

## Panama

### 1. General trends

Panama's economy posted GDP growth of 2.4% in 2009. The international financial crisis led to this break in the growth rate, which had averaged 9.6% in 2005-2008. The non-financial public sector recorded a slight deficit equivalent to 1.0% of GDP, as against a 0.4% surplus in 2008. The current account was balanced at the end of 2009, compared with a deficit equivalent to 11.5% of GDP in 2008. Unlike 2008, when inflation reached 6.8%, the annual rate for 2009 was more in line with historical levels, at 1.9%.

Overall demand contracted by 3.6%, driven by falling gross domestic investment (down 6.3%). The strongest effects of the crisis were felt in gross fixed investment, particularly in machinery and equipment, which went from an annual average growth rate of 27.4% in 2005-2008 to a 15.5% contraction in 2009.

The sectors that continued to grow in 2009, albeit at a far slower pace than the previous year, were transport, storage and communications (8.3%), fuelled by 38.5% growth in telecommunications. The electric power, gas and water sector grew at a brisk 7.1% in 2009 as more power was generated and its price fell. The construction sector advanced 4.5%, attributable essentially to the non-residential sector and public infrastructure projects. The sharpest contractions were seen in agriculture (down 6.5%) and commerce (-3.7%).

To counter the sluggish growth of economic activity, the government implemented a series of countercyclical measures, some of which involved active participation by the private sector. Infrastructure works focused on projects including the widening of the Panama Canal, the project to clean up the Bay of Panama, widening the coastal beltway and building hydropower plants. Several social programmes were implemented, and there were substantial minimum-wage hikes.

The non-financial public sector deficit reached 1.0% of GDP as central government current expenditure

and capital expenditure rose. This was offset in part by an increase in tax revenues from a slightly larger tax burden. In addition, laws were enacted to improve tax collection.

In 2010, the credit rating agencies Fitch Ratings, Standard and Poor's and Moody's gave Panama an investment grade rating, which will make it easier for the country to obtain financing on international markets.

In December 2009 the new government of President Martinelli, who took office on 1 July 2009, presented to the nation its strategic plan for 2010-2014. The plan focuses on three high-priority sectors: logistical services, tourism and agriculture. It calls for substantial investment in public infrastructure projects over the next five years, including building the Panama City metro and the third set of locks in the Panama Canal, as well as launching private electric power generation projects.

Panama's economy is expected to grow by around 5% in 2010, spurred by increasing investment in public infrastructure. This will exert pressure on the current account, with increasing imports of capital goods, such as machinery and inputs needed for projects, and rising interest payments because of new debt issued. The fiscal deficit is also likely to widen despite the projected gain in fiscal revenue yielded by increased tax collections.

## 2. Economic policy

### (a) Fiscal policy

The non-financial public sector posted a deficit of US\$ 253.2 million in 2009. This is equivalent to 1.0% of GDP and contrasts with a surplus equivalent to 0.4% of GDP in 2008. Tax receipts were up US\$ 200 million, a 5.7% increase in real terms over 2008 and equivalent to 10.8% of GDP, compared with 10.5% in 2008. This rise in tax collections was largely due to Act No. 45 of July 2009, which granted delinquent taxpayers a grace period for paying their taxes. Non-financial public sector spending totalled US\$ 5.663 billion, up US\$ 465.6 million (6.4% in real terms) over the previous year. This increase was the result of expanding current expenditure (6.6%) and capital expenditure (6.0%).

Current expenditure rose as the government reinforced social programmes, among them "Red Oportunidades", in which 69,670 families had enrolled by December 2009; the "100 para los 70" programme, which gives US\$ 100 dollars a month to 72,000 older adults who receive no pension; and wage hikes for seniority. The increase in capital expenditure was primarily the result of outlays for infrastructure investment, such as for the coastal beltway and the Madden to Colón highway.

Act No. 32 was enacted in June 2009 to amend the previous fiscal responsibility act. The new deficit ceiling for 2009 was set at 2.5% of GDP; it will decrease 0.5 percentage points each year from 2009 to 2012 until it reaches 1%, with exceptions for sluggish growth domestically and in the United States.

Several laws to expand tax collection have been enacted over the past few months. Noteworthy among these measures was an increase in the goods and services tax (equivalent to a value added tax) from 5% to 7%, an extension of this tax to previously exempt goods and services, and a decrease in the personal and corporate income tax rate. It is estimated that these measures together will increase the tax burden by 1.5% of GDP in 2010.

Public debt totalled US\$ 10.972 billion in 2009 (equivalent to 45.1% of GDP, similar to the previous year), and its composition changed. Until December 2008 81.2% of public debt was external and the remaining 18.8% was domestic. By December 2009, external debt had climbed to 92.5% of the total and domestic debt had dropped to 7.5%. The US\$ 1.673 billion rise in public sector external debt was due mainly to an

increase in private sources (US\$ 1.374 billion) and to US\$ 288 million from multilateral organizations (Inter-American Development Bank and World Bank).

The fiscal deficit is expected to be higher in 2010 than in 2009, owing to greater infrastructure and welfare expenses and interest payments in excess of the expected increase in tax receipts.

### (b) Monetary and exchange-rate policy

Lending by the national banking system was off 2.6% in real terms in 2009. The credit contraction had a procyclical effect and was an additional factor behind the GDP slowdown. This evolution was uneven: the sharpest credit contractions were seen in the sectors of fisheries (down 49.9%), mining and quarrying (29.0%), financial institutions and insurance (22.3%), manufacturing (17.5%) and commerce (8.8%) sectors. The construction and mortgage sectors posted the largest real increases, at 16.4% and 8.5%, respectively. Lending to these two sectors expanded because, despite the onset of the financial crisis, many projects were well under way and the banks decided to continue financing them.

Deposits were up 5.3% in real terms compared with December 2008, resulting from an increase in deposits from individuals and foreigners that was partially offset by a decline in foreign bank deposits. The increase in the former was likely caused by the fragility of the United States' financial system during the crisis, while deposits from foreign banks appear to have declined because parent companies needed to maintain sufficient liquidity in their countries of origin.

Despite the crisis, Panama's national banking system remains profitable and sound. Bank system earnings dropped by a nominal 31.8% in 2009, but the return on equity remained high, at a nominal 12.2% in 2009 versus 15.7% in 2008. The proportion of past-due loans to total loan portfolio edged up, to 1.9% as of December 2009 compared with 1.4% for December 2008. Real lending and borrowing rates returned to positive territory in 2009 after turning negative in 2008 because of high inflation.

### (c) Trade policy

A government trade-policy priority for 2010 is to have Panama removed from the list of countries classified as tax havens. To this end, the new administration set in

motion an agenda for signing double-taxation treaties, mainly with member countries of the Organisation for Economic Co-operation and Development. By May 2010 treaties had been signed with Barbados, Belgium, Italy and Mexico. Preliminary talks with France and the Netherlands began in April 2010. It is expected that treaties with 12 countries will be signed by late 2010; this also should prompt ratification of the bilateral agreement with the United States, pending since June 2007.

Industrial Promotion Act No. 76 was enacted in November 2009 to encourage the development of manufacturing industries already established or to be established in Panama. This Act created the Industrial Promotion Certificate, a non-transferable, nominative

tax-exempt document that the beneficiary company can use during an eight-year period to pay national taxes and levies. Among the activities eligible for these certificates are research and development, management and quality control, and human resource training. Expenses associated with these activities will also be entitled to a 35% rebate of amounts disbursed. The other industrial activities referred to in the Act will be eligible for 25%.

Act No. 82 was promulgated in December 2009, primarily to bolster farm export competitiveness. This law created Agricultural Promotion Certificates, a stimulus measure that will return to exporters 10% to 15% of the average marketing costs incurred in packaging, packing, transport and inland freight.

### 3. The main variables

#### (a) Economic activity

Decelerating growth in 2009 was the result of widespread slower growth in some economic sectors combined with a contraction in others. In the previous three years, construction and mining had been growing at brisk yearly averages of 23.6% and 24.0%, respectively, but in 2009 those rates had fallen to only 4.5% and 4.9%. The agriculture, manufacturing and commerce, and hotels and restaurants sectors contracted by 6.5%, 0.3% and 2.8%, respectively.

A sector that retained some of its bounce was transport, storage and communications with 8.3% growth (this sector generates 22.2% of total GDP). This expansion was fuelled by two new companies, Digicel and Claro, entering the mobile phone market. Electrical power grew at a brisk 7.7%, of which 4.1 percentage points were due to increased residential consumption. Growth in the construction sector (4.5%) was a result of the widening of the Panama Canal, the project to clean up the Bay of Panama, the construction of the second stage of the coastal beltway, and other non-residential public investments.

Panama Canal activity was slightly hurt by the world financial crisis and the ensuing drop-off in international trade. Canal traffic stood at 14,342 vessels with 299.1 million of total tonnage in 2009, down 2.4% and 3.4%, respectively. The sharpest contraction was in the container ship segment, which was down 5.0%. Nevertheless, Panama Canal toll

revenue rose a nominal 9.2% over the previous year, thanks to the increase in transit fees.

One sector that was particularly hard hit in 2009 was agriculture, livestock, hunting and forestry (down 6.5% in real terms), owing to the impact of adverse weather phenomena for crops and fisheries. Rice was one of the worst affected crops. A decrease in the area under cultivation led to a 4.8% drop in output, and the government had to increase the import contingent to ensure supply. Fruit production, especially melons, watermelons and bananas, also was severely impacted by bad weather. The sector was also hurt by the loss of European Union tariff preferences, which will probably not be restored until late 2010.

The growth of Panama's economy is expected to be in the 4.5% to 5.0% range in 2010. The sectors that are expected to pick up are construction and tourism, thanks to the large number of public infrastructure works in development and the increase in tourism projects.

#### (b) Prices, wages and employment

Inflation measured by the consumer price index slowed substantially in 2009, to an annual 1.9%, after closing 2008 at 6.8%. The steepest increases were in household equipment (6.2%) and food and beverages (5.8%). By contrast, there were marked declines in electrical rates (21.2%) thanks to state subsidies, and in transport (27.4%) owing to falling oil prices. The 2010

Table 1  
PANAMA: MAIN ECONOMIC INDICATORS

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
<b>Gross domestic product</b>	0.6	2.2	4.2	7.5	7.2	8.5	12.1	10.7	2.4
<b>Per capita gross domestic product</b>	-1.3	0.4	2.3	5.6	5.3	6.7	10.2	8.9	0.8
<b>Gross domestic product by sector</b>									
Agriculture livestock hunting forestry and fishing	6.5	3.3	9.3	1.4	2.6	4.2	0.6	7.9	-6.5
Mining and quarrying	-4.1	18.1	35.4	12.5	0.1	17.2	24.0	30.9	4.9
Manufacturing	-6.3	-2.6	-3.4	2.1	4.2	3.9	5.6	4.0	-0.3
Electricity gas and water	-4.7	6.9	1.4	6.1	5.6	3.3	8.2	3.5	7.1
Construction	-21.8	-7.1	32.5	13.9	1.0	18.4	21.8	30.7	4.5
Wholesale and retail commerce restaurants and hotels	3.7	-0.9	2.4	11.9	9.2	11.2	11.3	7.4	-2.8
Transport storage and communications	2.5	2.0	10.9	14.9	11.8	13.7	17.0	18.5	8.3
Financial institutions insurance real estate and business services	-0.5	-0.2	0.5	3.3	10.0	9.1	12.1	9.6	1.6
Community social and personal services	3.9	4.5	1.8	3.3	0.9	3.3	6.5	4.8	3.0
<b>Gross domestic product by type of expenditure</b>									
Final consumption expenditure	3.9	7.3	7.3	3.9	8.1	4.2	1.4	6.1	1.7
Government consumption	8.1	9.1	0.4	1.9	4.1	3.1	4.1	2.6	3.0
Private consumption	3.1	6.9	8.7	4.3	8.8	4.4	0.9	6.7	1.5
Gross capital formation	-24.2	-5.4	19.0	9.9	2.8	13.5	38.9	24.2	-1.0
Exports (goods and services)	0.3	-2.5	-10.1	18.5	11.3	11.1	22.0	10.3	1.5
Imports (goods and services)	-4.3	0.7	-3.5	14.4	11.2	7.4	18.1	10.3	-3.0
<b>Percentages of GDP</b>									
<b>Investment and saving<sup>c</sup></b>									
Gross capital formation	17.6	15.7	19.0	18.7	18.4	19.5	24.1	27.4	24.5
National saving	16.2	15.0	14.8	11.6	11.8	16.8	17.0	15.9	24.5
External saving	1.4	0.8	4.1	7.1	6.6	2.6	7.1	11.5	0.0
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-170	-96	-537	-1 003	-1 022	-448	-1 407	-2 677	-4
Goods balance	-696	-1 035	-1 202	-1 537	-1 558	-1 715	-3 190	-4 546	-2 026
Exports, f.o.b.	5 992	5 315	5 072	6 080	7 375	8 475	9 334	10 323	10 904
Imports, f.o.b.	6 689	6 350	6 274	7 617	8 933	10 190	12 524	14 869	12 931
Services trade balance	890	968	1 240	1 337	1 420	2 273	2 836	3 205	3 272
Income balance	-590	-272	-809	-1 020	-1 126	-1 258	-1 306	-1 574	-1 460
Net current transfers	226	244	234	217	242	253	253	238	210
Capital and financial balance <sup>d</sup>	803	241	269	608	1 697	620	2 029	3 262	614
Net foreign direct investment	467	99	818	1 019	918	2 557	1 777	2 402	1 773
Other capital movements	336	143	-548	-411	779	-1 937	252	860	-1 159
Overall balance	633	146	-267	-395	675	172	622	585	610
Variation in reserve assets <sup>e</sup>	-622	-138	267	396	-521	-162	-611	-579	-610
Other financing	-11	-8	1	-1	-154	-10	-10	-5	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>f</sup>	103.1	101.3	103.3	108.4	110.9	112.7	114.3	113.3	108.6
Terms of trade for goods (index: 2000=100)	102.7	101.6	97.2	95.3	93.5	90.8	90.0	85.9	90.0
Net resource transfer (millions of dollars)	202	-39	-539	-414	418	-648	712	1 683	-846
Gross external public debt (millions of dollars)	6 263	6 349	6 504	7 219	7 580	7 788	8 276	8 477	10 150
<b>Average annual rates</b>									
<b>Employment</b>									
Labour force participation rate <sup>g</sup>	60.5	62.6	62.8	63.3	63.6	62.6	62.7	63.9	64.1
Unemployment rate <sup>h</sup>	14.0	13.5	13.1	11.8	9.8	8.7	6.4	5.6	6.6
Visible underemployment rate <sup>i</sup>	...	...	...	4.4	4.6	3.4	2.7	2.1	2.1
<b>Annual percentages</b>									
<b>Prices</b>									
Variation in consumer prices (December-December)	0.0	1.9	1.4	-0.2	3.4	2.2	6.4	6.8	1.9
Variation in real minimum wage	7.0	-1.2	0.7	0.9	-2.8	3.4	-1.7	2.7	-2.4
Nominal deposit rate <sup>j</sup>	6.8	5.0	4.0	2.2	2.7	3.8	4.8	3.5	3.5
Nominal lending rate <sup>k</sup>	10.6	9.2	8.9	8.2	8.2	8.1	8.3	8.2	8.3

Table 1 (concluded)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total revenue <sup>l</sup>	17.7	16.8	15.4	14.4	15.2	18.6	19.2	19.7	18.3
Current revenue	17.2	16.1	15.2	14.3	15.1	18.5	18.9	18.2	18.0
Tax revenue	8.8	8.6	8.7	8.5	8.7	10.3	10.6	10.5	10.9
Capital revenue	0.5	0.7	0.3	0.1	0.0	0.1	0.1	1.1	0.2
Total expenditure	19.4	18.8	19.2	19.8	19.1	18.4	18.0	19.4	19.8
Current expenditure	16.7	16.1	16.1	16.6	16.6	15.9	14.0	13.8	13.5
Interest	4.2	4.1	4.3	4.2	4.4	4.2	3.4	3.1	2.9
Capital expenditure	2.7	2.7	3.1	3.2	2.5	2.5	4.0	5.6	6.3
Primary balance	2.6	2.2	0.5	-1.2	0.5	4.4	4.6	3.4	1.4
Overall balance	-1.7	-1.9	-3.8	-5.4	-3.9	0.2	1.2	0.3	-1.5
<b>Central government debt</b>									
Domestic	70.1	69.0	66.6	69.6	65.1	60.3	52.3	44.4	44.5
External	17.7	17.7	16.7	18.9	16.8	15.0	10.6	8.0	2.9
	52.4	51.3	49.9	50.6	48.4	45.3	41.7	36.4	41.5
<b>Money and credit<sup>m</sup></b>									
Domestic credit	99.0	91.1	88.8	90.3	90.3	90.6	87.8	85.4	83.0
To the public sector	-9.6	-6.4	-3.9	-0.0	-3.7	-3.2	-7.7	-8.9	-8.9
To the private sector	108.6	90.4	87.1	85.1	87.1	88.4	90.6	89.4	87.1
Others	0.0	7.1	5.6	5.2	6.9	5.5	5.1	5.0	4.8
Liquidity (M3)	85.6	80.9	79.5	78.3	78.0	86.1	87.5	84.5	...

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 1996 prices.

<sup>c</sup> Based on figures in local currency expressed in dollars at current prices.

<sup>d</sup> Includes errors and omissions.

<sup>e</sup> A minus sign (-) denotes an increase in reserves.

<sup>f</sup> Annual average weighted by the value of goods exports and imports.

<sup>g</sup> Economically active population as a percentage of the working-age population; nationwide total.

<sup>h</sup> Percentage of the economically active population; nationwide total; includes hidden unemployment.

<sup>i</sup> Percentage of the working population; total of urban areas.

<sup>j</sup> Six-month deposits in the local banking system.

<sup>k</sup> Interest rate on 1-year trade credit.

<sup>l</sup> Includes grants.

<sup>m</sup> The monetary figures are end-of-year stocks.

inflation figure is expected to pick up slightly but should not exceed an annual 3.5%.

Executive Decree No. 263 of December 2009 raised hourly minimum wages, effective 1 January 2010. On the basis of 208 hours worked per month and depending on the branch of economic activity, the minimum wage for small companies rose by between US\$ 20.80 and US\$ 29.10 a month, increases of between 4.6% and 7.5% in real terms over 2008. The hike was US\$ 54.00 dollars for large companies, which is 14% in real terms over 2008. In some economic sectors the wage increase was even higher, as much as 26.8% in real terms. This measure will improve the economic situations of 250,000 Panamanians who earn the minimum wage.

The unemployment and open unemployment rates stood at 6.6% and 5.2%, respectively. In both cases this is an increase of one percentage point over 2008. One of the sectors posting net job creation in 2009 was construction, boosted by hotel and tourism projects and public infrastructure works. These projects helped temper the impact of the international crisis on employment, and should, along with new projects which are at the planning stage, continue to do so in 2010.

### (c) The external sector

The current account posted a US\$ 3.5 million deficit in 2009, compared with a US\$ 2.677 billion deficit in 2008. This reflected a significant drop in the goods balance deficit, driven by a sharp contraction in imports. The services balance was stable, with a surplus of US\$ 3.272 billion, 2.1% higher than in 2008.

The decrease in the goods balance deficit resulted from a 13.0% drop in imports for the year and a 5.6% increase in exports. The dip in imports was triggered by a 15.9% decline in intermediate goods (including construction materials), a 14.9% drop in capital goods, and a 9.7% decline in consumer goods. Colón Free Zone exports rose by 12.2%, driven by medicines, manufactured goods and electrical equipment. National exports fell sharply (-28.3%) because of the financial crisis, weather and disease problems that impacted farm output, and the loss of European Union tariff preferences.

The services balance closed with a US\$ 3.272 billion surplus. This was 1.8% higher than the 2008 figure, thanks to a US\$ 120.7 million rise in Panama Canal toll revenue, an increase of 9.2%.

Table 2  
**PANAMA: MAIN QUARTERLY INDICATORS**

	2008				2009 <sup>a</sup>				2010 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	11.1	13.9	10.2	8.1	3.3	2.1	0.8	3.5	4.9	...
Gross international reserves (millions of dollars)	1 965	2 419	2 125	2 512	2 758	2 606	2 346	2 836	2 781	4 104 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	115.7	116.3	113.9	107.3	106.2	107.8	109.2	111.1	109.9	109.4 <sup>e</sup>
Consumer prices (12-month percentage variation)	8.8	9.6	10.0	6.8	3.7	1.8	0.5	1.9	2.7	3.2 <sup>e</sup>
Nominal interest rates (annualized percentages)										
Deposit rate <sup>f</sup>	4.0	3.5	3.4	3.3	3.6	3.6	3.5	3.3	3.3	3.3 <sup>c</sup>
Lending rate <sup>g</sup>	8.2	8.3	8.2	8.1	8.3	8.2	8.3	8.3	8.3	8.2 <sup>c</sup>
Sovereign bond spread (basis points) <sup>h</sup>	245	218	306	540	481	277	214	171	171	220
Domestic credit (variation from same quarter of preceding year)	13.6	14.1	17.1	13.9	7.6	7.6	2.2	1.9	4.8	5.9 <sup>c</sup>
Non-performing loans as a percentage of total credit <sup>i</sup>	2.3	2.0	2.3	2.6	2.6	2.7	2.9	2.8	2.8	2.7 <sup>c</sup>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 1996 prices.

<sup>c</sup> Data to April.

<sup>d</sup> Quarterly average, weighted by the value of goods exports and imports.

<sup>e</sup> Data to May.

<sup>f</sup> Six-month deposits in the local banking system.

<sup>g</sup> Interest rate on 1-year trade credit.

<sup>h</sup> Measured by JP Morgan's EMBI+ index.

<sup>i</sup> Includes credit in arrear.

The financial account ended 2009 with a surplus of US\$ 1.242 billion, 57.3% lower than in 2008. There are several reasons for this decrease. First, the foreign direct investment balance fell by 26.2% to US\$ 1.773 billion, owing essentially to a US\$ 486.7 million drop in the reinvestment of bank earnings. Second, the balance for other investments went from a US\$ 1.034 billion surplus in 2008 to a US\$ 989.3 million deficit in 2009. The reason is that while Panamanian banks continued to increase the number of loans in 2009, lending volume was far lower than in the previous year. Moreover, deposits by foreigners in Panamanian banks contracted

sharply, probably because of liquidity concerns and uncertainty born of the financial crisis. In contrast, there was a US\$ 458.9 million portfolio investment surplus in 2009, compared with a deficit of US\$ 526.6 million the previous year, resulting from the issuance and placement of US\$ 1 billion for early repayment of domestic debt.

Greater pressure on the current account is expected for 2010, resulting from an upturn in the economy, the related expansion of capital goods imports for infrastructure works, and higher interest payments on new sovereign debt issued to finance them.