

Panama

1. General trends

In 2008 the Panamanian economy witnessed vibrant growth in real GDP (9.2%) and expanded by an average of 8.8% over the last five years. The non-financial public sector recorded a slight surplus equivalent to 0.4% of GDP, below the figure for 2007 (3.5%). This result was due to a decrease in revenues and an increase in current expenditures used to mitigate the effects of higher food and fuel prices in the first half of the year.

The inflation rate reached 10% in September 2008, driven by food and fuel prices, but closed the year at 6.5% due to appreciation of the dollar and lower prices for imported goods.¹ The current account recorded a deficit equivalent to 12.1% of GDP and was 4.8 percentage points higher than the year before. In August 2008, the total employment and open unemployment rates fell from 6.4% to 5.6% and from 4.7% to 4.2% respectively.

The opposition candidate Ricardo Martinelli won the elections in May 2009 and took office on 1 July. His platform includes changing the tax system by introducing a flat income tax and introducing crime-fighting measures.

Despite the resilience of the Panamanian economy in 2008, a severe reduction in the growth rate is expected for 2009 and 2010 due to the international financial crisis.

ECLAC projects a growth rate of 2.5% for 2009. The contraction (or deceleration) of the residential construction sector is expected to be partially offset by government investment in social housing projects, infrastructure and the Panama Canal. As a result of decreased trade volume worldwide, and despite higher tolls, Panama Canal revenues are not expected to rise in 2009 as they did in previous years.

Demand for tourism services is also expected to be flat in 2009, though recovery in 2010 is possible. The open unemployment rate is likely to rise in 2009 and with it, the national poverty rate. Lastly, the slowdown in economic activity could impact tax revenues, while increased transfers to vulnerable sectors are expected to have fiscal implications in the short term.

2. Economic policy

Economic policy in 2008 focused on implementing public works programmes, ensuring the welfare of the poor in response to rising food and fuel prices and addressing the financial crisis in the last quarter of 2008.

(a) Fiscal policy

The non-financial public sector posted a surplus of US\$ 97.8 million, equivalent to 0.4% of GDP. The surplus was lower than the one recorded in 2007 (3.5% of GDP). The central government surplus shrank as well, going from 1.2% of GDP in 2007 to 0.3% in 2008.

¹ This rate refers to the consumer price index for the districts of Panama and San Miguelito.

These weaker results are due to the fact that total central government expenditures increased by 15.9% in real terms, while revenues expanded to a lesser degree (10.2%). The increase in public spending may be attributed to operational costs and transfers, in particular liquefied gas and basic food basket subsidies. Capital expenses grew significantly with respect to the preceding year (49.4% in real terms), owing to investments in public works projects such as roads, social infrastructure and housing.

After implementing several procedural changes, the Tax Administration Department has improved its tax-collecting capacity. Consequently, tax receipts grew by 7.2% in real terms, a lower figure than the 14.0% growth recorded for 2007. Revenues from direct taxes were up by 5.7%, while indirect tax revenues grew by 8.8%.

In December 2008 the National Assembly passed the General State Budget for fiscal year 2009, which totalled US\$ 9.763 billion. A sizable portion of the budget is allocated to public investments (US\$ 3.401 billion), including infrastructure projects in health, education and transport.

The new Fiscal and Social Responsibility Act, which caps the fiscal deficit at 1% of GDP, went into effect in January 2009. The Act mandates a 40% cap on the debt/equity ratio, which means reducing the sovereign debt by US\$ 2.8 billion over seven years. It likewise prohibits government entities from taking on fiscal obligations in the last six months of their term if they have insufficient budgetary resources to pay for them.

The Act also stipulates that during the last six months in office, the government cannot commit more than 50% of the annual operating budget. Each new administration must present an investment plan for their five-year term and all investments over US\$ 10 million have to be accompanied by a feasibility or social impact study. In case of emergencies or during periods of recession, the law contains contingencies which raise the limits when annual GDP growth falls below 1%. In such situations, the maximum limit can be increased to 3% of GDP for one year and 2% the following year.

The central government external debt grew by US\$ 197 million (0.9% of GDP) in 2008, due to an increase in loans from multilateral institutions (US\$ 109.1 million) and private institutions (US\$ 102.7 million). Loans from bilateral and official lenders decreased by US\$ 14.8 million. Domestic public debt, on the other hand, dropped by US\$ 257 million (1.1% of GDP). In March 2009, the government of Panama placed US\$ 323 million on the external market, a remarkable result in the context of the current international financial crisis.

(b) The international banking centre and credit policy

Towards the end of 2008, the financial sector began to show signs of deceleration owing to the global financial crisis. Term deposits in the Panamanian banking system decreased, as did sight deposits of firms. From December 2008 to March 2009, term deposits grew by only 0.4%, compared with 5.5% in the same period the year before. Deposits of private individuals totalled US\$ 3.764 billion in December 2008 and were down by US\$ 163 million by the end of March.

Assets in the Panamanian banking system maintained the accelerated pace of growth observed over the last few years, moving from US\$ 45.642 billion in 2007 to US\$ 53.427 billion in 2008. This increase (17.1%) is slightly lower than the 2007 figure (20%), though it still signals a significant expansion.

Banks in Panama, both national and foreign, have maintained positive real lending and deposit rates over the last five years. In 2008, however, as a result of the rise in the price index, these interest rates turned slightly negative, with the exception of the lending rates for consumer loans and credit cards. Deposit rates in national and foreign banks—both for individuals and firms—were negative as of the last quarter of 2007.

Loans granted by the national banking system grew by 12.6% in 2008, compared with 19.6% in 2007. In addition to a significant rise in lending to the construction sector (47.2%), there was an unusually sharp increase in lending to industry (55.4%).

In January 2009 the government adopted the Financial Stimulus Programme (FSP) with a view to injecting financial resources into the system and addressing the credit squeeze. The FSP has received US\$ 1.11 billion in financing from the Inter-American Development Bank, the Andean Development Corporation and the National Bank of Panama. The National Bank of Panama administers these funds through a trust. The trust extends loans to banking and financial institutions which, in turn, make loans to their clients using their normal standards. Implementation has been slow, however, and as of April 2009 only US\$ 18 million had been lent to banks.

Proposals have been made for the National Bank of Panama, which has US\$ 2.3 billion in international banks, to allocate funds to a programme which would channel loans to national productive sectors. An initiative of this kind was already attempted during earlier crises, such as at the beginning of the 1990s, when the government of Guillermo Endara set up a programme

to provide funds to private banks to boost liquidity in the national market.

(c) Trade policy

One of the priorities of the Panamanian Government in the area of international trade is the ratification of the bilateral agreement with the United States, which was signed in June 2007 but was not ratified in 2008. Given that Panama has demonstrated its commitment to addressing the concerns of the United States regarding workers' rights, protection of intellectual property and environmental standards, it is possible the agreement will be ratified in 2009.

With the signing of a free trade agreement with Costa Rica in 2008, Panama now has agreements with all of the Central American countries. It is therefore able to actively participate in the creation of a common customs system, as well as a regional association agreement with the European Union. Panama continues to seek opportunities to conclude bilateral agreements with Canada and Mexico. It is also likely to attempt to formalize its relations with China. Trade between the two countries has intensified in recent years, expanding from US\$ 60.9 million in 2004 to US\$ 426.7 million in 2007. Imports from China make up 85% of the total amount of trade between China and Panama.

3. The main variables

(a) Economic activity

Real GDP grew by 9.2% in 2008, driven mainly by construction (30%), transport, storage and communications (15.7%) and hotels and restaurants (9.3%). Domestic demand was up 10% in real terms, compared with 12.9% in 2007. Likewise, internal consumption climbed by 6.3% in real terms, compared with 9.7% in 2007.

Value added in the construction sector grew by 30% in one year, that is, 9.7 percentage points more than in 2007. In 2008, and since 2006, the average growth rate has been 22.9%. This result may be attributed to public and private investments in residential and non-residential projects, civil engineering works (such as hydroelectric projects), work relating to the second phase of construction of the Northern Corridor, the Panama-Colon highway, public works projects to clean up the Bay of Panama and works carried out by the Panama Canal Authority as part of the widening project.

In 2008, the transport, storage and communications sector posted real growth of 15.7%, slightly under the figure for 2007. The port sector grew by 12.9% following brisker container movement (14.2%). The Panama Canal operations expanded by 7.1%, owing largely to increased services to ships (16.9%). There was, however, a decrease in ship transit, with growth of only 0.2% and a reduction in total net tons transported. The telecommunications sector was more buoyant (21.8%) owing to higher cell phone usage and more widespread use and volume of land lines, Internet services and international calls.

Boosted by a 14.8% increase in hotel stays and an 11.7% rise in the number of visitors, the hotel sector recorded 9.3%. Visitor spending was up by 19%. Although the sector has seen average growth of 11.8% since 2006, the rate of growth slowed in 2008, which will mean a slowdown in external demand for tourist services in 2009 and 2010.

As a consequence of the international crisis and worldwide slowdown, the branches of economic activity that registered slowest growth in 2008 were commerce and financial intermediation. The commerce, restaurant and hotel sector contracted slightly, reaching 7.4% as compared with 9.3% in 2007. Commercial activity in the Colon Free Zone grew by 6.1% thanks to re-exports to Central and South America. Financial intermediation was impacted by the international financial crisis, particularly towards the end of the year, growing only 2.3% compared with 19.4% in 2007.

The agricultural sector grew by 6% in 2008, up from 1.7% in 2007. Watermelon production was up, but other tradable fruits were affected by problems linked to marketing, lack of financing and adverse weather conditions. Following a three-year long contraction, fishing recovered significantly reaching 13.4%.

As a consequence of the international financial crisis, the monthly index of economic activity declined at the end of 2008, which explains why the first quarter of 2009 posted an average 3.4%, compared with 9% in the same period of 2008. Internal credit dipped somewhat, following a contraction in consumer credit, which led to fewer automobile sales in the first quarter of 2009 (down an average of 20%).

Table 1
PANAMA: MAIN ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
Annual growth rates^b									
Gross domestic product	2.7	0.6	2.2	4.2	7.5	7.2	8.5	11.5	9.2
Per capita gross domestic product	0.8	-1.3	0.4	2.3	5.6	5.4	6.7	9.7	7.4
Gross domestic product, by sector									
Agriculture, hunting, forestry and fishing	9.6	6.5	3.3	9.3	1.4	2.6	4.2	1.7	6.0
Mining and quarrying	-10.6	-4.1	18.1	35.4	12.5	0.1	17.2	22.7	29.8
Manufacturing	-7.2	-6.3	-2.6	-3.4	2.1	4.2	3.9	5.5	3.8
Electricity, gas and water	9.3	-4.7	6.9	1.4	6.1	5.6	3.3	9.2	5.1
Construction	1.3	-21.8	-7.1	32.5	13.9	1.0	18.4	20.3	30.0
Wholesale and retail commerce, restaurants and hotels	3.8	3.7	-0.9	2.4	11.9	9.2	11.2	9.3	7.4
Transport, storage and communications	12.5	2.5	2.0	10.9	14.9	11.8	13.7	17.3	15.7
Financial institutions, insurance, real estate and business services	5.9	-0.5	-0.2	0.5	3.3	10.0	9.1	11.5	4.6
Community, social and personal services	-0.4	3.9	4.5	1.8	3.3	0.9	3.3	5.4	4.2
Gross domestic product, by type of expenditure									
Final consumption expenditure	0.2	3.9	7.3	7.3	3.9	8.1	4.2	9.7	6.3
Government consumption	1.8	8.1	9.1	0.4	1.9	4.1	3.1	5.9	6.0
Private consumption	-0.1	3.1	6.9	8.7	4.3	8.8	4.4	10.4	6.3
Gross domestic investment	-7.3	-25.7	-5.6	23.3	9.4	6.4	16.6	33.2	23.7
Exports (goods and services)	18.5	0.3	-2.5	-10.1	18.5	11.3	11.1	15.0	7.0
Imports (goods and services)	10.3	-4.3	0.7	-3.5	14.4	11.2	7.4	19.3	8.5
Percentages of GDP									
Investment and saving^c									
Gross domestic investment	24.1	17.6	15.7	19.0	18.7	18.4	19.5	23.5	30.9
National saving	18.4	16.2	15.0	14.8	11.6	11.8	16.4	16.2	18.8
External saving	5.8	1.4	0.8	4.1	7.1	6.6	3.1	7.3	12.1
Millions of dollars									
Balance of payments									
Current account balance	-673	-170	-96	-537	-1 003	-1 022	-527	-1 422	-2 792
Goods balance	-1 143	-696	-1 035	-1 202	-1 537	-1 558	-1 712	-3 182	-4 714
Exports, f.o.b.	5 839	5 992	5 315	5 072	6 080	7 375	8 478	9 338	10 289
Imports, f.o.b.	6 981	6 689	6 350	6 274	7 617	8 933	10 190	12 521	15 003
Services trade balance	854	890	968	1 240	1 337	1 420	2 210	2 818	3 262
Income balance	-560	-590	-272	-809	-1 020	-1 126	-1 278	-1 311	-1 579
Net current transfers	177	226	244	234	217	242	253	253	238
Capital and financial balance ^d	595	803	242	269	608	1 697	699	2 044	3 377
Net foreign direct investment	624	467	99	818	1 019	918	2 498	1 907	2 402
Other capital movements	-29	336	143	-548	-411	779	-1 799	137	975
Overall balance	-77	633	146	-267	-395	675	172	622	585
Variation in reserve assets ^e	109	-622	-138	267	396	-521	-162	-611	-579
Other financing	-32	-11	-8	1	-1	-154	-10	-10	-5
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^f	100.0	103.1	101.2	103.2	108.4	111.0	112.7	114.3	112.2
Terms of trade for goods (index: 2000=100)	100.0	102.7	101.6	97.2	95.3	93.5	90.8	90.0	85.9
Net resource transfer (millions of dollars)	3	202	-39	-539	-414	418	-589	723	1 792
Gross external public debt (millions of dollars)	5 604	6 263	6 349	6 504	7 219	7 580	7 788	8 276	8 477
Average annual rates									
Employment									
Labour force participation rate ^g	59.9	60.5	62.6	62.8	63.5	63.5	62.6	62.7	63.9
Unemployment rate ^{h1}	13.5	14.0	13.5	13.1	11.8	9.8	8.7	6.4	5.6
Visible underemployment rate ^h	...	...	...	...	4.4	4.6	3.4	2.7	2.1
Prices									
Annual percentages									
Variation in consumer prices (December-December)	0.7	0.0	1.9	1.5	1.5	3.4	2.2	6.4	6.8
Variation in real minimum wage	3.8	7.0	-1.2	0.7	0.9	-2.8	3.4	-1.7	2.7
Nominal deposit rate ^j	7.1	6.8	5.0	4.0	2.2	2.7	3.8	4.8	3.5
Nominal lending rate ^k	10.3	10.6	9.2	8.9	8.2	8.2	8.1	8.3	8.2

Table 1 (concluded)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
	Percentages of GDP								
Central government									
Total income ^l	18.2	17.7	16.8	15.4	14.4	15.2	18.6	19.5	19.7
Current income	18.1	17.2	16.1	15.2	14.3	15.1	18.5	19.2	18.3
Tax income	9.6	8.8	8.6	8.7	8.5	8.7	10.3	10.7	10.6
Capital income	0.0	0.5	0.7	0.3	0.1	0.0	0.1	0.1	1.1
Total expenditure	19.3	19.4	18.8	19.2	19.8	19.1	18.4	18.3	19.5
Current expenditure	16.9	16.7	16.1	16.1	16.6	16.6	15.9	14.2	13.9
Interest	4.2	4.2	4.1	4.3	4.2	4.4	4.2	3.5	3.1
Capital expenditure	2.4	2.7	2.7	3.1	3.2	2.5	2.5	4.1	5.6
Primary balance	3.1	2.6	2.2	0.5	-1.2	0.5	4.4	4.7	3.4
Overall balance ^m	-1.1	-1.7	-1.9	-3.8	-5.4	-3.9	0.2	1.2	0.3
Central government debt	65.5	70.1	69.0	66.6	69.6	65.1	60.3	53.2	44.6
Domestic	18.0	17.7	17.7	16.7	18.9	16.8	15.0	10.8	8.0
External	47.5	52.4	51.3	49.9	50.6	48.4	45.3	42.3	36.6
Money and creditⁿ									
Domestic credit	94.3	99.0	91.1	88.8	90.3	90.3	90.6	89.3	85.8
To the public sector	-7.6	-9.6	-6.4	-3.9	-0.0	-3.7	-3.2	-7.8	-9.0
To the private sector	101.9	108.6	90.4	87.1	85.1	87.1	88.4	92.0	89.7
Others	0.0	0.0	7.1	5.6	5.2	6.9	5.5	5.1	5.0
Liquidity (M3)	80.6	85.6	80.9	79.5	78.3	78.0	86.1	88.9	...

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

^a Preliminary figures.

^b Based on figures in local currency at constant 1996 prices.

^c Based on figures in local currency expressed in dollars at current prices.

^d Includes errors and omissions.

^e A minus sign (-) denotes an increase in reserves.

^f Annual average, weighted by the value of goods exports and imports.

^g Economically active population as a percentage of the working-age population; nationwide total.

^h Percentage of the economically active population; nationwide total.

ⁱ Includes hidden unemployment.

^j Six-month deposits in the local banking system.

^k One- to five-year loans for commercial activities in the local banking system.

^l Includes grants.

^m The overall balance for 2005 includes an adjustment for compensation to bondholders amounting to 111.6 million balboas.

ⁿ The monetary figures are end-of-year stocks.

(b) Prices, wages and employment

The inflation rate dropped significantly in August 2008, down from a high of 10%, and closed the year at 6.5%. Thus, the yearly average was 8.8%, or 4.6 percentage points above the 2007 figure. Average inflation for 2009 is projected at 5%. The sectors that saw the sharpest rise in prices were food (16.6%), fuels (17.5%) and tourism (15%).

With a view to addressing price hikes in the first half of 2008—particularly in food and fuels—the government implemented the Consumer Support Programme (PAC) by means of a law that came into force on 2 June 2008. In phase I, the programme provided assistance to 40,000 tax payers by reducing their income taxes. In phase II, the tax cut was extended, starting in January 2009, to 110,000 Panamanians whose monthly income was between US\$ 801 and US\$ 2,390.

Other measures implemented to increase the purchasing power of the Panamanians included liquefied

gas and energy subsidies, which benefit 90% of the population. The government also acquired Compita products, which were distributed and sold at below-market prices. An estimated two million Panamanians benefited from these measures.

The annual open unemployment rate for 2008 is a product of the rapid economic growth posted during the year. From 2007 to 2008, the total unemployment rate dropped 0.8%, to stand at 5.6%. Towards the end of 2008, however, the Panamanian economy showed signs of deceleration. Real estate sales slipped in October, which has repercussions for future construction and absorption of workers. The construction sector was the main engine for a significant rise in employment in 2008. In August 2007, some 134,495 people were working in the construction sector and this figure rose to 149,875 in the same month in 2008. Approximately 80,000 jobs are expected to be lost in 2009, mostly in construction, commerce and tourism.

Table 2
PANAMA: MAIN QUARTERLY INDICATORS

	2007				2008 ^a				2009 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	8.7	11.5	11.5	11.8	8.7	11.2	9.7	7.3	2.5	...
Gross international reserves (millions of dollars)	1 029	1 613	1 573	1 935	1 801	...	...	...	...	...
Real effective exchange rate (index: 2000=100) ^c	113.5	114.3	114.3	115.1	114.7	115.2	112.8	106.2	105.2	106.1 ^d
Consumer prices (12-month percentage variation)	3.2	3.7	5.2	6.4	8.8	9.6	10.0	6.8	3.7	2.5 ^d
Nominal interest rates (annualized percentages)										
Deposit rate ^e	4.9	4.8	4.7	4.6	4.0	3.5	3.4	3.3	3.6 ^f	...
Lending rate ^g	8.3	8.3	8.3	8.3	8.2	8.3	8.2	8.1	8.2 ^f	...
Sovereign bond spread (basis points) ^h	156	130	160	184	245	218	306	540	481	299
Domestic credit (variation from same quarter of preceding year)	13.6	10.4	8.6	12.1	13.6	14.1	17.1	13.8	7.6	7.1 ⁱ
Non-performing loans as a percentage of total credit ^j	2.3	2.4	2.5	2.3	2.3	2.0	2.3	2.8	2.6	2.9 ^d

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

^a Preliminary figures.

^b Based on figures in local currency at constant 1996 prices.

^c Quarterly average, weighted by the value of goods exports and imports.

^d Data to May.

^e Six-month deposits in the local banking system.

^f Data to February.

^g One-year loans for commercial activities in the local banking system.

^h Measured by JP Morgan's EMBI+ index.

ⁱ Data to April.

^j Includes credit in arrear.

(c) The external sector

The balance-of-payment current account deficit stood at US\$ 2.792 billion in 2008, equivalent to 12.1% of GDP and 4.8% higher than in 2007. This result stems from the deficit of the trade in goods balance and the negative income balance which increased by 48.1% and 20.4% respectively. The balance of the trade in services and transfer balance showed surpluses of US\$ 3.262 billion and US\$ 238 million, equivalent to 14.1% and 1% of GDP respectively.

With demand for agricultural products falling in the United States and European markets, national exports grew by only 1.6%.

F.o.b. imports increased by 19.8%, slightly less than the 2007 figure. There was a marked deceleration in

telephone calls, which grew by 19.4%, compared with 40.5% in 2007. Imports from the Colón Free Zone jumped from 12.4% in 2007 to 20.1% in 2008. Consumer goods accounted for the highest growth in 2008.

Net remittances in 2008 were negative, given that US\$ 10.8 million more remittances were sent than were received. This figure reflects the importation of labour from nearby countries like Colombia and Nicaragua.

The financial account showed a surplus of US\$ 2.855 billion. The steady inflow of capital into the country is due to the incorporation of new banks and non-financial firms into the local market who operate with non-resident equity. A sizable amount of this capital inflow is linked to the flow of foreign direct investment, which stood at US\$ 2.402 billion in 2008, reflecting an increase of 25.9% compared with the previous year.