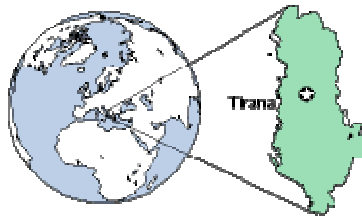


# COUNTRY REVIEW

## Panama



8 July 2009

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**EULER HERMES COUNTRY RISK GRADE: B**

Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.

## Strengths

- Stable political system with orderly, democratic transfers of power since the early 1990s
- Full dollarisation minimises transfer risk
- Relatively sound banking system
- Sound Structural Business environment

## Weaknesses

- Relatively high public debt ratios
- The economy is highly exposed to external developments (exports and services from Panama Canal) and growth of real GDP has been relatively volatile

## Key Risks

- **Recession/very sharp slowdown in growth**

## Country Risk Assessment

Ratings	Panama		Median Grade B	Peru	Peers	
	Latest	Previous			Colombia	Morocco
<b>Systemic Political Risk:</b>	<b>P2-</b>	<b>P2-</b>	<b>P2-</b>	<b>P3+</b>	<b>P3+</b>	<b>P3+</b>
<b>Systemic Economic Risk:</b>	<b>E4</b>	<b>E4</b>	<b>E4</b>	<b>E4</b>	<b>E4</b>	<b>E4</b>
ME rating:	ME4	ME4	ME4	ME4	ME4	ME3
<i>Structure</i>	5.0	5.0	4.8	5.0	5.0	5.7
<i>Policy</i>	3.9	2.8	3.7	3.8	4.0	3.6
<i>Solvency</i>	2.3	2.8	2.8	2.8	3.8	2.3
<i>External Liquidity</i>	5.2	4.3	4.0	2.8	4.2	3.2
SBE rating:	SBE3	SBE3	SBE3	SBE3	SBE3	SBE4
<b>COUNTRY GRADE:</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>B</b>

**Nomenclature:**

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

## ECONOMIC STRUCTURE

### Country Profile

Capital city:	Panama City
Population:	3.34 mn (2007)
GDP:	USD 19485 mn (2007)
Currency:	US Dollar (Balboa)
Form of state:	Republic (constitutional democracy)
Head of government:	President Ricardo Martinelli
Next elections:	2014 (Presidential & Legislative)

### Major Industries (% of GDP at market prices, 2008)

Agriculture & fishing	6.4%
Manufacturing & mining	8.2%
Utilities	3.0%
Construction	6.3%
Services	76.1%

### Global Assumptions

	2008	2009
Real GDP grth (% yr/yr) *	0.7	-3.0
Inflation (% , av) *	3.4	1.0
Dated Brent (USD/b)	98	50
* Major economies		

### Main Exports (% of total, 2007)

Colon free zone	88.3%
Other	11.7%
Fish	2.3%
Melon	1.2%
Banana	1.1%

### Main Imports (% of total, 2007)

Colon free zone	52.6%
Other	47.4%
Consumption goods	20.1%
Intermediate goods	13.8%
Capital goods	13.5%

### Lead Export Markets (% of total exports, 2007)

Venezuela	18.6%
Colombia	14.1%
US	7.5%
Costa Rica	5.2%

### Lead Import Markets (% of total imports, 2007)

US	19.5%
China	18.1%
Hong Kong	9.0%
Taiwan	5.7%

## Basic indicators

Selected economic indicators	2005	2006	2007	2008f	2009f
Nominal GDP (USD mn)	15,465	17,137	19,485	23,088	23,850
Population (mn)	3.23	3.29	3.34	3.40	3.45
GDP per capita (USD)	4,788	5,209	5,834	6,791	6,913
Real GDP growth (% yr/yr)	7.2	8.5	11.5	9.2	1.3
Inflation (% , eop)	3.4	2.2	6.4	6.8	2.0
Fiscal balance (% of GDP)	-2.5	0.5	3.5	0.4	-2.1
Current account balance (% of GDP)	-6.6	-3.1	-7.3	-12.1	-7.2
External debt/GDP (%)	63.0	58.3	54.6	47.6	47.4
External debt/Exports of goods & services (%)	89.0	79.0	72.5	66.2	72.4
Interest payments/Exports of goods & services (%)	6.1	6.2	4.8	4.0	4.2
Foreign exchange reserves (USD mn)	1,193	1,316	1,915	2,500	2,500
Import cover (months)	0.7	1.2	1.1	1.3	1.9
Exchange rate assumption	USD is legal currency				
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes Country Risk Unit

## Political Stability

Since General Noriega was removed from office in the early 1990s following US military invasion, transfers of power between administrations formed by different political parties through democratic elections have been smooth. There are no serious threats to stability from religious or ethnic tensions, although income distribution is badly skewed and unemployment is high. The armed forces were disbanded in 1994.

**In May 2009 the latest presidential elections were won by Ricardo Martinelli, a pr-business conservative, of the centre-right Cambio Democratico (CD), backed by a coalition of the Partido Panamenistas (PP), the main opposition party, and two other small parties. Martinelli, who assumed office on 1 July 2009, is the first president who is not from either the Partido Revolucionario Democratico (PRD) or the PP, which have alternated in power, since the return of civilian rule.** Former president Torrijos of the Partido Revolucionario Democratico PRD was not permitted by the constitution to stand for a second consecutive term and the PRD candidate was hit by a financing scandal as well as the Torrijos administrations failure to deal with rising crime and worsening personal security.

**Elected primarily as a change from the political status quo and on a platform of curbing crime, President Martinelli has a strong popular mandate having won the election by a 24 point margin. He also has a legislative majority through his coalition.** However, despite his strong position he will find it difficult to fulfil his election pledges, which also included tax reform (simplification and the introduction of a corporate flat tax) as the sharp economic slowdown will weaken government finances. As popular support erodes, the coalition can be expected to become more fractious. President Martinelli has been a supporter of expansion of the Panama Canal (approved by referendum) and this is unlikely to change, though public spending constraints may slow progress.

International relations are generally good under the umbrella protection of the US, which retains a strategic interest in the Panama Canal, even though its formal responsibilities have ended. US ratification of a crucial Free Trade Agreement with the US will be a priority of the new government. Ratification is currently held up by Panama's inclusion on the OECD's grey list of tax havens over the failure to improve the exchange of tax information. However, President Martinelli is opposed to any changes to the existing regime.

## Economic Stability

Panama is an upper middle income economy (World Bank classifications) and had an estimated per capita GDP USD6,800 in 2008. Annual average growth of real GDP per capita was a strong 3.6% during the past decade. **Services dominate the economy—accounting for 76% of GDP—and through the Colon free trade zone, the Canal and the international banking sector, the economy is highly vulnerable to external developments.**

Annual average growth of real GDP in 2004-08 was 8.8%. Growth began to slow in 2008, however, and in Q1 2009 was 3.4% yr/yr. hit by the collapse of world trade, the US and regional economies downturn in demand and a fall in construction and consumption as credit growth slowed. **Canal expansion may be enough to keep growth positive in 2009 as a whole, but may not be much more than 1%, though some recovery to 2-3% can be expected in 2010, as world trade and the US begin a slow recovery.**

Public finances have improved in recent years, as the fiscal balance (NFPS) in small surplus in 2005-08 (0.4% of GDP in 2008). This has reflected a sharp increase in revenues as a proportion of GDP (21% to 25%)—the result of strong economic growth and the tax reform introduced by the current government on taking office—and better control of expenditure, though expenditure increased as a proportion of GDP in 2008. The Fiscal Responsibility Law (FRL) was re-introduced in June 2008 and sets the deficit target at 1% of GDP. **However, with falling revenues in 2009 and increased outlays the deficit could be around 2% of GDP in 2009 and potentially widen further in 2010 without adjustment on the expenditure side.** The public debt-GDP ratio has trended downwards in recent years to an estimated 46% at end-2008 (compared with 70% in 2004) but will be difficult to contain at this level in 2009-10.

**Panama has no independent monetary policy, no central bank and no lender-of-last resort, as the US dollar is the legal currency.** (The local currency, the balboa, is an accounting unit.) Inflation is generally correspondingly low (aligned with the US) but accelerated in 2007-08 under the pressure

of food and energy prices, peaking at 10% yr/yr in September 2008, though it has since declined rapidly, as these pressures receded and domestic demand eased, falling to 2.5% yr/yr in May 2009. We expect inflation of 2% at end-2009 and 2.5% at end-2010.

**The banking system has “weathered the global financial crisis relatively well” according to the latest Article IV consultation of the IMF (July 2009).** The IMF also notes that the system is well capitalised, highly liquid and strong financial soundness indicators. Access to foreign credit lines declined following the intensification of the global financial crisis in September 2008, but have since stabilised.

The current account deficit widened to a very large 12.3% of GDP in 2008, as merchandise imports grew much more rapidly than exports of goods and services, though it was still 86% covered by net FDI inflows. **The current account deficit should narrow to around 7% in 2009 and 2010, as both exports and imports (goods, services and income) fall, but the latter by more. Net FDI is also expected to fall but should still cover around 90% of the current account deficit.**

The external financing requirement net of FDI inflows and excluding ST debt is modest at less than USD500mn and FX reserves are 250% of external debt due (ST and MT principal repayments) in 2009. However, in extremis, FX reserves fall just short of full coverage of the current account deficit, ST debt and MT principal repayments. **Formal dollarisation means that inconvertibility risk for the private sector is very low.** External financing for the expansion of the Canal—which will cost an estimated USD5.3bn—is in place and according to the IMF article IV consultation on favourable terms.

External debt was 47% of GDP at end-2008 and 66% of exports of goods and services. Almost 80% of the debt is owed by the public sector and around 6% is short term. Interest payments are around 4% of exports of goods and services.

## Structural Business Environment

**The Structural Business Environment is generally sound, ranking above average in our overall assessment, but falling short of the strongest ratings.**

The World Bank's 2009 Ease of Doing Business survey ranks Panama 81 of 181 surveyed. Based on data and definitions from the World Bank's 2009 Doing Business Survey, of ten areas surveyed, only one—Paying Taxes—was particularly weak and well below average. Three others—Employing Workers, Protecting Investors and Enforcing Contracts—were below average. The World Bank Institute's Governance Research Indicator 2009 puts rule of law and control of corruption just below average with regulatory quality well above average for the Latin American region, while regulatory quality was well above, control of corruption around and control of corruption well below average for the upper middle income group of economies. Transparency International's Corruption Perception Index, 2008, assigns Panama a score of 3.4—on a scale of 1 (bad) to 10 (good)—and a ranking of 85= out of 180. As a broad measure of the pro-business environment The Heritage Foundation 2008 Index of Economic Freedom ranks Panama 55 out of 179.

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## Charts

