

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 which 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. For the past May 2009 elections however, the PP joined forces with the small Democratic Change (CD) party, which led to the election of CD's candidate businessman Ricardo Martinelli as the new President of Panama. Martinelli 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 President 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 pro-Martinelli candidate Ricardo Bosco-Vallarina. 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 USD5.25bn expansion plan 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.

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. President Martinelli's top priority will be then to develop closer ties with the US. This agreement's potential to keep Panama within the US sphere of influence is an important factor and the FTA is likely to be ratified eventually.

Political Violence:

Panama faces no threats of hostility either domestically or externally. Street protests and strikes, usually in Panama City or Colón, are regularly used to attempt to sway political decisions and demonstrate public dissatisfaction, but these 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. While it is unlikely that Panamanian territory would be used as an organizational point or launching pad for terrorist attacks, it is believed that fund-raising activities are being conducted in the Free Trade Zone.

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

August 2009

Jorge Rave
jrave@edc.ca

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.

Economic

Credit Ratings:

Moody's: Ba1
S&P: BB+
Fitch: BB+

Nominal GDP (2007):

USD 19.5bn

Population (2007):

3.35mn

Currency:

Balboa/Dollar

Exchange regime:

Pegged at PAB1/USD

Merchandise Imports from Canada (2007):

CAD 74.5mn

Main sources of Foreign Exchange (excl. FDI):

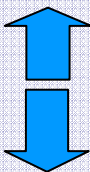
Transportation services

Largest Merchandise Trading Partner:

United States

Main imports:

Capital goods
Food Products

Risks to the Outlook:


Buoyant global trade.

Financial sector deterioration.

September 2008
Veronica Lares
vlares@edc.ca

Market Spotlight: Due to high food and energy prices, inflation is at a 28-year high. In the presence of less transfers from PCA and increased spending, the fiscal surplus is expected to shrink over the next two years. 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. Real Estate prices continue to increase as a result of higher demand from new immigrants arriving in the country.

Real Economy: GDP growth hit 11.2% last year - the highest in Latin America. EDC Economics forecasts slowed growth down to 8.5% in 2008 and 7.5% in 2009. Inflation has accelerated since the beginning of the year, reaching 9.6% y/y in July. Nevertheless, this rise is mainly due to higher global food and fuel prices and some distortions in the agricultural sector, and it is expected to decline as commodity prices fall. The canal expansion is expected to boost growth by an average of one percentage point a year during the first four years of construction, which should partially offset the effects of the slowdown in the U.S. Moreover, remittances are only around 1% of GDP, so the expected deceleration in those inflows should not affect growth dramatically, going forward.

External: Capital inflows have been driven by a surge in FDI. Going forward, FDI will fall back to a more normal level, 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 will push the current account deficit to around 12% of GDP this year, but it will shrink considerably once the canal's operations are finalized. As at April 2008, foreign exchange reserves stood at USD 1.76bn, equivalent to one month of import cover, a low level, but mitigated by the fact that Panama is a dollarized economy.

Monetary: Panama's official currency, the *balboa*, is pegged to the US dollar at a rate of PAB1:USD1. The absence of monetary authority and the fact that real interest rates (tightly linked to US interest rates) have been pushed in to negative territory, constitute downside risks on the already overheated economy, over the short term.

Fiscal: Solid economic growth, enhanced tax collection, and spending restraint have helped improve the government's fiscal position over the past few years. On the downside, the fiscal surplus is expected to shrink as a result of lower transfers from the Panama Canal Authority (PCA). The lack of monetary policy authority leaves the government with fiscal policy as the only tool to control inflation, and in the face of elections there is no appetite for major fiscal restraint.

Debt: Fiscal improvements have helped reduce Panama's public debt from 66% of GDP in 2004 to an estimated 53% 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 (excluding PCA debt) is projected to decline to 43% of GDP by 2011, when PCA debt peaks at 8.5%. Public debt would then fall below 35% of GDP by 2016, around the time that PCA debt is expected to be fully retired. This projection still allows for an increase of poverty-reducing programs and infrastructure spending.

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 through the medium-term. The country's disciplined policy track and dollar-induced stability are part of the reason Panama is rated just one notch below investment-grade. Main risks over the medium term are inflation and the rising current account deficit.

Economic Indicators

	02-06 avg.	2007	2008	2009
GDP (% growth, real)	5.9	11.2	8.5	7.5
Inflation (%chg, pa avg.)	1.4	4.2	8.0	7.0
Fiscal Balance (% of GDP)	-2.3	3.5	0.5	-0.2
Exports (% comp. annual growth)	7.2	9.9	20.0	12.0
Imports (% comp. annual growth)	8.8	23.8	27.3	22.4
Current Account (% of GDP)	-4.1	-8.0	-11.8	-17.2
Reserves (months of curr. debits)	1.2	1.3	0.9	0.7
External Debt (% of GDP)	64.4	52.9	47.7	45.8
Debt Service Ratio (due)	12.1	6.9	5.9	5.8
Exchange Rate (to USD; eoy)	1.0	1.0	1.0	1.0

Panama - Regional Leader

