

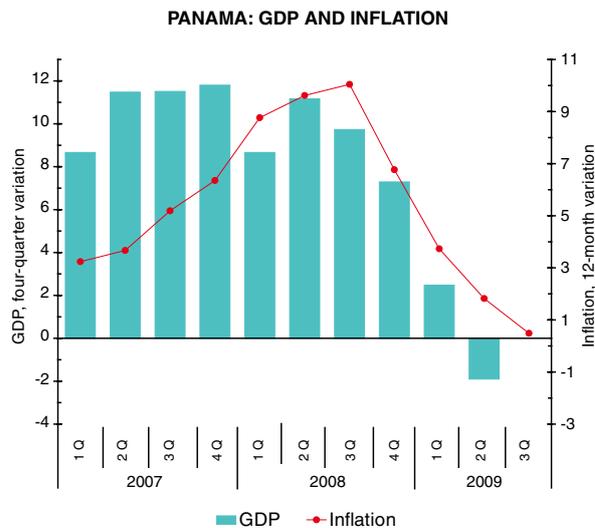
Panama

In 2009, Panama's economy slowed sharply and grew only 2.5%, compared to the 9% average annual rate registered over the previous five years. This performance reflected the fact that, though some domestic market sectors performed well, they were unable to offset the contraction in activities related to the external sector. Inflation, as measured by the consumer price index, came down and is estimated to end up at 2% year-on-year for December (it was 6.8% in 2008). Also, for the first time in three years the fiscal balance is expected to be in deficit (by 1.8% of GDP). The balance-of-payments current account deficit is expected to shrink to 9.2% of GDP because of the significant decrease in the trade deficit. In November 2009, Standard & Poor's upgraded Panama's long-term sovereign rating from stable to positive, stating that the country could shortly attain investment grade.

In 2010, GDP is expected to grow 4.5%, helped along by an upswing in world trade and the execution of infrastructure projects begun some time back, including the construction of the third set of locks in the Panama Canal and widening of the coastal beltway. Growth could be even greater if some of the large investments announced by President Martinelli come to fruition, such as the construction of a subway in the capital, another international airport in the southern part of the country and social housing. Inflation is expected to remain low. Estimates point to a smaller fiscal deficit (1.4% of GDP), thanks to the economic upturn and to implementation of new fiscal reforms, some of which were approved in September 2009.

A new fiscal and social responsibility law, which caps the fiscal deficit at 1% of GDP, went into effect in January 2009. In June, the government obtained authorization to raise the ceiling to 2.5%. In 2009, following three years of surpluses, the non-financial public sector (NFPS) posted a deficit. During the first half of 2009 this deficit was 0.8% of GDP and is expected to climb an additional percentage point by year's end, owing to the countercyclical fiscal policy deployed. For the period January to August 2009, the central government revenues fell off by 7.9%. Non-tax revenue slid by 35%, while tax income was up 11%. Expenditures increased 15%. Panama placed a bond issue on the international market for US\$ 323 million in March and another, for US\$ 1 billion, in November.

President Martinelli, who took office in July 2009, underscored that one of the goals of his administration is to modernize infrastructure projects and institute fiscal reform. In September, the Chamber passed a bill that, in addition to eliminating several exemptions and raising some taxes, for the first time will begin to consider activities of the Colón Free Zone (FTZ) as taxable transactions, subject to income tax. The next phase of the reform, expected to



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

be introduced in 2010, will seek to replace the current income tax with a single-rate tax.

Because of the international financial crisis, the country's banking system—foreign-owned and local banks alike—adopted a more precautionary stance. As the preference for liquidity increased, lending to most sectors began to fall from February 2009 onwards. In response, in March the government introduced a financial stimulus programme valued at 1.1 billion balboas, with resources from the Inter-American Development Bank (IDB), the Andean Development Corporation (CAF) and the National Bank of Panama, to encourage banks to resume local lending. By June, the programme had narrowed to 600 million balboas, as IDB funding was excluded. The Panama Banking Association has expressed disagreement with the requirements for access to the stimulus fund since it was first set up. Since then, the programme resources have been practically unused and, though bank deposits have increased, lending continues to be sluggish. In September 2009, the nominal balance of bank lending to the private sector was 1.4% higher than 12 months earlier and only 0.5% higher than that of private banks, principally reflecting the 30% decline in new loans.

In 2009, the six-month deposit rate reversed the downward trend begun in 2008 and, by September, reached 3.06%, which was 240 basis points above the London Inter-Bank Offered Rate (LIBOR). This contrasted the previous year in which the six-month deposit rate remained below LIBOR. Lending rates hovered close to their 2008 closing levels. In September, the rate for credit cards was 15.37% and for personal loans, 11.69%. In real terms this meant an increase in rates, given the lower inflation. An overly precautionary stance does reduce risks to the banking system, but it also restricts the countercyclical scope of some aspects of economic policy.

In the second half of 2008 it became evident that Panama's economy was slowing down. Nevertheless, between January and June 2009, real GDP growth was 2.4% up on the year-earlier period, driven primarily by growth in construction, transport, storage and communications. Growth in mining and construction reflected mainly works already under way, since new construction fell off significantly. Building work seems to have shifted away from multifamily luxury skyscrapers in the capital and towards lower-cost single family homes in the provinces. Expansion in the telecommunications sector was mainly the result of growth in cellular telephony. Manufacturing grew slightly, while agriculture, livestock and forestry declined, owing to adverse weather effects related to El Niño. Commerce also contracted. The monthly economic activity index showed an annualized decline of more than 3% between July and August. The global recession acted as a drag on activity in the Panama Canal. The number of

PANAMA: MAIN ECONOMIC INDICATORS

	2007	2008	2009 ^a
Annual growth rates			
Gross domestic product	12.1	10.7	2.5
Per capita gross domestic product	10.2	8.9	0.9
Consumer prices	6.4	6.8	0.7 ^b
Average real wage	1.3	-0.6	...
Real effective exchange rate ^c	1.4	-1.8	-5.8 ^d
Terms of trade	-1.0	-4.5	4.2
Annual average percentages			
Urban unemployment rate ^e	7.8	6.5	7.9
Central government overall balance/GDP	1.2	0.3	-1.8
Nominal deposit rate ^f	4.8	3.5	3.5 ^g
Nominal lending rate ^h	8.3	8.2	8.3 ^g
Millions of dollars			
Exports of goods and services	14 263	16 153	16 209
Imports of goods and services	14 627	17 604	16 715
Current account balance	-1 422	-2 792	-1 974
Capital and financial account balance ⁱ	2 044	3 377	2 124
Overall balance	622	584	150

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

^a Preliminary estimates.

^b Twelve-month variation to October 2009.

^c A negative rate indicates an appreciation of the currency in real terms.

^d Year-on-year average variation, January to October 2009.

^e Includes hidden unemployment.

^f Six-month deposits.

^g Average from January to September, annualized.

^h On one-year loans for commercial activities.

ⁱ Includes errors and omissions.

transits through the canal is estimated to have dropped by 2.4% in 2009, with cargo volume down 3.4%. Revenue was up, however, thanks to a toll hike, which translated into some improvement in the canal's cargo services and logistical support.

Inflation, as measured by the consumer price index, was down in 2009 because of lower prices for energy products and some foods. Year-on-year, the inflation rate dropped from 6.8% in December 2008 to 0.7% in October 2009, with a cumulative rate of 1.7% for January to October. The prices of electricity, gas and water (-10%) and transport (-1.9%) came down significantly. Furniture and household appliances posted the highest price increases (3.8%). Food and beverage inflation dropped off even more sharply, from 15.1% in December 2008 to 2.7% in October 2009. Estimates are that by the end of December 2009, inflation for the year will be about 2%.

Despite a shortage of data on the evolution of average wages, slowing inflation lessened erosion of real minimum wages, with nominal minimum pay remaining stable through November. The Minimum Wage Commission was formed in August 2009 and is expected to review wages in 2010. In August 2009 the unemployment rate was 6.6%, one percentage point higher than a year earlier. Unemployment rose faster in urban areas (7.9%) than in rural areas (3.9%), compared with 2008 when it was at 6.5% and 3.7%, respectively.

Between January and August 2009, the trade deficit was reduced by 52% because of a reduction in the goods trade deficit (39%) and an expansion in services trade surplus (4.8%). Imports of goods fell off by 8.9%, whereas exports climbed 5.8%, driven by activities in the Colón Free Zone (12.2%). Imports of services were down 18.8%, with exports up 2.4% due to higher receipts from tourism (1.5%)

and Panama Canal transit tolls (8.2%). In September 2009, Canada and Panama signed a free trade agreement aiming to expand trade between the two countries. In 2008, the value of imports from Canada was 128 million balboas; exports to Canada amounted to a mere 3.4 million balboas. Also, during the first half of 2009, foreign direct investment was down 39% compared with the previous year.