Panama

1. General trends

The strengthening of domestic demand in the wake of an expansionary fiscal policy triggered a recovery in the Panamanian economy in 2003, boosting gross domestic product (GDP) by 4.1%. In addition to the increase in domestic demand, there was a gradual improvement in the external environment that became more pronounced in the first half of 2004. The upturn helped to ease the unemployment rate slightly, in a context of macroeconomic stability. Inflation remained low (1.7%), in keeping with traditional patterns, and the non-financial public-sector deficit stayed at the preceding year's level (1.9%). The external deficit widened to 3.2% of GDP, owing to a larger outflow of profits and bank dividends.

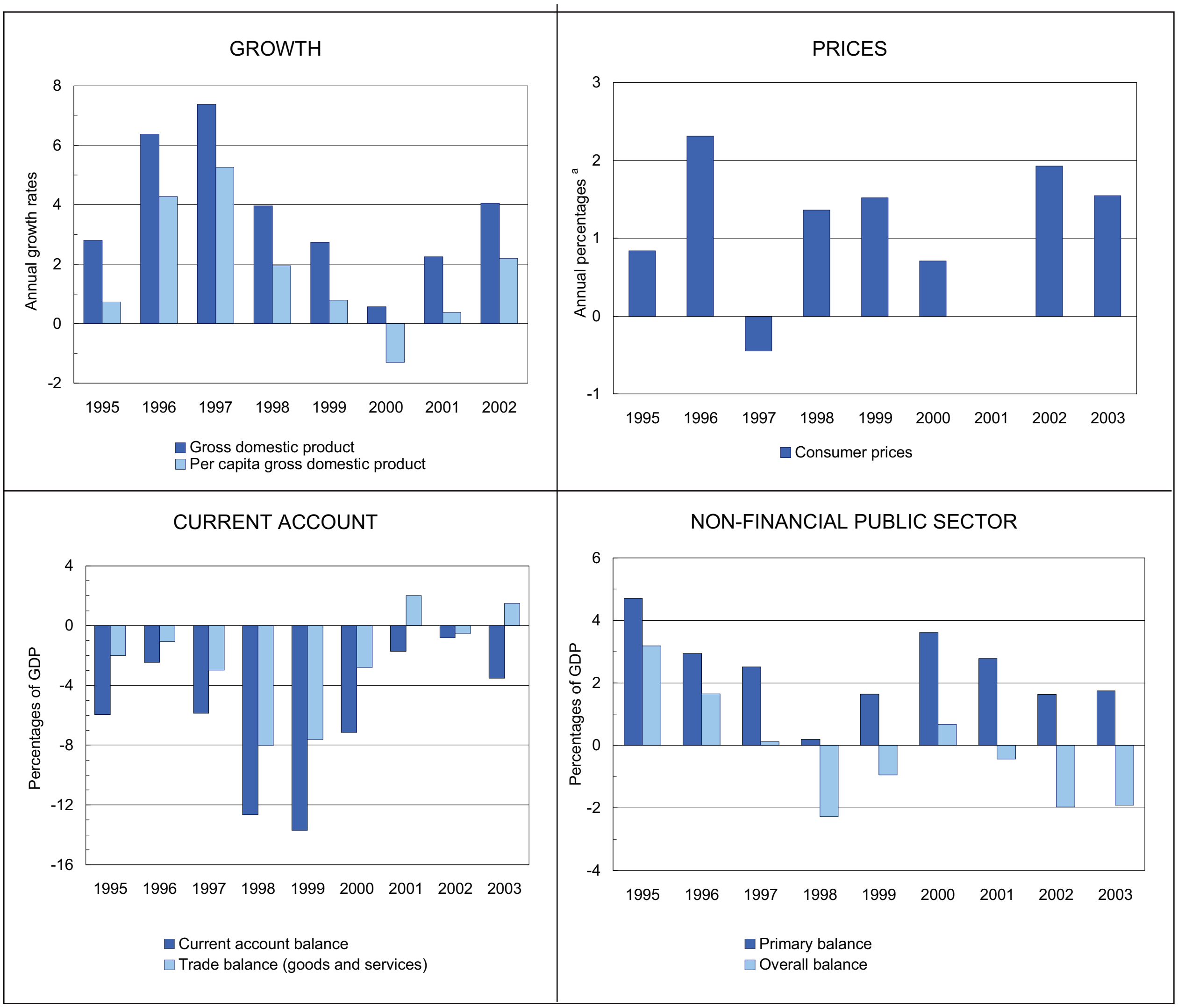
The local economy, which in 2003 was already emerging from the downswing phase of the business cycle of the previous three years, was further boosted by a policy of reactivation through public investments and tax incentives. The definition of the fiscal policy framework, which was supported by three laws passed in 2002, dispelled uncertainty and clarified the rules of the game. The expansion of employment and increases in both the minimum wage and civil-service remuneration also fuelled domestic demand. Although operations in the Colón Free Zone continued to decline, a slight recovery in other international service sectors helped to revive the economy. Foreign direct investment grew, and ports and tourism had a good year, owing in part to the celebration of special events such as the Centenary of the Republic.

GDP growth of around 5% is forecast for 2004 as a whole, given that economic growth had already reached 6.7% in the first quarter. The international environment has continued to improve and various public and private investment projects are still being implemented. Inflation is set to remain low, while the fiscal deficit should come in at about 2% of GDP. The presidential and parliamentary elections held in May dominated the local agenda in the first half-year, and their results gave the new administration ample room for manoeuvre, thereby improving the economic outlook.

2. Economic policy

In 2004 the outgoing administration maintained the economic policy approach it had applied the preceding year, the main features of which were an expansionary fiscal policy, the negotiation of free trade agreements and active public debt management. The new administration's objectives are to achieve sustained

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

economic growth with a view to reducing the high rate of unemployment; consolidate public finances and modernize the State; encourage competition and private-sector development; and modernize basic infrastructure.

(a) Fiscal policy

The government set a fiscal deficit target of under 2% of GDP for 2004, but tax and non-tax revenues came in 6.8% and 31.7% lower than budgeted, respectively, in the first four months of the year. To avoid putting the achievement of the fiscal target at risk, the outgoing authorities had to resort to expenditure cuts in the first half of the year.

The central government boosted domestic demand in 2003 by increasing public expenditure, while taking care to avoid a deterioration in its debt position. To that end, it sold assets in the reverted areas and used resources from the Development Trust Fund (an institution that finances public projects), together with profits earned in public debt buy-back operations. In addition, workers earning less than US$ 800 per month were exempted from income tax. Lastly, a third set of measures was adopted to create temporary incentives aimed at increasing private investment; a two-year (2003-2004) property tax exemption was granted and incentives for the construction of housing units under US$ 62,500 were extended. This stimulated growth of almost 30% in the construction sector.

The central government posted a deficit of 3.4% of GDP, following a 2% shortfall in 2002. Revenue in general shrank by 2% in real terms, although tax revenues rose by 5.8% owing to a 10.4% increase in receipts from indirect taxes. All this reflected the tax reform introduced in 2002, the most important aspect of which involved extending the transfer tax (equivalent to value added tax) to non-basic services. However, this increase was more than offset by a decrease in non-tax and capital income.

Total expenditure, meanwhile, grew by 6.4% in real terms. Specifically, current expenditure rose by 4% owing to larger interest payments (8.6%); domestic interest increased by 34% in response to a change in the government's approach to domestic debt. The wage bill went up by 3.2%, following the trend of previous years. Capital expenditure was the most dynamic spending category (up by 20%), reflecting infrastructure projects. Various public works will continue to be executed in 2004, including a second bridge across the Panama Canal and the extension of the Inter-American Highway; the Canal Authority also has a variety of investment plans.

The non-financial public sector as a whole posted a deficit equivalent to 1.9% of GDP, which was slightly lower than the 2002 deficit. Both income and expenditure were down slightly in real terms. While the Panama Canal Authority earned higher revenues and public enterprises ran bigger surpluses, the Social Security Fund saw a further downturn in its situation, as it recorded an operating deficit of US$ 67 million, which exceeded the 2002 imbalance by US$ 48 million.

The government continued to take an active approach to public debt management. It resorted to international capital markets only once in 2003, with a US$ 275-million global bond issue that matures in 2027. It also contracted loans with multilateral and private entities for US$ 146 million, and took advantage of opportunities offered by the international market to launch Brady bond buy-back operations for a total of US$ 123 million. Of the funds thus raised, US$ 474.5 million was earmarked for the payment of interest and commissions and US$ 287.9 million, for principal payments.

The domestic capital market continued to strengthen in 2003. Treasury bills, which are short-term instruments, were reduced by 10%, while medium-term treasury notes tripled, from US$ 159 million to US$ 500 million. Domestic debt outstanding was equivalent to 16.7% of GDP, while external debt amounted to 50.5% (US$ 6.503 billion). As a result, the total public debt, at 67.2% of GDP, was two and a half percentage points lower than it had been in 2002.

In the first quarter of 2004 Panama floated a new global bond issue totalling US$ 250 million and maturing in 2034, the longest-term instrument that the country has issued since its readmission to international markets in 1997. It also bought back US$ 407 million in Brady bonds by making a new issue of the 2023 global bond for US$ 326 million; this operation reduced the external debt by US$ 57 million. In January 2004 the government issued a new five-year treasury note, which will be sold through monthly auctions until a level of US$ 300 million is attained.

(b) The International Banking Centre and credit policy

In 2003 the restructuring of the International Banking Centre continued through mergers and acquisitions in a less hostile environment than in 2002. The Centre's total assets shrank by 2.4%, compared to the steep decline of almost 13% recorded in 2002 as a result of an adjustment in the foreign bank loan portfolio in response to the weakness of Latin American markets. On the other hand, net profits strengthened substantially, amounting to US$ 648 million. The banking system maintains high levels of liquidity (32%), while the ratio of capital to risk-weighted assets stands at 19%. The non-performing loans ratio fell from 3.3% in 2002 to 2.3% a year later, and loan-loss provisions currently represent 150% of non-performing loans.

Credit extended by the local banking system sustained a further decline (-3.8%), after having fallen by 15.2% in 2002. Domestic credit expanded slightly (1.2%), while external loans shrank for a sixth consecutive year (-16.4%). Interest rates continued their slow descent of recent years, in keeping with international patterns, and average six-month deposit rates eased by 181 basis points. Lending rates on commercial credit rose by 30 points, while loans to industry and consumer credit declined by 30 and 255 points, respectively. Lastly, the benchmark rate in the local mortgage market slipped from 9% to 8%.

(c) Trade policy

Trade policy continued to be geared towards opening markets through the conclusion of free trade agreements. In 2003 an agreement of this type was signed with Taiwan Province of China and entered into force that same year; a similar agreement with El

Table 1
PANAMA: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
					Annual growth rates [b]				
Gross domestic product	1.8	2.8	6.4	7.4	4.0	2.7	0.6	2.2	4.1
Per capita gross domestic product	-0.3	0.7	4.3	5.3	2.0	0.8	-1.3	0.4	2.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.2	1.1	3.3	6.6	1.8	10.1	6.4	2.0	4.5
Mining	-5.5	-16.3	80.8	26.1	23.9	-10.6	-4.1	18.1	32.0
Manufacturing	0.2	-1.3	3.3	2.2	1.1	-7.2	-6.3	-2.8	-1.5
Electricity, gas and water	1.9	17.7	6.2	-2.5	12.0	9.3	-4.7	6.6	1.2
Construction	4.1	-4.1	6.7	11.9	36.0	1.3	-21.8	-7.1	28.6
Wholesale and retail commerce, restaurants and hotels	-0.7	-1.0	12.1	6.8	-3.9	3.8	3.7	1.1	3.9
Transport, storage and communications	9.4	2.5	10.0	14.6	6.7	12.5	2.5	2.1	8.8
Financial institutions, insurance, real estate and business services	-0.9	8.2	5.2	7.8	5.8	5.9	-0.5	1.6	0.3
Community, social and personal services	2.7	2.6	3.1	4.2	3.7	-0.4	3.9	3.2	4.0
					Percentages of GDP				
Investment and saving [c]									
Gross domestic investment	30.3	30.5	31.1	32.1	33.1	28.7	25.5	24.7	28.5
National saving	29.8	28.9	26.0	22.5	22.7	22.1	23.9	23.9	25.2
External saving	0.5	1.6	5.0	9.6	10.4	6.5	1.6	0.8	3.4
					Millions of dollars				
Balance of payments									
Current account balance	-471	-201	-507	-1 182	-1 320	-716	-174	-92	-408
Merchandise trade balance	-589	-644	-685	-1 365	-1 386	-1 143	-696	-1 037	-1 092
Exports, f.o.b.	6 091	5 823	6 670	6 350	5 303	5 839	5 992	5 315	5 051
Imports, f.o.b.	6 680	6 467	7 355	7 715	6 689	6 981	6 689	6 352	6 143
Services trade balance	432	558	428	614	650	864	899	979	1 263
Income balance	-466	-249	-400	-591	-755	-614	-602	-284	-820
Net current transfers	153	135	151	159	171	177	226	250	241
Capital and financial balance [d]	139	467	850	803	1 173	388	818	152	255
Net foreign direct investment	223	416	1 299	1 296	652	603	405	78	792
Financial capital [e]	-84	52	-449	-493	520	-215	413	74	-537
Overall balance	-331	267	343	-380	-148	-327	644	60	-153
Variation in reserve assets [f]	-78	-298	-611	20	-185	108	-633	-52	163
Other financing [g]	409	31	268	360	332	219	-11	-8	-10
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	103.1	103.4	103.3	102.4	100.7	100.0	102.8	102.8	106.6
Terms of trade for goods (index: 1997=100)	96.7	98.0	100.0	99.9	102.4	96.5	97.0	96.0	91.8
Net resource transfer (% of GDP)	0.9	2.7	7.1	5.2	6.5	-0.1	1.7	-1.1	-4.7
Gross external public debt (millions of dollars)	3 938	5 069	5 051	5 180	5 412	5 604	6 263	6 349	6 502
Gross external public debt (% of GDP)	49.8	62.2	58.3	55.4	56.2	55.9	62.1	56.6	56.2
Net profits and interest (% of exports) [i]	-7.4	-4.3	-5.3	-7.7	-11.1	-7.8	-7.5	-3.8	-10.8
					Average annual rates				
Employment									
Labour force participation rate [j]	61.7	60.6	61.5	62.2	62.8	59.9	60.5	62.6	62.7
Unemployment rate [k]	14.0	14.3	13.2	12.7	11.8	13.5	14.0	13.5	12.8

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	0.8	2.3	-0.5	1.4	1.5	0.7	0.0	1.8	1.7
Variation in real minimum wage	-0.6	4.3	-1.2	2.7	3.4	3.8	7.0	-1.2	0.7
Nominal deposit rate [l] (December-December)	...	...	...	...	...	...	6.8	5.0	4.0
Nominal lending rate [m]	...	...	...	...	...	...	10.6	9.2	8.9
	Percentages of GDP								
Non-financial public sector									
Current income	22.7	21.4	21.0	21.2	23.1	24.3	23.4	22.2	21.1
Current expenditure	20.6	19.6	20.8	20.7	21.0	22.1	22.7	23.0	22.2
Current balance	2.1	1.8	0.2	0.5	2.1	2.2	0.7	-0.7	-1.1
Net capital expenditure	2.9	3.1	3.0	4.5	3.8	2.5	2.5	2.3	2.4
Primary balance	4.7	2.9	2.5	0.2	1.6	3.6	2.8	1.6	1.7
Overall balance	3.2	1.7	0.1	-2.3	-0.9	0.7	-0.4	-2.0	-1.9
Interest payments (% of current income)	6.7	6.1	11.4	11.6	11.2	12.1	13.8	16.2	17.3
Total public sector debt	95.8	84.0	78.2	75.8	79.8	77.2	83.3	76.0	74.8
Domestic	21.2	21.8	19.8	18.6	22.1	21.2	21.2	19.4	14.2
External	49.8	62.2	58.3	55.4	56.2	55.9	62.1	56.6	56.2
Money and credit [n]									
Domestic credit [o]	71.5	75.2	79.1	88.7	102.7	110.6	116.1	101.6	95.8
To the public sector	1.4	1.5	0.8	1.2	1.1	1.6	1.4	1.5	3.1
To the private sector	70.1	73.7	78.3	87.4	101.5	108.9	114.8	100.1	92.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] As from 1997, based on figures in local currency at constant 1996 prices. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Unemployed population as a percentage of the economically active population, nationwide total. Includes hidden unemployment. [l] Six-month deposits in the local banking system. [m] One- to five-year loans for commercial activities. Since 2000, local banking system. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

Salvador also went into effect. The latter is the first of five agreements to be concluded with the Central American countries, since it was not possible to reach a joint accord. Negotiations with the United States and Singapore started in the first half of 2004 and are expected to conclude in the course of the year. The negotiations with the United States encompass trade issues that have not been considered previously, such as shipping standards, competition, port security and the Panama Canal.

3. The main variables

(a) Economic activity

Economic activity grew by 4.1% in 2003, almost double the preceding year's rate. Production was spurred by domestic demand, which expanded by close to 6%. The most buoyant component was gross domestic investment (12%), which reflected the implementation of public and private projects. Consumption grew on a par with the average growth of the economy; household consumption was boosted by the rise in employment, the slight increase in the minimum wage and the tax incentives included in the 2002 reform. In contrast, the

Table 2
PANAMA: MAIN QUARTERLY INDICATORS

	2002				2003[a]				2004[a]	
	I	II	III	IV	I	II	III	IV	I	II
International reserves (millions of dollars)	1 157	1 072	947	1 183	1 405	1 310	1 101	1 011	974	792
Real effective exchange rate (index: 2000=100) [b]	101.6	103.1	103.2	103.2	104.8	106.6	106.7	108.2	109.5	109.2
Consumer prices (12-month percentage variation)	0.9	1.2	0.7	1.9	1.6	1.5	1.3	1.5	1.3	2.0
Average nominal exchange rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal interest rates (annualized percentages)										
Deposit rate [c]	5.3	5.0	4.8	4.9	4.6	4.7	4.0	2.6	2.4	...
Lending rate [d]	10.4	9.3	8.6	8.7	8.8	8.8	8.7	9.2	8.8	...
Sovereign bond spread (basis points)	348	447	553	439	402	372	367	327	344	354
Domestic credit [e] (variation from same quarter of preceding year)	-2.0	-4.4	-6.2	-6.9	-1.6	-3.2	0.0	-1.3	-0.3	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Six-month deposits in the local banking system. [d] One-year loans for commercial activities, local banking system. [e] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

external components of overall supply and demand remained weak.

The agricultural sector expanded by 4.5% (compared to 2% in 2002), thanks to higher output in fishing (12.6%) and forestry (6.8%), while crop and livestock production fell back slightly. Manufacturing suffered for the fourth year in a row, with output dipping by 1.5%. Specifically, there were downturns in the production of sugar, textiles, footwear, certain food products and oil refining, while fish and seafood processing and preservation, carbonated beverages, beer and dairy products all achieved positive growth. There were also significant expansions in various segments linked to construction, such as cement, metal goods, non-metallic minerals and glass products.

The sectors that posted the highest growth rates in 2003 were construction (28.6%) and mining and quarrying (32%), both of which benefited from tax incentives. The electricity, gas and water segment increased by 1.2%, slowing down considerably from the preceding year's expansion of 6.6%. Transport, storage and communications rose by 8.8%, led by port and railway activity. Panama Canal operations grew by 8%, which was the first significant expansion in five years. Toll receipts, which were up by 13.1%, were boosted by two rate hikes totalling 15% over the fiscal year (October 2002-September 2003), while the number of transits went down slightly (-0.2%) and cargo volumes displayed zero growth. As in previous years, container shipping was the fastest-growing component of this subsector, at the expense of other types of cargo. Telecommunications and postal services recorded a modest 3.6% expansion.

The commerce, restaurant and hotel sector grew by 3.9%. Domestic commerce and tourism expanded considerably, while external trade was not yet able to regain its former dynamism. The 2.4% increase in value added in the Colón Free Zone represented a recovery from the 4.3% drop experienced in 2002, but continued to reflect the difficult situation of its main customers in South America. Restaurant and hotel activity grew by 7.6%, in contrast to the financial services, insurance and real estate sector, which was broadly flat (0.3%) owing to difficulties in the banking sector. Personal, social and community services expanded by 4%.

Preliminary data on the real sector for the first quarter of 2004 show an accentuation of the preceding year's positive trends. Agriculture rebounded (6.7%), while the fishing industry and the mining and quarrying segment continued to display robust growth (of close to 20% in both cases). Construction is expanding vigorously, just as it did in 2003, and the same is true of ports, telecommunications, transport and the Panama Canal, thanks to the upturn in world trade. While the Colón Free Zone currently boasts a 13% rate of expansion, financial intermediation has yet to post positive growth. Lastly, the monthly index of economic activity showed a variation of over 6% in May.

(b) Prices, wages and employment

Average inflation came in at 1.4% in 2003, four tenths of a percentage point higher than in 2002. The December-to-December variation was 1.7%, which is within the bounds of Panama's historical trends. Food prices contributed significantly to the rise in inflation, increasing by 1.3%, whereas in 2002 they had fallen by 0.7%. Rentals and furniture prices rose faster than inflation overall, while average health-care costs declined once again. Transport costs were up by just 0.9%, following a 6.4% rise in 2002. High oil prices had not yet begun to show through in this subsector in the first half of 2004, as inflation followed a pattern similar to that of the preceding year, with an annual variation of 1.5%. After having fallen in the preceding biennium, wholesale prices moved up by 1.4% in 2003, reflecting the pass-through of higher prices for imports (up by 1.6%) and manufactures (up by 2.9%).

The minimum wage, which is usually adjusted every two years, was raised by 4.1% in August 2003. Given the low inflation rate, this entailed a slight real increase of 0.7% in the year-on-year average.

The labour market strengthened somewhat in 2003. The nationwide unemployment rate subsided from 13.5% in 2002 to 12.8% in 2003, thanks to a half-point increase in employment, while the economically active population stayed practically the same as a percentage of the working-age population. Unemployment fell faster in urban areas than in rural ones.

(c) The external sector

The merchandise trade deficit widened from US$ 1.037 billion in 2002 to US$ 1.092 billion in 2003. Exports dipped by 5%, owing entirely to the weak performance of re-exports from the Colón Free Zone (-6.7%), since national exports were up by 6.9%, rebounding strongly from the 6.6% decline posted in 2002. Individual export categories varied widely: banana exports contracted for the fourth year in a row, this time by 7%, while coffee sales soared (by almost 33%) after having fallen for four straight years. Exports of other fresh tropical fruits performed well, increasing by 16.4%. Marine products showed mixed results, as the export value of shrimp and lobster contracted while that of other marine products rose by 27.9%. The standout in this sector was fishmeal, whose export value skyrocketed (160%). In the first quarter of 2004 exports made a recovery, growing by an estimated 11%.

Meanwhile, merchandise imports shrank for the third year running, this time by 3.3%. As in 2002, this reflected a fall in the value of goods imported into the Colón Free Zone (-7.4%), since national imports edged up slightly (1.8%). The sharpest increases were in transport equipment, base metals and metal manufactures and chemical products –all of which were linked to the construction boom– while imports of livestock, vegetables and food products grew at slower rates. Imports of mineral products, textiles and textile manufactures and footwear dropped back.

The traditional surplus on trade in services expanded from US$ 979 million to US$ 1.263 billion in 2003. Transport services grew by 15.8%, reflecting upturns in the Panama Canal and in port and railway activities. Another factor in this outcome was the strong performance of tourism, which contrasted with the negative growth posted by the Colón Free Zone and the International Banking Centre. The deficit on the income account widened to US$ 820 million, largely because of profit and dividend repatriation, which surged from US$ 277 million in 2002 to US$ 711 million in 2003. On the other hand, net current transfers did not vary, with the result that the deficit on the balance-of-payments current account widened from 0.8% of GDP in 2002 to 3.2% in 2003.

Lastly, the financial account recorded a surplus of US$ 25 million, compared to a US$ 76-million deficit in 2002. Foreign direct investment increased from US$ 78 million to US$ 791 million, thereby returning to its usual levels in the Panamanian economy. This recovery was due in part to International Banking Centre activities. Assets and liabilities relating to other investments did not change as dramatically as they had in 2002, when International Banking Centre assets had contracted sharply. The other areas showed no significant changes relative to the preceding year.