

**Economic**

**Credit Ratings:**

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

**Nominal GDP (2009):**

USD 24.5bn

**Population (2009):**

3.5mn

**Trade/GDP:**

105%

**Currency:**

Balboa/Dollar

**Exchange regime:**

Pegged at PAB1/USD

**Merchandise Imports from**

**Canada (2009):**

CAD 80.2mn

**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

**Veronica Lares**  
vlares@edc.ca

**MARKET SPOTLIGHT:** Panama was one of the few Latin American countries that avoided a recession last year. Over the MLT, GDP is expected to grow above the Latin American average. ■ Debt ratios are expected to continue improving. ■ The country's MLT rating was recently upgraded to investment grade by the major rating agencies. ■ The current account deficit will continue widening as a result of growing imports due in part to the Canal's expansion, but EDC Economics does not foresee any financing problems.

**Real Economy:** Driven down by a deceleration in construction activity, trade and domestic demand, GDP expanded 2.4% y/y in 2009, down from 9.2% in 2008. Inflation will remain low as a result of subdued global food and fuel prices. On the upside, the Canal expansion will boost growth by an average of 1% in each of the next two years, which should partially offset the effects of a still weak U.S. economy. EDC Economics expects growth to be around 4.5% in 2010 and 5.5% in 2011.

**External:** Capital inflows have been driven by a surge in FDI. After the Canal's construction is completed, 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. The current account deficit is expected to increase over the next two years due to import growth related to the Canal's expansion; however, it will shrink considerably once construction is finished in 2014.

**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 lower domestic borrowing costs.

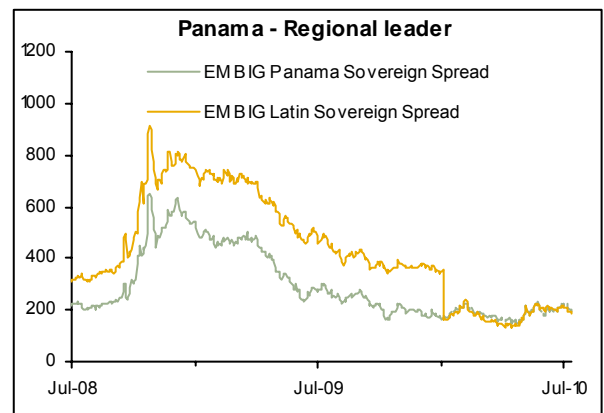
**Fiscal:** Solid economic growth, enhanced tax collection, and spending restraint have helped improve the government's fiscal position over the past few years. Nevertheless, the lack of monetary policy authority leaves the government with fiscal policy as the only tool to control inflation. On that note, the government 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. It has also introduced a tax reform that is anticipated to improve the health of fiscal accounts going forward. The main elements of the reform are a reduction in the income tax on wages from 24% to 15% for those who earn less than US\$3,846 a month and an increase in the Impuesto a la Transferencia de Bienes Muebles y Servicios (ITBMS), from 5% to 7%.

**Debt:** Fiscal improvements have helped reduce Panama's public debt (domestic and external) from 70% of GDP in 2004 to an estimated 47% 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 the PCA debt is fully repaid, which will be by 2016. Due to the size and the importance of the Canal project, we do not think the country will lack financing even under 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 until 2014. EDC Economics does not expect any radical change in economic policy by the recently elected government.

**Economic Indicators**

|                                   | 04-08 avg. | 2009  | 2010 | 2011 |
|-----------------------------------|------------|-------|------|------|
| GDP (% growth, real)              | 9.2        | 2.4   | 4.5  | 5.5  |
| Inflation (%chg, eop.)            | 3.7        | 2.4   | 3.7  | 4.0  |
| Fiscal Balance (% of GDP)         | -0.7       | -1.0  | -1.4 | -0.5 |
| Exports (% comp. annual growth)   | 15.3       | 5.6   | 28.0 | 8.7  |
| Imports (% comp. annual growth)   | 18.8       | -13.0 | 33.3 | 17.0 |
| Current Account (% of GDP)        | -7.0       | 0.0   | -3.3 | -7.5 |
| Reserves (months of curr. debits) | 1.1        | 2.0   | 1.8  | 1.7  |
| External Debt (% of GDP)          | 57.2       | 51.8  | 52.6 | 50.1 |
| Debt Service Ratio (due)          | 10.1       | 7.0   | 6.3  | 6.0  |
| 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](http://freedomhouse.org)

#### Control of Corruption Index:

- 2008 Score: -0.15 (-2.5: Worst; +2.5: Best) [worldbank.org](http://worldbank.org)

**Jorge Rave**  
**[jrave@edc.ca](mailto: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, as it was the case in March 2010 when police clashed with protesters rallying against a recently passed tax reform bill. These protests however do not pose a threat to the country's overall security or political stability. Smuggling and money laundering are issues of concern. 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

Although the May 2009 elections brought a resounding defeat for the two traditional political parties and the emergence of a new political map in Panama, President Martinelli's promise to deliver broad radical change seems to be taking longer than expected and the President's approval ratings have been sliding. Also, as a result of controversial judicial appointments and a tax reform bill that it's viewed as detrimental for the country's poorest strata, the honeymoon with the electorate seems to be over. This could test the limits of the ruling coalition, in which Martinelli's party is only the second-strongest member.