

Economic

Credit Ratings:

Moody's: Ba1

S&P: BB+

Fitch: BB+

Nominal GDP (2009e):

USD 29bn

Population (2009e):

3.5mn

Trade/GDP:

108%

Currency:

Balboa/Dollar

Exchange regime:

Pegged at PAB1/USD

Merchandise Imports from Canada (2009e):

CAD 76mn

Main sources of Foreign Exchange (excl. FDI):

Transportation services

Largest Merchandise Trading Partner:

United States

Main imports:

Capital goods

Food Products

Risks to the Outlook:
Upside: buoyant global trade

Downside: Sustained global recession

January 2010
Veronica Lares
vlares@edc.ca

Market Spotlight: Panama is expected to be one of the best economic performers in the region, one of the only countries that will avoid a recession. Over the MLT, GDP is expected to grow above the Latin American average. Debt ratios are expected to continue improving. The current account deficit will continue widening as a result of growing imports due in part to the Canal's expansion, but we do not foresee problems to finance it. S&P has recently put Panama in watch for a potential upgrade to investment grade.

Real Economy: Although slowing, the GDP growth rate is expected to be among the highest in Latin America. Driven down by a deceleration in construction activity and domestic demand, EDC Economics expects growth to slow down significantly this year and rebound in 2010. We forecast GDP will grow 2.1% in 2009 and 4% in 2010. Inflation will remain low as a result of lower global food and fuel prices and a weakening in domestic demand. On the upside, the canal expansion will boost growth by an average of 1% per year during the first four years of construction, which should partially offset the effects of the slowdown in the U.S. Moreover, remittances only account for 1% of GDP, so the expected deceleration in those inflows should not affect growth dramatically.

External: Capital inflows have been driven by a surge in FDI. After the Canal's construction is over, FDI will fall back around 7-7.5% of GDP. Together with elevated public sector borrowing, this will help the country cover import requirements related to the canal project. Import growth related to the canal's activities will increase the current account deficit over the next two years, but it will shrink considerably once the canal's operations are finalized.

Monetary: Panama's official currency, the *balboa*, is pegged to the US dollar at a rate of PAB1:USD1. In the absence of monetary authority, real interest rates (tightly linked to US interest rates) have been pushed into negative territory, which should help to lower domestic borrowing costs.

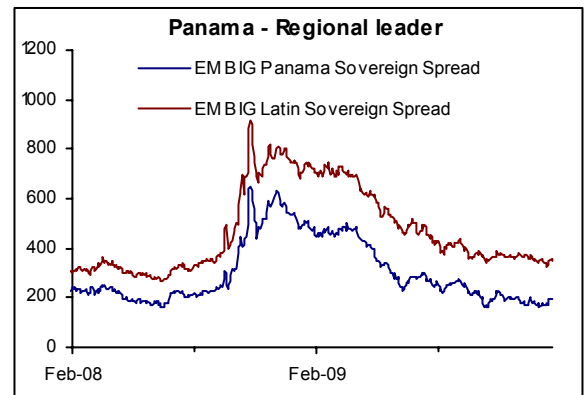
Fiscal: Solid economic growth, enhanced tax collection, and spending restraint have helped improve the government's fiscal position over the past few years. Nevertheless, the lack of monetary policy authority leaves the government with fiscal policy as the only tool to control inflation. On that note, the government has recently modified the Law of Fiscal Responsibility to allow for an expansion of the fiscal deficit from 1% to 3% of GDP if faced with adverse external economic conditions.

Debt: Fiscal improvements have helped reduce Panama's public debt from 70% of GDP in 2004 to an estimated 46% last year. In addition, good debt management has allowed the government to extend the average maturity of its obligations and reduce interest rates. Public debt is expected to fall further around the time that PCA debt is fully re-paid by 2016. Due to the size and the importance of the Canal project, we do not think the country will lack financing even under the current tight credit conditions.

Outlook: Over the medium-long term, Panama's economy will continue to benefit from its position as a major international hub. Further, the Canal expansion is expected to boost growth above potential. The country's disciplined policy track and dollar-induced stability are part of the reason Panama is rated just one notch below investment-grade by the major rating agencies.

Economic Indicators

	03-07 avg.	2008	2009	2010
GDP (% growth, real)	7.8	9.2	2.1	4.0
Inflation (%chg, eop.)	2.0	8.8	2.4	2.0
Fiscal Balance (% of GDP)	-1.8	0.4	-2.8	-2.0
Exports (% comp. annual growth)	11.9	10.3	11.6	2.0
Imports (% comp. annual growth)	14.5	19.4	-4.8	6.3
Current Account (% of GDP)	-5.6	-10.4	-8.3	-8.3
Reserves (months of curr. debits)	1.1	1.0	1.1	1.5
External Debt (% of GDP)	61.6	46.0	53.4	52.0
Debt Service Ratio (due)	10.9	6.0	7.2	6.9
Exchange Rate (to USD; eoy)	1.0	1.0	1.0	1.0



Source: JP Morgan, HAVER

Political

Political Structure
Presidential Republic

President
Ricardo Martinelli (CD)

Legislative Bodies
• National Assembly – 71 members directly elected for five year terms.

Major Parties (and number of seats)
• CD/PP-led coalition Alliance for Change (AC)- 37
• Democratic Revolution Party (PRD) (center-right) – 23 seats

Last Elections
3 May 2009

Next Elections
May 2014 (Presidential, Municipal and Legislative)

Press Freedom Survey:
• 2008 Score: 44 - Partly free (0: Free; 100: Not Free)
freedomhouse.org

Control of Corruption Index:
• 2008 Score: -0.15 (-2.5: Worst; +2.5: Best)
worldbank.org

January 2010

Jorge Rave
jrave@edc.ca

General Political Environment: Until the May 2009 Presidential election, the fight for political power in Panama had been essentially limited to the *Partido Revolucionario Democrática* (PRD) and the *Partido Panameñista* (PP). Both of these parties are on the right of the political spectrum and made up of elites that move smoothly between business and politics depending on the opportunities at hand. However, for the May 2009 elections, the PP joined forces with the small Democratic Change (CD) party which led to the election of CD's candidate Ricardo Martinelli as the new President of Panama. Martinelli, a successful local businessman, centered his presidential campaign on the necessity to bring "radical change" to the country, especially now that the effects of the global economic downturn are being felt in Panama and GDP growth is expected to be down in 2009.

Results for the congressional election also showed an important advantage for Martinelli, as the CD-led Alliance for Change won enough seats to form a legislative working majority (37 out of 71 contested seats) at the National Assembly. The CD also won the mayoralty of Panama City with a pro-Martinelli candidate, Ricardo Bosco-Vallarina. Not surprisingly, during his first weeks in power, President Martinelli has praised liberal policies as the essential path to prosperity and development.

Panama is firmly within the US sphere of influence, although politicians are careful to outwardly steer a path between the Americans and other countries such as Venezuela. The impact of the powerful forces of authoritarianism, military dominance, the US presence, and the oligarchy continues to permeate Panamanian politics and, in tandem with the strategic and economic importance of the Panama Canal, are variables that account for current and future political strategies.

Investment Environment: Panama is very attractive to investors given its fully dollarized economy with no exchange risk; an absence of barriers to repatriation of funds, low inflation, and its stable and sophisticated banking sector. Corruption and cronyism are rampant and business people are wary of a biased judicial process. To counter delays and a lack of independence in the judicial system, Panama has set up an alternative dispute settlement mechanism, the Conciliation and Arbitration Center (CAC). The CAC appears to have a good reputation and is a powerful instrument for foreign investors. Panama is a signatory to major international dispute settlement agreements. In September 2007, the first case against Panama was registered at ICSID in a dispute between the government and an electricity generation project.

The Panama Canal expansion and reaching a free trade agreement (FTA) with the US were former President Torrijos' most important business/economic priorities. Once elected, President Martinelli announced his intention to maintain policy continuity, confident that the USD 5.25bn expansion plan for the Canal will allow him to further consolidate his political power, as it should bring economic recovery to the country. It is unlikely that the new administration will try to radically alter the Torrijos' administration's investor-friendly practices, which brought strong economic growth to Panama but failed to create a sense of inclusiveness among Panamanians.

Canada concluded negotiations towards an FTA with Panama in August 2009, and the two countries are currently carrying out a legal review of the text after which the agreement should be ratified by their respective legislative branches. A Foreign Investment and Promotion Agreement has been in force between the two countries since 1998. The US-Panama FTA has yet to be ratified, as it is stalled in the US Congress over criticisms that Panama is an offshore tax haven and lacks tough labor rights standards.

Political Violence: Panama faces no threats of hostility either domestically or externally. Street protests and strikes are regularly used to attempt to sway political decisions and demonstrate public dissatisfaction, but do not pose a threat to the country's overall security or political stability. Smuggling and money laundering are issues of concern. The lack of aerial surveillance has made Panama a popular location for illegal runways that serve the drug trade. There is also evidence that powerful Mexican cartels are operating in Panama, and it is believed that fund-raising activities are being conducted in the Free Trade Zone.

Political Outlook

Growing crime rates, delays in anti-corruption initiatives and the need to put in place effective measures to tackle inflation and high food prices are the most pressing challenges for Panamanians, and are likely to dominate the new government's agenda during its first months in power. Although the past elections brought a resounding defeat for the two traditional political parties, they also indicate that Panama is an evolving democracy where the delivery of the broad radical change promised by Martinelli may take longer than expected.