to simplify the fiscal rules and the new rules of the sovereign fund SAP which should help to increase the public resources from the Panama Canal Authority.

Financial Sector

We commend Panama progress on the Banking sector as supervision improved and transition to Basel III is on the way. However, progress on financial transparency, integrity and fiscal cooperation remains a top priority

as this factor is essential to better assess risks and to fight against tax evasion. We thank staff for the attention paid to this major issue, notably in the dedicated selected issues paper, since the materialization of the reputational risks, notably if Panama was to be put on the FATF grey list, could strongly and negatively affect investment and increase significantly borrowing costs. Reforms to further strengthen the AML/CFT framework and ensure a more effective implementation should therefore stand high on the authorities' agenda. As a matter of priority, we strongly encourage the authorities to adopt the draft legislation to criminalize tax fraud before the end of the year in order to comply with FATF requirements. We thank staff for the technical assistance aiming at accompanying Panama's efforts to enhance financial transparency and encourage further work to fill the remaining data gaps.

Could staff provide some assessment about the development of crypto-currencies/FinTech in Panama banking sector and would it be possible to have a focus on this topic in the next Article IV?

Structural Reforms

More details about structural policies would have been welcome. The country is characterized by a strong services sector with few high skill workers and less productive sectors (agriculture, manufacturing) with many but low skilled workers, especially in the informal sector. Consequently, reforms in the education field to improve skills and to further improve the business climate are welcome, notably to tackle informality. The dedicated selected issues paper insists on the necessity to improve productivity gains to move towards the club of high income economies, and to avoid the middle-income trap. Could staff elaborate in more detail on the necessary policies to improve productivity, competitiveness and education?

Mr. Jin and Ms. Ma submitted the following statement:

We thank staff for the informative set of papers and Mr. Tombini and Mr. Maciá for their helpful buff statement. We welcome the sustained and rapid growth in Panama in the past decades. We broadly share staff's assessment and would focus our comments on the following.

The AML/CFT framework and tax transparency should be strengthened to maintain Panama's position as a regional financial center. Possible setbacks in ongoing efforts to comply with international standards on AML/CFT and tax transparency remain one of the major domestic risks that could bring about reputational risks and reduce external funding. We therefore

encourage the authorities to remain steadfast in enhancing financial integrity in line with international standards, in particular where entities were not properly supervised in the past. It is also important to further improve tax transparency and information sharing by advancing the relevant initiatives such as the Base Erosion and Profit Shifting (BEPS).

The authorities' commitment to fiscal prudence is commendable. With a fully dollarized economy and no central bank, fiscal policy remains the main macroeconomic tool. The authorities' continued fiscal discipline and improvements of the fiscal rule would help strengthen the transparency and operationality of the fiscal framework and keep the public debt sustainable. We note from the text figure on Page 5 that fiscal policy has largely been procyclical since 2012. Could staff share more background information and their appraisal? Further progress is warranted in revenue administration given the underperformance in tax collection compared to Panama's regional peers.

Continued vigilance is warranted to safeguard financial resilience. We are encouraged that the banking system remains profitable, well capitalized, and relatively liquid. However, due to a relative oversupply in property markets and other factors, NPLs have been on the rise, which deserve close monitoring. While noting from the text figure on Page 17 that NPL provision is much lower in Panama compared to its regional peers, we wonder on what ground staff assess that "NPLs appear adequately provisioned"? We encourage the authorities to address data gaps on housing prices as well as household and corporate indebtedness to enable a complete assessment of macro-financial vulnerabilities. Given the absence of a central bank, we support staff's recommendation of strengthening coordination on systemic risk oversight.

We appreciate staff's in-depth analysis in the Selected Issues Paper of Panama's growth patterns, in which staff point out that continued buoyant growth critically depends on comprehensive growth-enhancing structural reforms. Could staff elaborate on their discussions with the authorities on structural reforms and why these discussions are missing in the 2017 and 2018 Article IV reports?

With these remarks, we wish the authorities every success in their policy endeavors.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

Panama continues to maintain a sound macroeconomic framework as demonstrated by its long period of strong growth. Still, Panama risks its position as a financial and services hub for the region unless the authorities more forcefully address AML/CFT and transparency issues. We agree with Fund staff's emphasis on financial integrity and the fiscal framework and broadly agree with staff's appraisal. At the same time, we felt that the Article IV was overly-focused on giving credit to Panama's technical compliance on AML/CFT standards, rather than on overall effectiveness.

Panama's AML/CFT evaluation by GAFILAT published in January 2018 was less than favorable. While Panama fared well on the technical compliance ratings, the focus of the FATF in this round of assessment is on effectiveness—assessing whether the legal and institutional AML/CFT framework is achieving effective results. In these cases, Panama received several sub-par ratings, with 9 out of 11 factors rated low or moderate. In this context, the report appears to over simplify technical compliance to progress on AML/CFT standards, stating that the GAFILAT report and the positive technical compliance results confirms [Panama's] "significant progress toward compliance with AML/CFT standards." However, we would note that both technical compliance measures and effective implementation of those measures better represents how successful a country is implementing a strong AML/CFT system.

Still, we agree with Fund staff's clear message to Panamanian authorities to continue prioritizing effective implementation of the AML/CFT framework. In addition to approving the draft legislation to criminalize tax crimes so that Panama can support international requests involving tax offenses, we would also emphasize that the authorities should demonstrate their ability to investigate and prosecute complex money laundering cases and to prevent the misuse of entities incorporated in Panama for criminal purposes.

In a dollarized economy, fiscal policy is Panama's main policy tool. We are supportive of the recent amendments to the fiscal responsibility law to simplify the rule and agree that a fiscal council should be established. While authorities have maintained fiscal discipline, we see scope for authorities to improve the quality of fiscal accounts. Improving tax revenue collection would help support public capital expenditure, which is being crowded out by rapidly growing current expenditures.

2018 budget deficit figures have been deteriorating with the slowdown in economic activity this year. Even with the amendments to raise the deficit ceiling to 2 percent of GDP this year, will authorities be able to meet the ceiling this year? What correction mechanisms are outlined in the fiscal responsibility law if the ceiling is breached?

The Acting Chair (Mr. Furusawa) noted that Panama continued to be one of the most dynamic economies in the region, with high growth rates and solid macroeconomic fundamentals, and the outlook was positive. Gray statements highlighted that the most pressing challenge was to address the weaknesses in the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework and tax transparency to reinforce Panama's position as a regional financial center. Strengthening systemic financial risk oversight and prudential regulations would also be needed. On the fiscal side, the authorities had done well and should continue to maintain discipline while creating space for investment and social spending. Gray statements also highlighted the importance of continued efforts to improve productivity and competitiveness to support strong and inclusive growth.

Mr. Tombini made the following statement:

I thank Directors for the opening remarks, which are very supportive of this Article IV consultation.

At this juncture, I just wanted to make a brief intervention to talk about one of the issues that was addressed in the staff update. This has to do with budget execution and the fiscal deficit at the end of this year. I wanted to make two remarks.

First, the authorities have restated their commitment to keep the public deficit within the established 2 percent of GDP ceiling by the end of the year. The track record of the Panamanian authorities is convincing in this respect, as they have consistently closed their fiscal figures at the end of the year under the ceiling established by the Social and Fiscal Responsibility Law.

Second, the payment of dividends to the National Treasury from different companies—most notably, the Panama Canal—is concentrated in the fourth quarter. This point has also been made by the staff in their responses to the Directors' questions. In addition to the canal, other state-owned enterprises (SOEs), for instance, the public savings banks, the national lottery, the Colón Free Zone, among many others, also follow this pattern of concentration of dividends being paid to the Treasury in the fourth quarter. We are still waiting for the numbers, but this gives assurances that they have

the instruments to meet their fiscal target of 2 percent of GDP for the year. In this respect, we are confident that the authorities will deliver on this once again.

Mr. Meyer made the following statement:

I thank the staff for a well-written set of reports, as well as for the good and comprehensive answers to technical questions. I also thank Mr. Tombini and Mr. Maciá for their helpful buff statement and for the comments.

Panama's economic success story since the 1990s is truly impressive. Prudent policies and an ambitious reform agenda have resulted in a tripling of per capita income and a significant reduction in poverty. The key challenge ahead will be to sustain the strong growth performance in the context of a more difficult external environment, as well as elevated domestic risks.

As also being highlighted by the staff and other Directors, strengthening AML/CFT oversight and tax transparency needs to remain a key policy priority for the short and medium term. Vigilance also appears warranted in the context of potential oversupply in the real estate market and the presence of strong macro-financial linkages. Furthermore, we thank the staff for the circulated update on the recent developments and take note of the increased spending in the first three-quarters of 2018. We, therefore, concur with the staff that the authorities need to adjust spending in the last quarter of 2018 and ensure compliance with the modified fiscal responsibility law.

I take good note of Mr. Tombini's comments. It would be important to convey to the authorities the importance of achieving the compliance with the responsibility law. With this, I wish the authorities all the best.

Mr. Anwar made the following statement:

We thank staff for the comprehensive report and Mr. Tombini and Mr. Maciá for their insightful buff statement. We have issued a gray statement, where we broadly agree with the thrust of the staff appraisal.

We commend Panama's sustained solid macroeconomic performance that has contributed to an improvement in socioeconomic conditions.

Over the past decade, Panama has been one of the most impressive and dynamic growing economies in the world. Panama has made significant

progress in reducing poverty in recent years. Economic growth and public transfers have helped reduce poverty substantially.

We share the sentiment with the Directors who raised question No. 7 in staff's written responses to technical questions and would like to elaborate a bit.

According to the OECD, despite economic growth in traditional economic activities, such as the Panama Canal, financial trade, and the construction sector, these activities are increasingly limited and are unable to be sustained on their own.

The economic model based on physical investment begins to show levels of depletion and deterioration. The study showed the exhaustion of the growth model based on physical investment and the need to seek a new growth engine capable of compensating the social structure that already exhibits a strong level of fragmentation and that simultaneously has the capacity to overcome its own vulnerabilities.

We would appreciate the staff's comments on the potential sectors in addition to the traditional economic activities that could be developed as alternative growth drivers for the economy going forward.

With these comments, we wish the authorities success in their future endeavors.

Mr. Castets made the following statement:

I thank staff for the very valuable set of reports and Mr. Tombini and Mr. Maciá for their helpful buff statement.

We issued a gray statement. I just would like to insist on two points this morning.

First, I have general comments on the growth levels that have been sustained in Panama over the recent years, allowing for a reduction of poverty. Nonetheless, as also recalled this morning, in view of the trade openness and reliance on the proceeds of the Panama Canal, as well as the absence of an independent monetary policy in Panama, we see increasing external tensions, notably trade tensions, as a risk for the country.

Second, like Mr. Meyer, we also would like to insist on the need to progress on both financial integrity and tax cooperation. While we thank the staff for the selected issues paper dedicated to financial integrity, which was very informative, we would like to strongly emphasize the need for further progress, notably to avoid Panama being put on the Financial Action Task Force (FATF) gray list in the upcoming FATF plenary session in February. The materialization of this reputational risk could significantly weigh on borrowing costs and on investment. We see that as a risk for the economy as a whole. In this regard, we would like to strongly support the point made by Ms. Pollard regarding not only upgrading the regulatory framework but also the effectiveness of the implementation of this framework.

We also would like to share the point made by Mr. Lopetegui regarding the spillovers of not effectively implementing this framework, as regards the ability of other countries to tackle tax evasion and also to ensure financial integrity. Moreover, obtaining a deeper understanding of the development of fintech, with regard to the financial integrity issue, seems particularly relevant for Panama, considering the weight of the financial sector. We welcome the planned technical assistance (TA) from the Fund in this field to help the authorities to fill the remaining data gaps.

Mr. Razafindramanana made the following statement: [

We thank staff for the full set of reports and Mr. Tombini and Mr. Maciá for their enlightening buff statement. We have issued a gray statement and would like to underscore a few points.

First, we join other colleagues in commending the Panamanian authorities for their continued high growth rate and stable fiscal position.

Second, we welcome the improvements made to align the AML/CFT framework and laws with international standards.

Third, as noted by Mr. Gokarn and other Directors, maintaining fiscal discipline is essential to strengthen the fiscal framework further and keep public debt on a sustainable path.

Finally, we agree on the need to advance the structural reform agenda further to support the efforts made in reducing poverty and inequality in recent years to achieve sustained and inclusive growth.

Mr. Haydon echoed the calls from Mr. Meyer and Mr. Castets for further progress on financial integrity and tax transparency. He welcomed the staff‘s focus on those issues in the report, including in the selected issues paper. He welcomed that the staff had recognized that it was crucial to maintain progress on those points in order to sustain Panama’s recent economic gains. He noted that Panama’s case demonstrated how governance issues were not marginal but could be critical to overall economic development and progress.

The staff representative from the Western Hemisphere Department (Mr. Santos), in response to questions and comments from Executive Directors, made the following statement:[1]

As mentioned by several Directors, we issued a statement underlining some of the recent developments. We also issued corrections to the report, mostly to acknowledge the fact that the National Assembly has approved legislation for the creation of the fiscal council and also to correct some typos on a few tables. We also provided answers to all the interesting questions posed by Directors.

I would like to stress three points that have already been included in the report.

As mentioned by some Directors, Panama has been the fastest-growing economy in Latin America in the last quarter of a century. It is really a global event because it has been the fastest-growing economy in the world in the last quarter of a century at that economy’s level of per capita income. In doing that, Panama has achieved the highest per capita income in Latin America in purchasing power parity (PPP) terms, with per capita income close to US$27,000. It has, by far, the highest investment rate in Latin America, with over 40 percent.

On fiscal policy, I have three main points. The first point is that it is the only tool for macroeconomic stabilization. There is no monetary policy because they use the U.S. dollar as their currency. The authorities have decided not to actively use macroprudential policies. In that regard, the approval of the fiscal council is important because that will strengthen the framework of fiscal policy in Panama. I would also note the modification of the fiscal responsibility law, which will simplify the law. In the past, there was a relatively complicated rule that was difficult for most market participants to

[1] Prior to the Board meeting, SEC circulated the staff’s additional responses by email. For information, these are included in an annex to these minutes.

understand. Now it is a simple rule. It is just a limit on the deficit of the non-financial public sector. In doing so, the authorities have also provided some room for having a more supportive fiscal policy, given the weakening of the economy in 2018.

As several Directors have pointed out, financial integrity is one of the most important policy issues in Panama simply because, by having a dollarized economy, the only way by which credit is created is from having healthy correspondent banking relations (CBRs) with other banks. Consequently, it is important that Panama does not fall into a gray list.

However, having been there on mission, we sensed the determination of the authorities and civil society to overcome all these problems and to move forward with this agenda. It is encouraging that there is a draft law in the National Assembly, with the criminalization of tax evasion, which is an important point for the Financial Action Task Force (FATF) meeting that will take place in 2019.

Mr. Tombini made the following concluding statement:

On behalf of my authorities, I would like to express our gratitude for the open dialogue with the authorities. I also would like to welcome the new mission chief, Mr. Santos, and his team for the important work done in this consultation. I take this opportunity also to thank Ms. Cerra, the former mission chief, and wish her success going forward.

I thank the staff for answering the Directors' questions and I thank Directors for their statements and their oral interventions, and for their thoughtful comments and candid policy recommendations. Their comments will be faithfully transmitted to the authorities in Panama City.

Panama has shown continued good economic performance over several decades and prospects for the medium term remain robust. This is a small open economy that has evolved, combining specialization in service niches while diversifying into new growth opportunities. Despite the slight economic slowdown in 2018 in the face of the construction sector strike, economic activity is expected to surge to above 6 percent in 2019 and to sustain its dynamism going forward.

With the strong support of a large public infrastructure program, the authorities also foresee continued strong FDI inflows, the beginning of copper

exports, and increasing cargo and vessels transits through the new canal facilities that will all contribute to the overall growth prospects in Panama.

The country is also working to expand new international partnerships and enhance its role as a regional logistics and service provider hub. In this respect, a free trade agreement with China is in progress and potential investment opportunities are promising. Panama also signed the South Korea-Central America Free Trade Agreement last February. In addition, during the Global Forum for Latin America and the United Arab Emirates, Panama signed with Dubai an agreement to seek bilateral commercial opportunities and investments.

I want to reassure Directors that strengthening the AML/CFT supervision and regulatory framework is a cornerstone of Panama's development strategy. The authorities want to keep consolidating this identity as a services hub, so this is critical for them. In this respect, I wanted to thank the Fund for its continued support, and particularly the Legal Department (LEG), to strengthen this area of the regulatory dimension in Panama.

The last Financial Action Task Force on Latin America (GAFILAT) report on the 40 recommendations from the FATF praised Panama's substantial progress on this front. The authorities, however, recognize that more needs to be done and have continuously expressed their determination, as was mentioned by Mr. Santos, to enhance the effectiveness of the AML/CFT framework and reinforce risk-based tools for better oversight of the so-called designated non-financial subjects. In the same vein, the authorities have been working with the National Assembly to approve the law criminalizing tax evasion.

The Acting Chair (Mr. Furusawa) noted that Panama is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended Panama's impressive growth performance and noted that macroeconomic fundamentals remain solid, with growth set for a rebound in the near term. Directors considered that, while the outlook remains positive, the balance of risks is tilted to the downside. Against this background, they called for sustained policy efforts to strengthen the AML/CFT framework and enhance tax transparency to preserve Panama's competitive advantage as a regional financial center. They also recommended measures to enhance

financial sector resilience and reforms to facilitate continued robust and inclusive growth.

Directors welcomed the recent good progress on technical compliance with FATF standards, bringing Panama on par with its peers, while underscoring the importance of effective implementation of the AML/CFT framework. In this context, they encouraged the authorities to continue strengthening supervisory capacity for AML/CFT oversight, including through risk–based approaches, and further addressing AML/CFT risks to which Panama is exposed. Directors emphasized the need to promptly address the remaining shortcomings in the AML/CFT framework, including making tax crimes a predicate offense to money laundering and ensuring the availability of timely and accurate beneficial ownership information of entities incorporated in Panama. In addition, the authorities should advance the implementation of tax transparency initiatives to ensure a successful Global Forum assessment against enhanced standards.

Directors were encouraged by the authorities' continued commitment to a prudent fiscal stance and agreed on the importance of preserving the track record of fiscal discipline to keep the public debt-to-GDP ratio on a downward trajectory. They concurred that the revised deficit ceilings provide the budgetary space to accommodate additional capital spending, given the softening activity this year, but recommended a gradual withdrawal of the stimulus in the near term as growth gathers pace. Directors also saw scope for raising tax revenue through improvements in revenue administration to support key social expenditures. They welcomed modifications to the social fiscal responsibility law, which simplified and enhanced the transparency of the fiscal rule; and noted the approval of a law to establish a fiscal council, which further bolsters the fiscal framework.

Directors noted the stability of the financial system and the continued progress in financial sector reforms, including the alignment of prudential regulations with Basel III. They urged the authorities to strengthen risk-based supervision and reiterated the importance of putting in place robust frameworks for crisis management and bank resolution. In addition, Directors recommended measures to further strengthen macro-prudential policies and systemic risk oversight, including through improved inter-agency coordination.

Directors called for a reinforcement of the structural reform agenda to sustain high potential growth, while also reducing inequality. They agreed on the need to sustain productivity growth through reforms to improve skills and

education quality, attract talent, and further improve the investment climate. Strengthening social policies to continue reducing poverty, improve income distribution, and ensure inclusive growth over the medium-term were also encouraged.

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

APPROVAL: April 9, 2020

JIANHAI LIN
Secretary

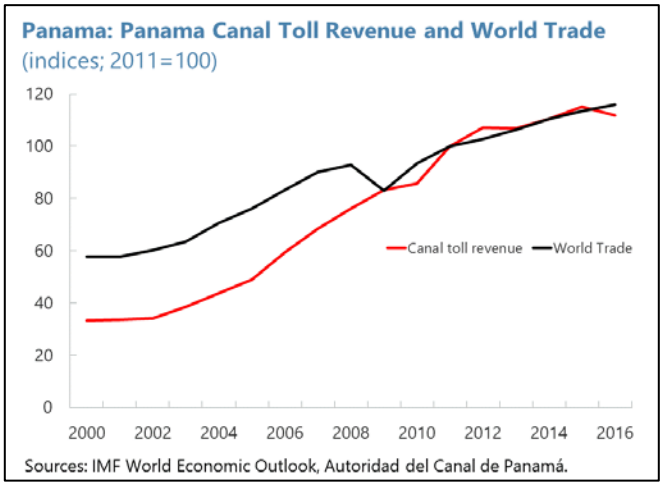
Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Could staff provide more details on potential negative impacts on Panama's Canal revenue under the WEO scenarios for intensifying trade disputes?***

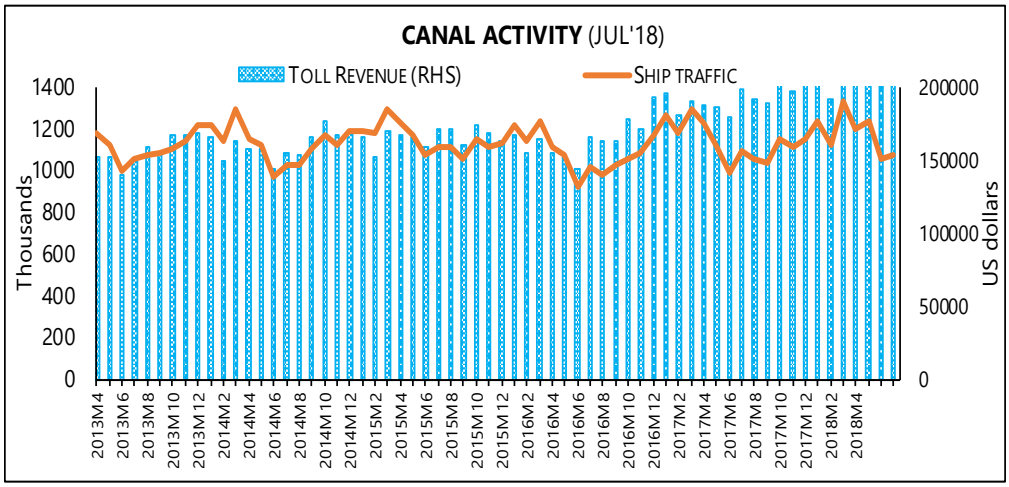
- Panama Canal revenue is sensitive to world trade. Ships transiting the Panama Canal pay a toll fee, depending on the market segment. Besides, canal revenue is also sensitive to commodity prices, for example, crude oil, that alter the relative price competitiveness of other shipping routes, in favor of the Canal.



- About 5 percent of world trade goes through the Panama Canal, while transits on the U.S. East Coast – Asia route account for a third, making traffic particularly sensitive to trade between the U.S. and Asia. The U.S. accounts for over 70 percent of total cargo flows through the canal (including both origin and destination flows) with China accounting for a further 20 percent.

- Escalating trade tensions will directly impact Canal revenue through slower growth in world trade, and the associated reduction in shipping traffic. Staff analysis suggests that a 1 percentage reduction in world trade will lower canal revenue by 0.31 percent contemporaneously, with the impact rising to 0.64 percent after a year.

- While the Canal Authority is concerned about trade wars, specifically the U.S.–China case, they noted that direct U.S.–China trade that will be affected is natural gas and soya beans. In this context, natural gas may be redirected to other countries, such as Japan, Australia and Mexico. Nonetheless, they are confident that trade tensions will not escalate. Moreover, they have not seen a reduction in trade flows. They said that typically, shippers are required to give 4 to 6 months advanced notice for cancellation of service, through their reservation system. Despite the ongoing trade tension, canal activity and toll revenue growth remain healthy.



2. ***Could staff give a quantitative assessment of the impact of a sharp price decrease in property markets both on GDP and banking sector?***

- It is difficult to create such scenario as there might be unsuspected feedbacks from the financial to the real economy, but the presence of large down payments in mortgages, collaterals and significant capital buffers in banks suggest that the banking system could be robust and tolerate large property price shocks. A stylized scenario would go as follows: The segment of the property market at risk of a sharp price decrease is that in the higher end of the market, with properties priced above US$150 thousand. For properties below that amount, there is an excess demand and prices are unlikely to fall. The amount of banking credit for the properties in the risky segment is difficult to estimate, but a back of the envelope calculation suggests that it could be as much as US$15 billion, or some 25 percent of GDP (i.e., US$9 billion in non-preferential residential mortgage, US$2 billion in commercial mortgage, and about US$4 billion in loans to construction).

- Banks in Panama generally require 20 percent down payment on mortgage and full collateral for all loans. A property price decline of about 20 percent or less is likely to be absorbed by the equity of loan holders. The resulting decline in their wealth will likely lead to lower private consumption, which staff estimates could amount to ½ percent decline in growth, without much impact on the financial system.

- A stronger property price decline could lead to loan repayment problems as some properties would be “under water” and non-performing loans would increase potentially creating some strains in the financial system. Fortunately, there are large capital buffers that can be used in supporting a larger decline in property values. For example, a decline in property prices of about 40 percent could lead to credit losses of some US$3 billion, which could be absorbed by the banking system without falling below the minimum capital requirement of 8 percent. A property price decline stronger than 40 percent would deplete banks capital buffers and may put them below

the minimum capital adequacy requirements, requiring capital injections from bank's shareholders.

- The broad numbers in the scenario are based on averages for the financial system, and the distribution of credit at risk by bank will be equally important as some banks that have higher exposure to the property market and lower capital buffers will be able to tolerate less dramatic shocks, whereas those with less exposure and higher capital buffers would be doing better.

Growth and Structural Reforms

3. ***The report would have benefitted from a broader discussion of structural policies aiming at further bolstering growth prospects in the medium and longer term. While we take note that the current political context is challenging, we are somewhat surprised that the structural reform agenda – e.g. relating to enhancing productivity and reducing poverty – is missing in the section on policy discussions and finds only brief mentioning in the staff appraisal. Staff's comments would be welcome.***

- Panama's current structural reform agenda is centered around the two pillars of inclusion and competitiveness. "The Strategic Government Plan: 2015-19" lays out the priorities set by the current government centered around enhancing productivity and diversifying growth, largely through public investments in infrastructure, and improving access to clean water and sanitation, housing and the education system. Key infrastructure projects include the Panama Metro, the Fourth Bridge across the Canal, the Urban Development of Colón, *Techos de Esperanza* (a housing initiative), a new Technical Institute, the Program of Sanitation of Panama and the construction various hospitals and policlinics in Colón, Darien, Veraguas, Chiriqui and Los Santos.

- The government presented the National Strategic Plan with a Vision of the State "Panamá 2030" last year to achieve the 17 Sustainable Development Goals that Panama adopted in 2015. Staff welcomes this commitment to poverty reduction.

- Staff has covered growth and structural reform issues extensively in recent years (please see Staff Reports and Selected Issues Papers (SIP) for the 2015, 2016 and 2017 Article IV Consultations; and IMF Working Paper WP/17/150), as well as in one of the SIPs for the 2018 Article IV Consultation. Previous staff recommendations on these issues continues to be relevant. However, given that the government has a few months left in its tenure with a minority in the National Assembly, which limits the space for implementing far-reaching reforms, staff took advantage of the authorities' appetite to push through other difficult reforms at the top

of their agenda (e.g. improvements in financial integrity and strengthening of the fiscal framework).

- Staff reiterated in the 2018 Staff Report the need to reinforce the structural reform agenda to create the conditions for higher potential growth, while reducing poverty and inequality. Staff will revisit structural reforms issues in greater detail in the 2019 Article IV Consultation when it will receive more traction following a change in administration. Panama's medium-term structural reform agenda depends on the May 2019 presidential election outcome. According to the Fiscal Responsibility Law, the next government will be required to present a new strategic plan within the first 6 months in government on its initiatives on structural reform for the next 5 years. The change in administration will automatically shift emphasis back to structural issues in the next Article IV Consultation.

4. ***We would welcome if staff could provide further background on the mentioned large-scale mining project as well as on the related recent Supreme Court ruling***.

- *Minera Panamá* is a large copper mine owned by the Canadian mining company, First Quantum. It ranks among the 15 biggest copper mines in the world. The mine has invested around US$6¼ billion (almost 10 percent of GDP), making it the largest private investment project in Panama's history (larger than the expansion of the Panama Canal). Its construction, which started in 2012 is nearly completed, and it is expected to start operating in the first half of 2019, with export of 150,000 tons of copper, to reach 320,000 tons of copper at full capacity (exports of about US$2 billion, or about 3 percent of GDP). It has completed a port and power plant to facilitate copper production and exports. The mine is among the largest private employers of labor, accounting for 6 percent of total construction sector jobs, mostly Panamanians, and it will become the largest taxpayer in Panama.

- In September 2018, the Supreme Court of Panama ruled as unconstitutional Law 9, which was used to approve the mining concession in 1997. The lawsuit was filed by the environmental organization CIAM in 2009 (on environmental concerns about another mining company (*Minera Petaquilla*), now closed) and the ruling came as a surprise to both the authorities and *Minera Panamá*. So far, the government maintains that the ruling only affects the enactment of Law 9 and does not affect the contract of the mining concession. However, Law 9 provided special protection to the contract and the ruling creates legal uncertainty as to whether it would allow the government to renegotiate the contract or even allow it to revoke the concession. Currently, the parties are awaiting clarification from the Supreme Court regarding the ruling before any decisions are taken. In the meantime, the project continues as scheduled.

5. ***However, we note that the REER assessment has been hampered by data issues and hence the REER may not accurately capture the movements in Panama's price competitiveness relative to its trading partners. Could staff comment***?

- While staff acknowledges data issues surrounding the measurement of the REER (as the REER estimates use mostly commodity prices and Panama is a service economy), the movement is the REER and NEER continues to track the developments in the U.S., its major trading partner, and thus far provides a reasonable indication of the relative price competitiveness of Panama's economy. Staff analyzed the external position under the external sustainability approached and assessed the exchange rate as broadly in line with fundamentals.

6. ***Could staff comment on the authorities' plans to deal with any climate change and extreme weather-related events in Panama in the medium to long-run?***

- A Special Report of the Intergovernmental Panel on Climate Change (IPCC) shows that human activities have caused approximately 1.0º Celsius of global warming above pre-industrial levels and global warming is likely to reach 1.5ºC between 2030 and 2052. This warming will persist for long periods of time and will continue to cause further long-term changes in the climate system, such as sea level rise.

- Panama is vulnerable to climate change impacts and experiences a series of extreme weather events including intense and protracted rainfalls, windstorms, floods, droughts and wildfires. Panama has taken first measures to prepare for climate change and extreme weather-related events. Staff welcomes these initiatives but urges the authorities to prioritize measures to reduce carbon emissions and adapt to climate change going forward.

- Panama has identified rising sea levels and changing precipitation has the main climate risks faced by the country. Regarding the first, several programs target the adaptation to the consequences of climate change. For example, the government invested US$12 million to relocated 1,450 citizens from indigenous communities on the *Isla de Carti* to the main land. Moreover, the authorities work on several initiatives jointly with other international bodies such as EUROCLIMA PLUS, UN Environment and the Association of Caribbean States. The National Plan on Water Security 2015-50 sets out to tackle the second risk. Currently, the government has invested US$34 million in a study on the viability of multipurpose reservoirs at three locations in Panama. Additional initiatives include Joint Task Force of several bodies to collaborate in the event of environmental or humanitarian crisis and the reforestation of one million hectares in the next 20 years.

7. ***We would like to note that education reforms are one of the key priorities in the Government Strategic Plan (2015-19) and would welcome staff elaboration on the progress made, especially on narrowing skills gaps and facilitating the reallocation of labor following completion of large infrastructure projects. We would also welcome staff comments on the plan beyond 2019, especially on issues related to sustaining high growth rates over the medium term.***

- In Panama, educational reform is crucial to build the human capital needed to sustain high and inclusive growth in the future. Under the current administration, education initiatives such as *Aprende al Maximo* and *Panama Bilingue* focused on teacher training to improve the quality of education, investment in education infrastructure and the introduction of an extended school day. Staff also welcomes that Panama has re-joined the PISA evaluation in 2018. Panama last participated in the evaluation in 2009 and the results showed great deficits and challenges regarding quality and equity of education. For instance, the poorest 10 percent of children in Shanghai scored higher than the most affluent 10 percent in Panama. The results of the 2018 PISA evaluation will show the effectiveness of some of the measures taken. Continued effort to improve the education system will be needed also by the next government.

- Staff has also highlighted the need to improve the efficiency of public service delivery and reduce restrictive labor regulations. For example, Panama has restrictive regulations that prevents foreign residents from working in certain industries such as medicine, law, retail and real estate.

8. ***In addition, there may be value in investigating how climate change might affect precipitation and Panama Canal operations, similar to staff's analysis of the macroeconomic impact on small island countries. We would welcome staff's views on this issue.***

- The Panama Canal operations use a considerable amount of fresh water. On average, 52 million gallons of fresh water are used in each transit. All water used comes from Lake Gatun, a large artificial lake created during the construction of the Canal. At the same time, Lake Gatun is the principle source of fresh water for over a million-people living in Panama City and Colón. Although currently water levels in the Lake are high, larger variations in precipitation and the absence of rain fall for long periods of time present a risk to Panama's water supply and Canal operations.

- The Canal authorities are aware of this risk. In addition to water-saving measures, such as the construction of basins during the Canal expansion to recycle fresh water from the locks, they are evaluating investments to access additional sources of fresh water. Currently, Panama only uses around a quarter of all its fresh water resources,

the rest flows into the oceans. However, Panama needs to increase its water storage capacity and improve the water distribution system. Growing demand for clean water due to urbanization will require water management measures such as reducing water loss in the pipes and monitoring water quality.

9. ***What is the impact of the changes in employment structures and has the number of daily and temporary workers been increasing and the quality of employment deteriorating?***

- The structure of employment has been relatively stable. Of the total employment in August 2018 that amounted to 1.8 million, urban employment, mainly in Panama City, represents 70.7 percent of the total, up marginally from 69.9 percent in 2011. Three economic activities accounted for 40.5 percent of urban employment: commerce (20.6 percent); construction (11.1 percent), and transport, storage and communication (8.8 percent), broadly unchanged in the last decade. The proportion of construction jobs hovered at around 11–13 percent. Meanwhile, despite the observed recent reduction in agricultural employment due to seasonal factors, the sector remains the largest source of employment in the rural areas, and the second largest in the economy, behind commercial activities. Agricultural jobs accounted for 42.9 percent of total rural employment in August 2018, compared to 47.8 percent in 2011.

- Regarding temporary contracts, data from the authorities indicates that in 2017, 48.4 percent of the employees had an indefinite contract; 23.8 percent were permanent and; 14.3 percent had a temporary contract, the rest of the employees had a contract for specific work or did not have any type of contract. They reported that in the last 5 years, permanent employees have increased by 12.7 percent, while temporary contracts decreased by 7.7 percent. The reported decline in temporary employment would suggest an improvement in quality of jobs.

10. ***The authorities are well advised to further improve education, address skill mismatches, support knowledge-based economic sectors, and strengthen the business environment. In this context, we would appreciate staff's additional elaborations on the preferred sequencing of structural reforms in Panama.***

- High investment in infrastructure has facilitated capital accumulation over the last decade and integrated markets. Going forward, capital accumulation in the public sector is expected to decelerate, and growth will need to depend much more on raising productivity. In this context, it will be essential to focus efforts on improving human capital (the quality of public education and healthcare). Policies should aim at reducing skill mismatches including internship and training programs, attracting

foreign talent, promoting greater female labor force participation, and strengthening public institutions to improve efficiency of public service delivery.

11. ***Could staff elaborate in more detail on the necessary policies to improve productivity, competitiveness and education?***

- Improving the quality of the public education system is crucial to enhance human capital and achieve sustained high and inclusive growth in the future. Labor market policies should focus on reducing the shortage of adequate skills in the labor market, also by reducing the restrictions that prevent foreign residents from working in certain industries such as medicine, law, retail and real estate. Panama could benefit from skilled migration. It will be important to continue efforts to address skill mismatches including through internship and training programs, promote greater female labor force participation (e.g. by increasing the flexibility of working arrangements), and strengthen institutions. It will also be important to strengthen public institutions and reduce red tape.

12. ***Could staff elaborate on their discussions with the authorities on structural reforms and why these discussions are missing in the 2017 and 2018 Article IV reports?***

- Please see answer to question 3

Fiscal Policy

13. ***We would like to have a further elaboration on the staff's call for strengthening the recording of public investment in the fiscal accounts.***

- The authorities finance certain strategic investment using a deferred payment arrangement ("turnkey" projects) whereby fiscal accounts recognize capital expenditures when the government makes payments to contractors upon partial, or full completion of their work. The contractors of these projects are responsible for obtaining financing. Under the government's approach, it is difficult to measure the effects of public spending when the reporting is done on a cash-basis. For example, in the published fiscal accounts of 2017-HI, capital expenditure registered a substantial decline compared to the previous year, while public investment projects were the key driver of strong growth performance of the construction sector during that period.

- Best practice–accounting methods call for recording public investment in the fiscal accounts in line with the actual timing of the activity (accrual basis). Besides, the deferred recognition of capital expenditure tended to undermine budget planning and the transparency of fiscal commitments.

14. ***Could staff comment on the level of autonomy of FC on its mandates and the political commitment to the medium-term fiscal goal under the FC?***

- According to the legislation approved by the National Assembly in late October, the fiscal council (FC) will be an independent, permanent body mandated to promote accountability and nourish informed public debate about fiscal policy. It will comprise three independent professionals with experience in public finance, or macroeconomics, appointed by the government for a 7-year term. The first appointments will be staggered. With the help of a technical secretariat, the Council is mandated to evaluate macro fiscal policy, and issue a non-binding opinion through periodic reports, focused on strengthening fiscal policy. It is expected to focus on the compliance of the fiscal rule, legislations that impact government revenue and spending, budget assumptions and execution, macro projections in the context of the medium term fiscal framework, main fiscal risks, and debt sustainability.

- While the advice of the council will not be binding in line with international experience, if the authorities do not follow the council's advice, they would need to explain the reason for not implementing such advice. The authorities have reiterated their commitment to comply with the modified deficit limit under the Social Fiscal Responsibility Law (SFRL). In staff's view, the FC will further improve fiscal discipline, and promote accountability and transparency. However, to fulfil its mandate, it will be critical to ensure operational independence of the council and adequate financing.

15. ***Staff comments are welcome on the allocation of resources to improve access to public services and social assistance programs.***

- The authorities are working to improve access to public services and to promote inclusive growth overall. During the first nine months of 2018, about 72 percent of total wages of the central government (CG) workforce, equivalent to 2.5 percent of GDP, was allocated to the education, health and security sectors. Transfers and subsidies over the same period amounted to 2.6 percent of GDP. The government is taking measures to improve the targeting and effectiveness of social assistance programs, strengthen the monitoring of conditional cash transfers, and provide specific support for the elderly and the disabled. However, the investment and maintenance of water and sanitation infrastructure has lagged residential development, partly due to low and outdated tariffs. An ongoing IDB Water and Sanitation project is expected to address this issue.

16. ***Would staff comment on measures the authorities could implement to control salaries and transfers without affecting allocations to the education and health services and possible rooms for cuts.***

- The authorities recently adopted an expenditure rule to contain current spending growth, excluding allocation to health and education. Strengthening public financial management will enhance spending efficiency. In addition, raising tariffs for some public services (e.g. water), better targeted social assistance, and strengthened monitoring of conditional cash transfers, would lower the fiscal burden. It will be critical to invest in the energy infrastructure to bring about efficiency improvements in generation and transmission, further reducing electricity subsidy.

17. ***Given that despite being the fastest growing economy, Panama's tax revenue remains the lowest compared to its regional peers, we would have welcomed further staff analysis on this issue.***

- An important element in Panama's strategy to attract business is through low taxation. However, low tax effort in Panama reflects not only low tax rates, but also numerous tax exemptions that have eroded the tax base, and structural weaknesses in revenue administration. The tax–to–GDP ratio of the government was 9.2 percent in 2017, lower than the average of 10 percent in 2012–16. Direct taxes accounted for 52 percent, while indirect taxes, including VAT, accounted for the remaining 48 percent. Total revenue of the government reached 14 percent of GDP in 2017, partly because of a high share of non-tax revenues (representing about 34 percent of total revenue), mainly contribution from the Panama Canal (2.7 percent of GDP), as well as dividends from other public agencies (0.4 percent of GDP).

18. ***Staff stresses the need to ensure adequate buffers to mitigate fiscal risks related to unfunded pension liabilities, which had already been flagged in the past. Could staff comment on the perspectives for reforming the pension system, along the parametric reform advocated in the 2016 report?***

- Due to the sensitivity of pension reform, the authorities are taking a measured approached, and intend to revisit the issue in the near–medium term. As reflected in the 2016 staff report, without parametric reforms, the reserves of the exclusively defined benefit subsystem would be depleted in 2027, beyond which pension expenditure would impose fiscal cost of 1–2 percentage points of GDP annually on the budget. Thus, staff suggested reform options, such as increasing the retirement age and reducing the replacement rate. Since the 2016 Article IV Consultation, the pace of economic reform has been uneven, with the authorities prioritizing strengthening financial integrity and the fiscal framework.

19. ***Are the authorities considering any parametric pension reforms?***

- Please see answer to question 18.

20. ***Could staff elaborate on the weaknesses in public debt data that require particular attention? Are the authorities considering any parametric pension reforms?***

- The primary concern relates to the lack of consolidation of the fiscal accounts and debts of public sector institutional units, including the Panama Canal and SOEs excluded from the NFPS (i.e., the airport, an electricity distribution company, and the National Highway company). It would also be necessary to compile and disseminate information on these SOE, as well as turnkey projects, in a timely fashion. The authorities intend to revisit pension reform in the near–medium term.

21. ***Additional work to improve tax administration is warranted; during last Art. IV, staff informed the authorities' plans to introduce electronic invoicing and modernize IT systems with this purpose. Has there been any progress in the implementation of these measures? Are there any plans to streamline tax incentives and exemptions?***

- There has been some progress in the implementation of recommendations of the 2016 and 2017 Article IV Consultations. The Revenue Authority (DGI) adopted a new online tax platform (etax 2) in mid-2016 to facilitate tax compliance. A pilot program for electronic invoicing was introduced early this year by the DGI. With the 6-months pilot plan, the government sought to guarantee the reliability of the system, before extending it to all tax payers. However, there is no concrete plan to review and streamline the numerous and complicated schemes of tax exemptions.

22. ***As staff is repeating the same recommendations that in the last Art. IV for customs' administration, we wonder if there are any improvements towards defining an action plan to address the shortcomings identified.***

- The customs administration reform is advancing albeit slowly, with the agency trying to balance competing demands of national security and revenue mobilization in the context of a tight budget. The agency has modernized its processes, but implementation appears challenging. A law to strengthen governance has been drafted. It has adopted a modified action plan following IMF technical assistance recommendation.

23. ***It is not clear how the fiscal targets set in the law link to the expenditures being excluded from the NFPS accounts, such as the ACP, the Tocumen International Airport, the Electricity Distribution Company and the National Highway; in addition, the recording of public investment is not made on accrual basis. All this complicates to measure the actual stance of fiscal policy. We would like to hear from staff if there is any progress in the compilation and dissemination of timely***

information on these entities, the liabilities of the turnkey projects and the contingent liabilities of state-owned enterprises. Do the authorities have future plans to move to an accrued basis recording of public investment?

- The authorities have started to publish the contingent liabilities of SOEs. However, data on turnkey projects are not provided on a systematic and timely basis, covering all the different stages. They are taking steps to avoid budgetary surprises and better track turnkey projects. They are also considering moving to accrual accounting with technical assistance from the Fund, but it will take some time.

24. ***Could staff explain the significant drop and volatility in public investment since 2015?***

- This partly reflects the winding down/completion of large public investment projects (especially metro line 1, several sections of important highways and the renovation of the old Panama city). In addition, the recent rapid current spending growth, driven by a significant increase in public sector wages, particularly in education, health and security sectors are crowding out public investment. Given the deficit limit, the space for capital expenditure has been shrinking. Over the medium term, the government plans to keep public investment stable at around 4 percent of GDP.

25. ***We note from the text figure on Page 5 that fiscal policy has largely been procyclical since 2012. Could staff share more background information and their appraisal?***

- Fiscal policy has mostly been procyclical indeed in the last few years, reflecting the authorities' medium term fiscal consolidation plan, which commenced in mid-2014, with an overarching goal of entrenching fiscal discipline. The fiscal stance tightened by about 1 percent of GDP in 2015 and by a further 0.4 percent of GDP in 2016, to contain the fiscal deficit that reached 3.1 percent in 2014 and the growing debt burden, despite a small negative output gap. Staff viewed the policy stance as broadly appropriate given that growth has been robust, and inflation firmly subdued.

26. ***Even with the amendments to raise the deficit ceiling to 2 percent of GDP this year, will authorities be able to meet the ceiling this year? What correction mechanisms are outlined in the fiscal responsibility law if the ceiling is breached?***

- Given the weakening activity, the authorities continued to accelerate budget execution, particularly capital spending. As a result, the fiscal position nine months to September 2018 is weaker than last year. Based on preliminary results, the NFPS deficit reached 3.8 percent of GDP compared 1.5 percent a year ago, which suggests that some measures will be needed to reach the new deficit ceiling of 2 percent of

GDP. Although higher contribution of the Panama Canal and dividends from some government agencies are expected in 2018-Q4, the government must additionally adjust spending significantly, perhaps through reduction in capital spending and deferment of payments, which has been the case in the recent past, to achieve the fiscal target.

- The SFRL requires the government to publish a detailed explanation for a failure to meet the fiscal target and the magnitude of the fiscal adjustments needed to resume compliance. There are no financial or administrative sanctions for noncompliance with the fiscal rule. Rather, the law provides that civil servants in charge of decision making, authorization or execution should be accountable to the public for their decisions, but fails to provide implementable procedures. The Ministry of Economy and Finance is the main institution that can correct deviations from the numerical targets, although corrective actions are not triggered automatically. The recently approved Fiscal Council, is expected to strengthen compliance with the fiscal rule.

27. ***Given the absence of monetary policy, would a fiscal rule that balances the budget over the cycle, and hence allows automatic stabilizers to play, be an option in staff's opinion.***

- The introduction of a structural fiscal rule would certainly be a welcome option. However, for the time being, the authorities' primary objective of introducing the SFRL was to institutional fiscal discipline and debt sustainability by setting a fiscal rule that limited the deficit of the Non-Financial Public Sector (NFPS). This explains why fiscal policy tended to procyclical in the last few years, reflecting the authorities' fiscal consolidation plan. The SFRL built in some room of flexibility, that allows for a temporary suspension of the fiscal rule in case of national emergency declared by the Cabinet and significant deceleration in output—GDP grows 2 percent or less during two consecutive quarters.

Financial Integrity

28. ***Could staff comment on the authorities' plans to upgrade the administrative and legal framework to comply with BEPS's four minimum standards? Staff comments are also welcome on the measures to deal with the characterization of income for tax purposes amidst the spread of digital economy in Panama.***

- Panama joined the BEPS inclusive framework in late 2017, becoming the 87th member. Since then, the authorities have followed a step-by-step approach, focusing first on addressing Action 5 (countering harmful tax practices) shortcomings, primarily through legislative amendments. To this end, a new call center regime has

been approved. They are developing a new regulation on Country-by-Country (CbC) reporting (Action 13) and a template for multinational corporations (MNCs).

- The authorities are aware of the opportunities and challenges of the digital economy. In this regard, a draft legislation is under consideration to modernize the financial sector and support the development of FinTech within the context of a suitable regulatory framework. Additionally, legislation criminalizing tax crimes as serious offenses and the tax code are currently under review by the authorities to ensure compliance with international standards on AML/CFT and tax transparency.

29. ***Could staff specify what will be required of the Intendance of Supervision to effectively fulfill its new mandate of overseeing the DNFBPs?***

- The Intendency, established under the Ministry of Economy and Finance in 2015, is making significant progress in the regulation and supervision of designated non-financial businesses and professions (DNFBPs), benefiting from Fund technical assistance. To effectively fulfil its mandate, the Intendency needs to become independent and equipped with the necessary risk-based tools and systems to provide sound and effective monitoring and/or supervision of a diverse and large number of DNFBPs operating in Panama. Its staffing was 55 in 2017, with about 25 in the supervision unit. In this respect, the authorities continue to build capacity, with Fund assistance, within a specialized group of examiners responsible for supervision.

Financial Sector

30. ***We therefore agree that the development of a macroprudential framework is essential to address these challenges and would welcome if staff could share its views on the suggested design and implementation of specific macroprudential instruments.***

- The authorities need to develop a comprehensive framework for macroprudential policies, but they have been reluctant to do it in the past. Even reserve requirements are not used as a tool to control credit expansion. The Selected Issues Paper "Safeguarding financial stability in Panama: a framework for Systemic Risk Oversight and macroprudential Policy" (2017) provides an outline on such macroprudential framework.

- Among other things, staff has been recommending to review the caps on the loan-to-value ratio (LTV) and debt service to income ratio (DSTI) to ensure it is consistent with financial stability. LTV limits reduce funding available for borrowing and help contain credit and house price growth; bolster borrowers' resilience to house price shocks by increasing their equity and contain lender losses, reduce borrowers'

incentive to default when house prices fall. LTV ratio can become less binding when house prices are rising. DSTI cap enhances borrowers' resilience to interest rate and income shocks, contributing to lower delinquency rates and become more binding when house prices grow faster than disposable income (acting as automatic stabilizer); and therefore, can smooth credit booms even without time-varying element.

31. ***On the publication of the financial stability report, could staff comment on why the authorities have not decided on this.***

- Staff supports the publication of the Financial Stability Report (FSR) and the authorities have published the FSR, but with a lag. The 2017 FSR is now available on the web-site of the Superintendency of Banks. The authorities are working on strengthening financial education to avoid misunderstandings with the concepts published in the FSR.

32. ***We note that the authorities do not intend to introduce deposit insurance. What is staff's view?***

- Staff has encouraged the authorities to introduce a deposit insurance scheme, but there are no plans for introducing a formal deposit insurance scheme. However, the banking law requires that small depositors (below US$10,000) must be paid first in case of bank liquidation. The authorities consider this to be sufficient for protecting small depositors and argue that thus far the current arrangement has worked well in maintaining confidence. A formal deposit insurance scheme is unlikely to be adopted in the near-term given moral hazard and funding concerns.

33. ***On macroprudential oversight and policies, we would appreciate staff's clarification on the enhanced role of the CCF in systemic risk assessment as proposed in the report.***

- The Financial Coordination Council (CCF) is responsible for coordination of financial sector supervision and regulation. Its Board includes representatives from all supervisory bodies, including the Superintendency of Banks (SBP), the Superintendency of the Securities Market, the Superintendency of Insurance and Reinsurance, the Panamanian Autonomous Cooperative Institute (IPACOOP), the System of Savings and Capitalization of Pensions of the Public Servants (SIACAP) and the Financial Companies Directorate of the Ministry of Commerce and Industries. The CCF Board meets bi-monthly to exchange information and coordinate each other with the purpose of promoting regulatory policies and ensuring effective supervision of the financial market. The SBP continues to take a leadership role in systemic risk

analysis and efforts to introduce macroprudential policy, including through its role as chair of the CCF.

- The CCF contributes to the supervision of financial sector in several ways. First, it coordinates joint oversight of financial conglomerates through effective monitor of the group-wide activities and risks arising from these entities. This enhanced cooperation helps addressing systemic risks since the effects of supervisory tools targeting banks are partly extended to the non-bank sectors through conglomerate supervision. Second, it coordinates implementation of the GAFILAT action plan on AML/CFT. Third, it publishes financial statistics (balance sheets, income statements and financial indicators) for the banks, insurance, and securities sector, as well as for the consolidated system.

34. ***Have the authorities considered an ex post funding scheme that – while no longer in accordance with the IADI Core Principles – would recover deposit insurance obligations from the banking system following the failure of an institution.***

- As mentioned in the answer to question 32, the banking law requires that deposits lower than US$10,000 be paid first in case of bank failure, so in a sense the authorities have elements of an ex-post funding scheme but it is not formal nor comprehensive. Again, staff has supported a formal and explicit deposit insurance scheme.

35. ***There were many recommendations in the 2017 Art. IV to enhance the institutional framework for macroprudential policy and systemic risk monitoring. Staff comments on the stance of the implementation of these recommendations are welcome.***

- The authorities have made progress in implementing the recommendations included in the 2017 Article IV Consultation. Panama has taken important steps in transition to prudential regulations required by Basel III. The authorities introduced regulations on country risk (rule 7-2018), operational risks (rule 11-2018), financial instruments (rule 3-2018), liquidity risk and liquidity coverage ratio (rules 2-2018, 4-2018), with the latter being implemented gradually over 2019-20.

- In regulations on credit and counterparty risks (rule 4-2013, 3-2016) and capital adequacy requirements for banks and banking groups (1-2015), banks are also required to present the Superintendency of Banks (SBP) with future capital needs according to their business model. Together with regulations finalized earlier and financial derivatives (rule 11-2017), these changes to regulations make Panama's financial system more resilient.

36. ***Crisis preparedness plans must come from both the banks identified as systemic and the authorities. Is there any roadmap and timeline for the elaboration of these plans?***

- The SBP has already developed the methodology to identify the domestic systemically important banks (D-SIBs), consistent with Basel III, for which additional capital requirements will be introduced.

- The authorities have agreed to strengthen the crisis management and resolution frameworks and are in the process of creating a liquidity fund. However, there is no timetable for the strengthening of these frameworks at this point.

37. ***Relative to the bank resolution framework it is encouraging to hear a draft law is under consideration. Is there a timeline for its approval?***

- Unfortunately, there is no time table for the consideration of the draft legislation to strengthen the bank resolution framework. Additionally, the complex political setting limits the scope for approval of legislation in general.

38. ***Staff has recommended moving towards a more centralized supervisory structure over the medium term. Are the authorities given any consideration to this?***

- The authorities are not considering creating a more centralized supervisory structure at this point. They focus on strengthening overall supervision through the work of the Financial Coordination Council and its three-year strategic plan.

39. ***Could staff provide some assessment about the development of crypto currencies/FinTech in Panama banking sector and would it be possible to have a focus on this topic in the next Article IV?***

- Panama aspires to become an international provider of FinTech services and is rapidly accommodating its regulations. The government is preparing legislation for the Modernization of the International Financial System of Panama. This law defines the “Specialized Financial Entities” with powers to open and manage payment accounts, transfers, remittances of money and issuance of electronic money and creates a regulatory sandbox for FinTech enterprises, including for crowdfunding platforms and initial currency offers, and registration requirements with the Superintendence of the Securities Market.

- The number of FinTech ventures registered in Panama is on the rise. These ventures engage in cryptocurrencies trade, blockchain technology, online credit services, and electronic payments.

- The team will discuss with the authorities the analytical agenda for the 2019 Article IV Consultation and FinTech could be a topic.

40. ***While noting from the text figure on Page 17 that NPL provision is much lower in Panama compared to its regional peers, we wonder on what ground staff assess that "NPLs appear adequately provisioned"?***

- Staff issued the correction; about 89 percent of the NPLs are covered by provisions.