

## Panama

The Panamanian economy grew rapidly (7.5%) in 2006 for the third consecutive year, thanks to burgeoning external demand generated by the vigorous expansion in the world economy, supported by increasingly strong domestic demand. The fiscal and external deficits (2.0% and 4.2% of GDP, respectively) were less than those recorded in 2005. Inflation dropped below 2%, back into its normal range, while nationwide unemployment fell by more than one percentage point to 8.6%. For 2007, GDP growth is expected to remain at around 7%, with domestic factors compensating for weakening external demand—given the forecasts for a slowdown in the world economy. In addition, improvements are expected in the labour market, together with a reduction in the fiscal deficit (1.5%) and low inflation (around 2%).

The key event in 2006 was the approval given in a plebiscite for an expansion of the Panama Canal. This project envisages the construction of a third set of locks allowing larger vessels to pass through the canal as from 2014. The estimated cost of the works is US\$ 5.3 billion.

The fiscal outcome for the year was better than expected. The deficit of the non-financial public sector (NFPS) decreased from 2.5% to 2.0% of GDP, while the central government shortfall narrowed from 3.9% to 2.9%. Tax revenue was up by about 20%, thanks to buoyant economic activity and the effects of the fiscal and social security reforms of 2005. Revenues from non-recurring taxes also rose, following an agreement signed between the government and a port enterprise, and as a result of revenue generated by the Panama Canal Authority (US\$ 105 million).

Fiscal expenditure grew strongly (13%), although by less than revenue (16%), reflecting the substantial increase in subsidies to the electric power sector and higher payments to service the floating debt. Although capital spending was up by a quarter, it was impossible to implement all the measures contained in the investment programme. Lastly, the “PanamaCompra” programme was launched to facilitate government procurement and promote transparency, efficiency and accountability in government accounts.

Up to September, the public debt had grown by US\$ 400 million, but it is estimated to have decreased from 66.3% to 63.1% of GDP by year-end thanks to

strong economic growth. The government continued to manage the public debt proactively in 2006, with a view to obtaining investment grade for its sovereign debt. Between November 2005 and January 2006, the external debt was restructured to extend maturities and reduce interest payments in an operation worth US\$ 2.34 billion. In the middle of the year, the outstanding balance of Brady bonds (US\$ 350 million) was repaid in advance; as these bonds represented the last vestiges of the country’s debt default, their elimination has a profound symbolic significance.

Bank assets grew by 8%, reflecting favourable conditions among the leading external customers and the prosperous domestic situation. The soundness of the Panamanian market was backed by the purchase of the country’s largest bank, Primer Banco del Istmo, by Hong-Kong Shanghai Bank Corporation (HSBC) for US\$ 1.7 billion. This would seem to herald the start of a new phase in the consolidation of the banking sector nationwide.

The lending portfolio had expanded by roughly 18.7% until September, thanks to growth in its external component (26%). The fastest-growing categories of domestic credit were mortgage and consumer loans. As nominal interest rates remained broadly unchanged, lower inflation meant that real rates increased slightly.

The goal of trade policy was to strengthen the policy of opening markets for Panamanian products through free trade agreements. In particular, negotiations were resumed

for free trade treaties with Costa Rica, Guatemala, Honduras and Nicaragua, which had been at a standstill for several years; negotiations for a free-trade agreement with Chile were resumed and completed; and the trade agreement with Singapore was ratified. The start of negotiations between the Central American countries, Panama and the European Union was also announced, with a view to reaching an association arrangement that would include a free trade agreement. Negotiations with the United States, on the other hand, came to a halt.

GDP growth of 7.5% reflected a favourable international situation and increases in employment and credit levels. Investment was particularly buoyant (15%), fuelled by a real estate boom—the fastest-growing sector was construction (25%). The construction of luxury tower blocks (with up to 100 storeys) in Panama City and residential tourism in several parts of the country are shifting the dynamic of the sector away from its reliance on domestic demand, since most of the buyers are foreigners. The mining sector also put in a strong performance as the supplier of construction inputs. Growth in manufacturing broadly matched the 2005 figure (3.0%), while agriculture reported better results, boosted by strong performances by products such as pineapple and watermelon, bovine livestock and bananas—the latter for the first time in several years. In contrast, the fisheries sector slipped back. Transport, particularly air and rail, posted positive figures as did the financial sector. Revenue from the Panama Canal was up by about 20%, more as a result of higher tolls than larger volumes transported. Trade also expanded significantly, largely thanks to the Colón Free Zone.

Inflation dropped back to normal levels in 2006, falling from 2.9% to 2% as an annual average, despite higher international oil prices. Food products, clothing and footwear, and health care were sectors that helped to ease price increases. Minimum wages were raised by 8% as from April, the first increase for three years. The rapid growth of the economy allowed the national unemployment rate to fall from 9.8% to 8.6%.

Table 1  
PANAMA: MAIN ECONOMIC INDICATORS

|   | 2004   | 2005   | 2006 <sup>a</sup> |
|---|--------|--------|-------------------|
| <b>Annual growth rates</b>                |        |        |                   |
| Gross domestic product                    | 7.5    | 6.9    | 7.5               |
| Consumer prices                           | 1.5    | 3.4    | 2.0 <sup>b</sup>  |
| Real minimum wage                         | 0.9    | -3.0   | 3.6               |
| Money (M1)                                | 14.2   | 10.3   | 18.6 <sup>c</sup> |
| Real effective exchange rate <sup>d</sup> | 5.0    | 2.4    | 0.9 <sup>e</sup>  |
| Terms of trade                            | -1.9   | -1.9   | -2.9              |
| <b>Annual average percentages</b>         |        |        |                   |
| Unemployment rate <sup>f</sup>            | 11.8   | 9.8    | 8.6               |
| NFPS overall                              |        |        |                   |
| balance/GDP                               | -4.9   | -2.5   | 2.0               |
| Nominal deposit rate                      | 2.2    | 2.7    | 3.6 <sup>g</sup>  |
| Nominal lending rate                      | 8.2    | 8.2    | 8.1 <sup>g</sup>  |
| <b>Millions of dollars</b>                |        |        |                   |
| Exports of goods and services             | 8 817  | 10 736 | 12 351            |
| Imports of goods and services             | 9 077  | 10 636 | 12 143            |
| Current account                           | -1 061 | -782   | -716              |
| Capital and financial account             | 666    | 1 456  | 616               |
| Overall balance                           | -395   | 675    | -100              |

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

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Twelve-month variation to November 2006.

<sup>c</sup> Year-on-year average variation, January to September.

<sup>d</sup> A negative rate indicates an appreciation of the currency in real terms.

<sup>e</sup> Year-on-year average variation, January to October.

<sup>f</sup> Includes hidden unemployment.

<sup>g</sup> Average from January to October, annualized.

The balance-of-payments deficit narrowed from 5.3% to 4.2% of GDP. Goods exports grew by 13%, thanks mainly to exports of non-traditional products such as watermelon and pineapple, and re-exports from the Colón Free Zone. Imports were substantially higher (20%) especially consumer goods and intermediate products. The surplus on trade in services increased by US\$ 370 million, reflecting higher earnings from transport and tourism.

The financial account posted a surplus of US\$ 615 million, largely as a result of foreign direct investment flows totalling US\$ 2.5 billion, a record for the country. This amount is equivalent to 15% of GDP, and mainly reflects the sale of Panama's largest bank.