PANAMA

1. General trends

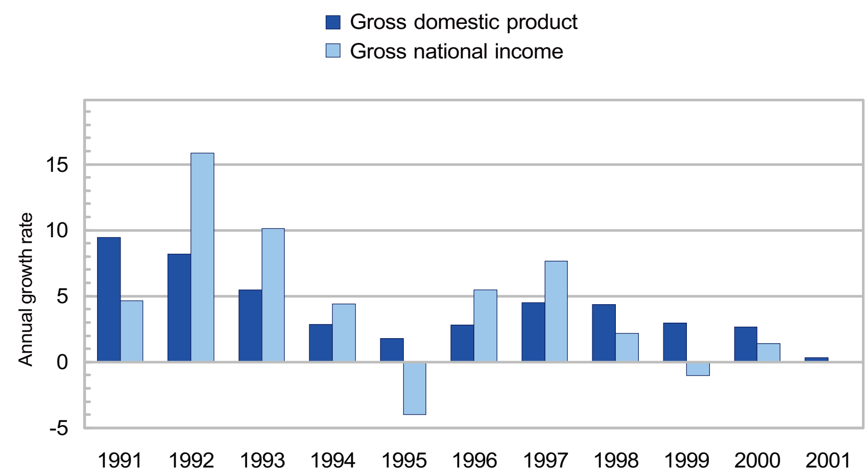
The slowdown in economic activity that had been discernible in Panama since 1998 deepened in 2001, with growth receding to 0.3%, compared with 2.7% in 2000. Consequently, per capita GDP declined (-1.3%) for the first time since 1989. Economic performance was much lower than projected by the authorities at the beginning of the year (3.5%-4%) owing to a contraction in domestic demand (-5.4%), compounded by a very sharp decline in external demand in the last quarter of the year. Together, these factors contributed to an increase in the rate of unemployment.

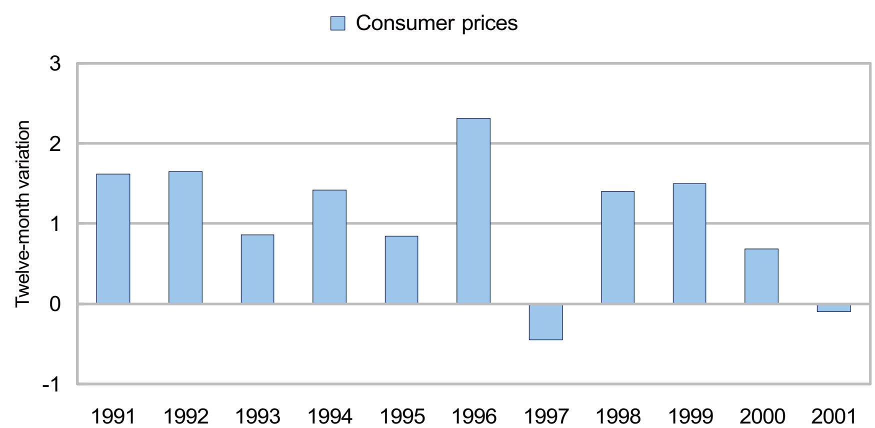
THE GOVERNMENT'S response to this unfavourable economic panorama was proactive, albeit cautious, given the weakened state of public finances. Steps were taken to curb current expenditure and collect extraordinary revenue through the issue of global bonds on the international market. This measure prevented the authorities from meeting their target of eliminating the non-financial public-sector deficit, however, which was equivalent to 1.4% of GDP by the year's end. Against this background, prices remained stable and the balance-of-payments current-account deficit declined substantially: from 9.4% of GDP in 2000 to 5% in 2001.

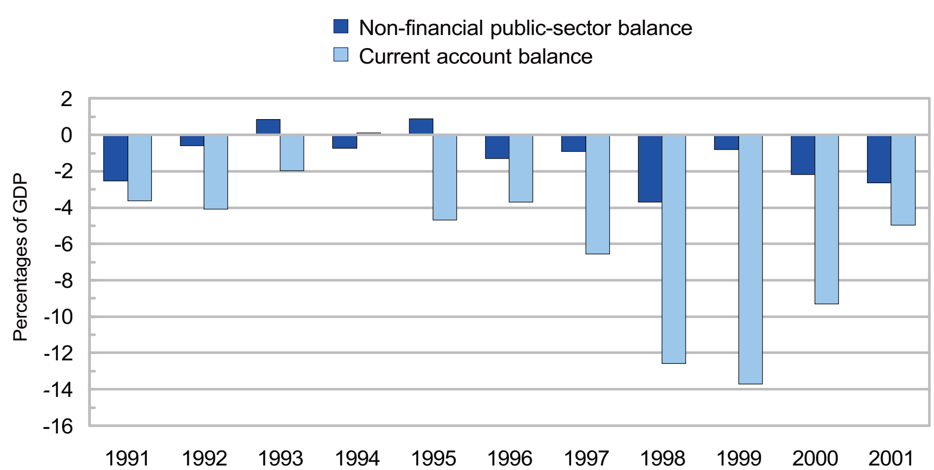
The fall-off in domestic demand was due to a contraction in credit from the principal lending institutions and the delayed effects of the withdrawal of United States military bases, which was completed in December 1999. These domestic difficulties were exacerbated by the slowdown in international trade, which was reflected in a downswing or outright contraction in industries linked to the external sector. The activity of the Panama Canal Authority declined by 1.2%; both the Colón Free Zone and the international financial centre recorded zero growth; and tourism grew at a less vigorous rate of 8% (compared with 18% in 2000). By contrast, the ports –one of the few sectors to escape this downward trend– recorded an expansion of 13%.

For the year 2002, the authorities project economic growth of 1% to 1.5%, inflation of less than 1% and a non-financial public-sector deficit equivalent to 2% of GDP. The growth of output will be contingent on an upturn in world trade and also on the effects of public expenditure in different investment projects, which, it is hoped, will start to show up in the second half of the year. In this regard, in early May 2002 the legislative power approved a key project which arose as the result of a national dialogue for economic recovery. This project authorized the use of up to US$ 200 million for social works and a maximum of 2,540 hectares of the areas reintegrated into the State of Panama as a source of financial support for carrying out new public works, mainly in the second half of the year.

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

At the start of the year, macroeconomic policy was geared towards the implementation of the programme established under the agreement signed in June 2000 with the International Monetary Fund (IMF). The agreement set strict macroeconomic targets and commitments in other areas, including strengthening of the banking system and the adoption of measures to combat money laundering. The global slowdown and its impact on Panama shifted the focus of economic policy towards mitigating the negative impact of the downswing by means of moderate counter-cyclical action. With public finances still fragile, however, the Government had little room for manoeuvre and was forced to cut current expenditure as well, in order to prevent the fiscal deficit from ballooning. In view of the constraints imposed by the precarious state of public finances, discussions began on possible uses for the National Trust Fund, which culminated in the organization of a national dialogue for economic recovery.

(a) Fiscal policy

The main fiscal policy objective at the beginning of 2001 was to achieve an equilibrium in the finances of the non-financial public sector in the framework of the IMF stand-by agreement. With this in view, the budget for the year included additional income which was to be derived from a tax reform geared towards the financial consolidation of the public sector. The fiscal reform failed to materialize, however. Moreover, tax revenues declined heavily, because of the economic slowdown and current spending rigidities. The non-financial public sector posted a deficit equivalent to 1.4% of GDP, compared with 0.8% in 2000.

The Panamanian Government sought to moderate the negative impact of the economic slowdown by adopting a moderate counter-cyclical policy. Central government gave priority to expenditure on education, health, public safety and justice. In addition, it had to shoulder extraordinary outlays on national security and on dealing with the adverse effects of the drought that affected the region during the year. These measures prevented the economy from ending the year with a negative growth rate, but the fiscal deficit widened to 2.7% of GDP, which was 0.5 percentage points higher than the rate recorded in 2000.

The Government's decision to forgive interest and charges on tax arrears facilitated the payment of more than US$ 15 million in overdue taxes, which partially offset the downturn in tax income. Government revenue from decentralized institutions, non-tax income and capital inflows also increased. Faced with slackening economic activity and declining tax revenue, however, the authorities implemented a programme to cut public expenditure by US$ 104 million in the second half of the year, in order to avoid a higher fiscal deficit. Economic agents and representatives of civil society were convened to discuss possible uses of the monies in the Development Trust Fund. These discussions culminated in a national dialogue for economic recovery, which continued into the early months of 2002.

Central government current revenues continued to weaken, with a growth rate of only 0.9%, reflecting a decline in tax revenue (-7.5%). Direct taxes were 5.9% lower than in 2000 owing to a decrease in income tax receipts. Indirect taxes fell more sharply (-9.2%), which was the result of a decline in receipts across practically all the categories. Conversely, non-tax revenue grew by 12.6% thanks to an increase in dividends paid by the National Bank of Panama and resources from the Development Trust Fund.

Total expenditure increased by a mere 3.3%, compared with 8.8% in the previous tax year. Current spending increased by only 0.3%, as a result of the Government's containment policy, while a significant expansion was recorded in capital spending (37.1%). Payroll rigidities meant that the Government had to absorb a 4.9% increase in expenditure on wages, while operating costs, current transfers and payments of debt principal and interest together diminished slightly.

Taking advantage of the lower interest rates prevailing on the international capital markets, in 2001 the Panamanian Government undertook a number of operations in order to finance the budget for the year and improve the country's debt profile. In February, Panama issued global bonds in the amount of US$ 750 million repayable in 2011. In November and December, two reissues of global bonds redeemable in 2008 raised US$ 650 million.

In addition, in July the Government conducted a swap of options for Eurobonds that were to mature in 2002, which pre-funded US$ 158 million in amortization payments. In November, Brady bonds were redeemed on the secondary market. Together, these two operations represented a saving of close to US$ 10 million.

Figure 1

PANAMA: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growt rates [b]								
Growth and investment									
Gross domestic product	5.5	2.9	1.8	2.8	4.5	4.4	3.0	2.7	0.3
Per capita gross domestic product	3.5	1.0	0.0	1.0	2.8	2.7	1.3	1.1	-1.3
Gross domestic product, by sector									
Goods	8.8	3.3	2.0	-1.0	4.3	5.5	0.6	-1.1	-4.2
Agriculture	0.0	2.7	3.2	1.1	0.0	6.3	2.1	1.6	0.8
Mining	16.9	9.6	-5.5	-16.3	88.9	22.8	15.6	-6.7	-12.8
Manufacturing	6.3	4.3	0.2	-1.3	6.4	3.9	-7.5	-5.3	-5.7
Construction	40.5	2.2	4.1	-4.1	5.5	6.7	16.0	2.5	-9.7
Basic services	1.6	4.9	7.4	6.3	4.3	6.7	12.3	10.5	3.4
Electricity, gas and water	18.1	6.3	1.9	17.7	0.8	-4.6	17.9	11.8	0.1
Transport, storage and communications	-3.2	4.4	9.4	2.5	5.7	10.9	10.5	10.0	4.6
Other services	4.3	4.4	0.1	3.6	5.0	4.2	3.3	1.8	1.0
Commerce, restaurants and hotels	5.1	4.9	-0.7	-1.0	8.9	2.2	-2.9	1.7	-1.8
Financial establishments, insurance, real estate and business services	5.9	4.4	-0.9	8.2	2.1	6.6	8.5	3.3	1.8
Consumption	3.8	-1.2	-3.3	7.9	12.6	8.7	-3.6	3.9	-3.1
General government	2.8	-0.4	4.6	3.4	7.0	4.3	-2.0	5.5	4.0
Private	4.1	-1.3	-5.2	9.1	14.0	9.8	-4.0	3.6	-4.8
Gross domestic investment	13.8	14.3	10.8	6.1	1.1	11.9	12.7	-9.6	-10.4
Exports of goods and services	-10.4	-3.7	10.2	-9.4	12.7	-2.4	-8.5	6.5	5.0
Imports of goods and services	-9.1	-3.1	9.0	-4.1	17.2	4.5	-8.3	1.4	-3.0
	Percentages of GdP [c]								
Gross national income	102.1	103.3	97.3	100.0	102.8	100.3	95.9	94.8	…
Gross domestic investment	25.1	27.8	30.3	31.3	30.2	32.2	35.2	31.0	…
National saving	23.7	27.3	24.5	23.4	20.5	14.2	13.9	12.3	…
External saving	1.4	0.6	5.8	7.9	9.6	18.0	21.3	18.8	…
	Percentages								
Employment and wages									
Labour force participation rate [d]	60.4	60.7	61.7	60.6	61.5	62.2	62.8	59.9	60.3
Open unemployment rate [e]	13.3	14.0	14.0	14.3	13.2	12.7	11.8	13.3	13.7
Real minimum wage (index: 1995=100)	102.0	100.6	100.0	104.3	103.1	105.9	109.5	113.6	121.8
	Growth rates								
Prices (December-December)									
Consumer prices	0.9	1.4	0.8	2.3	-0.5	1.4	1.5	0.7	-0.1
Wholesale prices		4.4	1.8	3.5	-3.9	-3.9	2.7	8.8	-3.2
External sector									
Terms of trade (index: 1995=100) [c]	106.8	110.1	100.0	101.3	103.4	103.3	105.9	99.8	100.3
	Millions of dollars								
Balance of payments									
Current account	-143	9	-369	-302	-567	-1,176	-1,320	-933	-499
Trade balance (goods and services)	-36	89	-157	-120	-327	-780	-736	-498	-153
Exports	6,691	7,448	7,610	7,381	8,320	8,078	7,096	7,666	7,701
Imports	6,727	7,359	7,768	7,501	8,647	8,857	7,832	8,164	7,854
Capital and financial accounts [f]	-165	-371	32	566	908	713	1,172	605	199
Overall balance	-308	-362	-337	264	341	-463	-148	-328	-300
Variation in reserve assets (- indicates an increase)	-93	-106	-75	-297	-610	103	-184	109	-484

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Percentages								
External debt									
Gross debt (as a percentage of GDP) [g]	72.6	71.2	74.5	62.2	58.3	57.2	57.8	55.9	62.1
	Percentages of GDP								
Central government									
Current income	17.8	17.7	18.6	18.6	18.2	17.8	19.8	19.3	19.2
Current expenditure	15.8	16.3	16.1	17.6	17.4	19.8	18.6	19.9	19.7
Saving	2.1	1.4	2.5	1.0	0.8	-2.0	1.2	-0.6	-0.5
Capital expenditure	2.1	2.1	1.8	2.4	2.4	2.5	2.1	1.8	2.4
Financial balance	0.8	-0.7	0.9	-1.3	-0.9	-3.7	-0.8	-2.2	-2.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1982 balboas. [c] Based on constant 1995 dollars. [d] Percentages of the working-age population. [e] Percentages of the economically active population. [f] Includes errors and omissions. [g] Refers to external debt contracted by the public sector; no adjustment has been made for currency fluctuations.

Public debt amounted to US$ 8.4 billion, comprising US$ 6.26 billion in external obligations and the rest in domestic debt. The balance of public debt at the year's end thus rose from the equivalent of 77% of GDP in 2000 to 83% in 2001, while the ratio of external debt to GDP increased from 56% to 62%. It should be noted that the balance includes US$ 342 million for the global Eurobond payment to be made in February 2002. Conversely, the domestic debt/GDP ratio remained unchanged at 21%.

(b) The international financial centre and credit policy

Activity in the International Banking Centre was sluggish in 2001. Its assets scarcely varied from the previous year's level of US$ 38.04 billion, which reflected a slight increase (0.5%) in the assets of the national banking system, which account for 82% of the total, offset by a decline in the assets of international banks (-2.3%). This flat growth was attributable to adjustment in the sector caused by the contraction in commerce (which is the main client for bank loans), the correction of problems resulting from the excessive expansion of credit granted previously and the application of banking oversight rules in line with the Basle Accord. Several banks therefore had to increase their reserves, improve their liquidity position and make additional capital contributions. This was achieved, in a number of cases, through the merger of some entities and the closure of others.

The adjustment process consisted of keeping the expansion of domestic credit at a lower rate than the increase in deposits, widening the spread between lending and deposit rates, which enabled banks to cover their arrears losses and shore up their financial position, and improving the quality of portfolios, partly by increasing the ratio of loans to foreign companies and attaching more stringent conditions to new loans. These adjustments enabled the banks to set up reserves and provide for overdue loans, which had the effect of slightly increasing the net worth of local private banks (5.2%).

Domestic credit operations expanded by 5.8%, by contrast with external loans, which contracted by 1.1%. While the balance of credit to the public sector diminished for the fifth consecutive year in 2001 (in this instance, by 16.5%), loans to the private sector expanded by 7.4%. Credit for commerce, housing and personal consumption, which accounted for the bulk of loans, however, posted only small increases (1.2%, 4.8% and 3.6%, respectively), which sharpened the slowdown that began in 1998, when double-digit growth rates were recorded for these activities.

Interest rate trends in Panama ran counter to those existing in the leading world economies in 2001. Practically all interest rates in the local banking system rose slightly as an annual average, although they were low compared with rates in other countries in the region. On the other hand, deposit rates paid by foreign banks operating in Panama declined in line with the London Inter-bank Offered Rate (LIBOR) to which they are indexed.

One noteworthy point is Panama's progress in managing its financial system to prevent money-laundering. In late 2000, Panama adopted a strict legal system based on a definition of money-laundering that encompasses funds from arms trafficking, terrorism, extortion, corruption and international trafficking in persons and vehicles. The reform also contributes to international cooperation through the exchange of information and confers responsibilities for oversight, including trusts, upon the Superintendency of Banks. These measures led to Panama's removal from the blacklist of the International Financial Action Task Force on Money-laundering.

(c) Trade policy and agreements

Within the framework of the negotiations on free trade agreements aimed at facilitating trade liberalization and expanding export markets, bilateral talks were held in 2001 with Chile, El Salvador, Mexico and with Central America as a bloc.

The negotiations with El Salvador culminated in the signing of a free trade agreement in March 2002. In November 2001, Panama and Mexico started preliminary talks with a view to signing a free trade agreement, which is expected to materialize soon. Panama also signed a framework agreement on free trade with the five Central American countries. This has led to significant advances with respect to market access, agriculture, health standards and telecommunications.

3. The main variables

Monetary policy is not available as a tool in a dollarized economy such as Panama's and this, when combined with a fragile financial and fiscal situation, leaves very little scope for countering adverse external phenomena such as the global slowdown which took place in 2001. Consequently, economic performance was poor.

(a) Economic activity

Domestic demand declined by 5.4%, which was attributable to a downturn of 10% in gross domestic investment and a smaller dip in consumption (-3.1%). A decrease of almost 5% in private consumption was partly offset by an increase of 4% in public consumption.

The trend towards a generalized weakening in the productive sectors, which was visible in the three preceding years, steepened in 2001. Services, which account for just over 80% of GDP, contracted sharply, while merchandise production shrank considerably, since agriculture was the only sector to record positive growth.

Fewer ships transited the Panama Canal than in previous years, although cargo volumes remained practically unchanged. Toll receipts were slightly higher (0.9%) at US$ 580 million, thanks to an increase in canal rates. During the year, the Panama Canal Authority continued with its programme of improvements and modernization of facilities.

Transport and communications expanded by 4.6%, which was a modest figure in comparison with the three preceding years, when these sectors recorded double-digit growth rates. Telecommunications and postal services, which were up by 11.4%, were less dynamic as a result of slower growth in cellular telephony.

Port operations expanded by 13% thanks to the modernization of container-handling facilities in the port of Balboa. Next in line were tourism services, which received a boost from the construction of specialized cruise terminals and the start-up of railway services across the Isthmus. Tourism was not immune to the effects of the global economic slowdown, however, as spending by tourists and in-transit passengers increased by 8% (compared with 18% in 2000), while the number of tourist arrivals went up by a mere 2.8% in 2001.

Agriculture grew by only 0.8%, which was a reflection of the decline in banana production for the second year running and the diminishing incentive for coffee production caused by the fall in prices on the international market. Coffee prices reached their lowest real level for several decades. This sector's performance was also affected by various climate problems, including an abnormally long dry season, which delayed the sowing of a number of crops.

Slack domestic demand hurt commerce and firms were forced to cut prices to adjust stocks. The weak economic state of its main clients in the region caused a loss of momentum in the Colón Free Zone, where production increased by only 2% compared with 10% in 2000.

Manufacturing fell sharply (-5.7%) for the third consecutive year, with practically all subsectors showing declines. This contraction was due to continued adjustments to trade liberalization, the diminished purchasing power of Panamanians, a downturn in a number of agricultural activities and a slump in the construction industry following the completion of various commercial centres, hotels and road works.

(b) Prices, wages and employment

Price movements were strongly affected by the fall in international oil prices and the decline in domestic demand. Inflation measured by the consumer price index was zero, as a result of lower prices in both transport and communications (-3.6%) and food and beverages (-0.7%), although other items posted increases. The wholesale price index fell by 3.2%, which reflected the weakness in economic activity.

The slowdown in economic activity, in general, and in labour-intensive sectors, in particular, pushed the unemployment rate up to 13.7%. If, however, the rate is calculated without factoring in the main sample changes made during the year, it would reflect an increase of almost one percentage point with respect to the figure recorded in August 2000 (13.5%). In urban areas, the unemployment rate increased from 15.2% to 16.6% between August 2000 and August 2001.

The minimum wage, which is adjusted every two years, remained unchanged in 2001. Other wage categories recorded substantial increases which were at odds with the sluggish performance of the economy, however. Average public-sector wages increased by 3.5% and in the Colón Free Zone pay rose by 3.8%. In the banana-growing areas, the increase was somewhat smaller at 2.4%. Given the low rate of inflation, these nominal increases reflect a real improvement.

(c) The external sector

Exports of goods and services proved less dynamic than in recent years owing to the slower pace of world trade. The balance-of-payments current-account deficit narrowed for the second year in a row to stand at US$ 500 million by the end of 2001, compared with US$ 930 million in late 2000. The deficit to GDP ratio thus declined from 9.4% in 2000 to 5% in 2001.

In 2001, the Colón Free Zone posted a balance of US$ 490 million, or 4.2% less than in the previous year, due to difficulties faced by its Latin American clients, stiffer competition and losses incurred on a number of markets. Zero growth in reexports –which account for more than 80% of external sales– was largely responsible for the meager expansion of total exports (0.4%, as against 8% in 2000), while total imports were down by 3.8%. As a result, the trade deficit narrowed to US$ 150 million, which represented only one third of the figure recorded in 2000.

Up to September national goods exports grew by close to 11%, but the rate at the year's end was only 3.9%, because of the slump experienced in the last quarter. In this context, shrimp and livestock exports performed very well, with growth rates of close to 20%. Conversely, income from banana and coffee exports fell sharply, by 24% and 31%, respectively.

The decline in imports was attributable to a variety of factors, including the downturn in domestic consumer spending, a contraction in personal credit, adjustments in commercial stocks, lower private investment in construction and the decline in direct investments by international companies. In fact, total merchandise imports shrank by 4.5%. Imports into the Colón Free Zone recorded lower growth (0.7%), while national imports were down by more than 10%, with the steepest slumps in investment goods and goods for construction. Purchases of raw materials and intermediate goods were also down.

The services trade balance, which has traditionally been positive, declined from US$ 690 million to US$ 670 million. Income from travel, mainly tourism, grew by 19%, while revenues from the activities of the Panama Canal Authority decreased by 2.3%. The income account posted a deficit of US$ 545 million. This was lower than the figure of US$ 610 million recorded in 2000, since net outward payments by Panamanian banks decreased in view of lower interest rates in the main markets.

The balance-of-payments current-account deficit was financed by net inflows into the financial account, which amounted to US$ 590 million. Net foreign investment inflows stood at US$ 510 million, which was almost US$ 90 million lower than the previous year.