



# Panama

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| COUNTRY                  |            | CREDIT RATING                        |          | TRADE             |   |
|--------------------------|------------|--------------------------------------|----------|-------------------|---|
| Real GDP growth (%) 2015 | 5.80%      | S&P Foreign Currency                 | BBB (S)  | Partners:         | US 20.2%, Canada 14.6%, Costa Rica 6.6%, Netherlands 5.9%       |
| Real GDP growth (%) 2016 | 6.10%      | Fitch Foreign Currency               | BBB (S)  | Exports           | Gold, bananas, shrimp, sugar, iron and steel waste, pineapples. |
| Exchange Rate (USD/PAB)  | PAB 1.00   | Moody's Foreign Currency Debt        | Baa2 (S) | Foreign Reserves  | US 3.874 billion  |
| FX Direction             | Dollarized |                                      |          | Reserve Direction | Climbing  |
|                          |            |                                      |          | Import Cover      | >2  |
|                          |            |                                      |          | Direction         | Stable  |
| INFLATION                |            | POLICY INTEREST RATE                 |          |                   |   |
| Target Rate              |            | Target Rate                          | none     |                   |   |
| Current Month (y/y)      | 0.00% Nov  | Current Rate                         | -        |                   |   |
| Direction                | Stable     | Direction                            | -        |                   |   |
| Forecast 2016            | -0.10%     | Last Year 2014                       | -        |                   |   |
|                          |            | No central bank. Dollarized economy. |          |                   |   |
| FISCAL                   |            | POLITICAL                            |          |                   |   |
| Budget Deficit (%) 2015  | 3.7%       | Last Election                        | May-14   |                   |   |
| Deficit Trend            | Elevated   | Next Election                        | May-19   |                   |   |
| Debt/GDP                 | 38%        | Term                                 | 5        |                   |   |
| Debt Direction           | Stable     | Other                                |          |                   |   |

**ECONOMIC OUTLOOK**

The Panamanian economy expanded by 5.8% in 2015 driven by strong foreign investment in infrastructure, trade, power and other key sectors. Construction activity is expected to grow to 13.5% in 2016 (13.3% - 2015) despite the completion of the Panama Canal expansion project in June. The Canal accounts for 10% of GDP. Once completed, the IMF expects that the expanded Canal and the new copper mine (Minera Panama, in 2018) will help maintain growth at 6% to 7% over the next five years. Panama benefits from a very diversified economy with the service sector accounting for 75% of GDP. The financial services sector measured 7.8% of GDP in 2015 while the transport and communications sector measured 18.5% of GDP. Further diversification is expected in canal operations, mining, logistics services, tourism and financial services. Growth is forecasted at 6.1% in 2016 and 6.5% in 2017.

**INFLATION MONETARY POLICY & BANKING**

Annual inflation was estimated at 0.1% in 2015. Inflation remains at historically low levels but it is not a major concern at the moment. Inflation is projected at 0.8% in 2016, as low oil prices continue to depress overall price levels. **Panama does not have a central bank** and the country has a dollarized economy, so that authorities lack the freedom to use monetary policy or exchange rate adjustments to tackle inflation.

In December 2015, Fitch Ratings noted that risks in the Panamanian banking system are on the rise, but the impact on the banks' balance sheets is expected to be gradual due to the still favorable operating environment. "Liquidity should remain adequate, though some investments might lose value if international interest rates rise. The industry has limited upside potential in the short term, with any improvement unlikely until pressure on interest margins, profitability, and asset quality is reduced."

**TRADE BALANCE/ BOP**

The IMF estimated the 2015 current account deficit to have fallen to 6.5% of GDP from 9.8% one year earlier. Broad-based FDI inflows financed this shortfall. The recovery of the US economy should support Panama's external accounts. Panama benefits from rising FDI inflows to finance the deficit. Portfolio inflows are a relatively small contributor to foreign exchange inflows. The current account deficit is estimated at 6.1% of GDP in 2016. Gross international reserves in 2015 were estimated at USD3,874 million providing in excess of 2 months of cover.

**FISCAL ACCOUNTS**

Panama ran an overall deficit (including Panama Canal Authority) of 4.1% of GDP in 2015 (Panama's Fiscal and Social Responsibility act specifies a ceiling deficit of 2.8% of GDP). It is forecast to decline further over the next two years. Debt to GDP ratio stood at 39% (IMF) in 2015. The fiscal deficit is forecasted at 3.5% of GDP in 2016 and debt to GDP to remain stable around 38.8%.

There have been no recent changes to Panama's credit ratings. S&P maintains a stable outlook based on their expectation that the government will continue to implement its investment plans and sustain good economic growth rates without eroding its fiscal stance or reversing the gradually declining debt burden. Moody's Investor Services affirmed its Baa2 rating on Panama with a stable outlook in December 2015, based on Panama's continued strong economic performance despite external headwinds, and fiscal metrics that remain in line with Baa median.

**POLITICAL**

Juan Carlos Varela (Partido Panameñista) succeeded in beating Domingo Arias (Partido Cambio Democrático) in May 2014. Arias was the chosen successor to outgoing President Ricardo Martinelli. Varela strongly objected to Martinelli's administration on corruption and dictatorial grounds. However, Martinelli's party still holds a majority in the Panamanian parliament making legislation difficult. Varela launched a corruption inquiry into Martinelli and his close aides in January 2015 in a move that will garner support from the population. Martinelli has fled to Miami. The leaking of the 'Panama Papers' in April 2016 hurt the country's international image. It can be expected that the government will take more aggressive steps in order to boost transparency in the country and continue President Varela's anti-corruption drive.

**BUSINESS ENVIRONMENT**

The country boasts of a strong trade environment due to the Colon Free Trade Zone and business friendly government policies which help encourage the free flow of trade. Further, Panama has a highly sophisticated logistics network as the support infrastructure for the Panama Canal has improved the country's infrastructure relative to its peers. Strong financial services firms bolster Panama's trade and investment environment. Panama is not expected to change its investor friendly business environment though there have been some indications from President Valera of new government intervention into the economy.

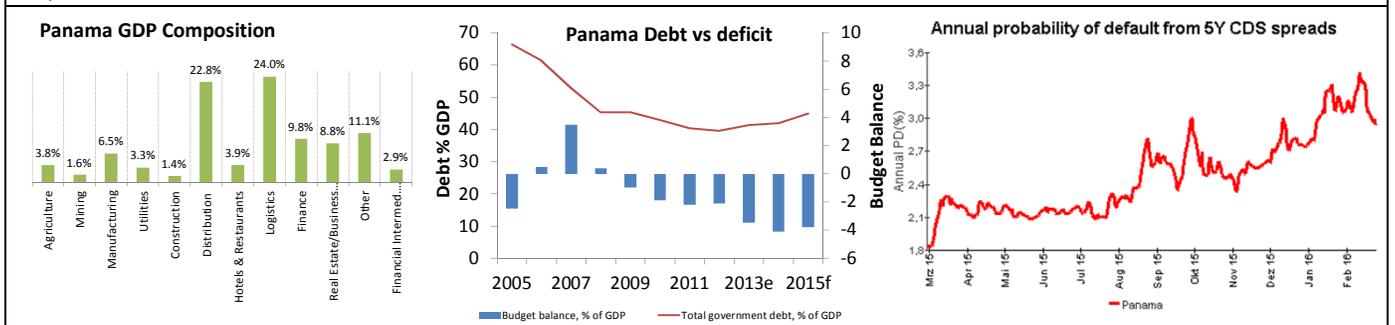
**CDS**

Some tightening can be expected on CDS spreads as the Panama Canal looks set to finally come on-stream by May 2016. The lead up to its completion was hindered by postponements, faulty construction (leaking locks) and disputes with contractors. In the longer term the potential of a slowdown in trade due to a weakening China could have negative repercussions and lead to a widening of CDS spreads. The profitability of the canal is linked to trade flows. There is also the threat of increased competition from the Suez Canal in Egypt which has launched a USD4 billion upgrade project and plans for a competing canal in the neighboring country of Nicaragua.

## OUTLOOK

With a moderate debt load, low inflation rate and strong foreign direct investment inflows into infrastructure, trade, power and other key sectors, Panama remains a strong credit. The country's reputation as an economic hub, the opening of the expanded canal and lower fuel prices will temper the effects of slowing global growth and U.S. dollar appreciation and support growth in the future. Tourism has also been positive growing by an estimated 14% in 2015 and will continue to show growth in 2016 driven by the positive outlook of the U.S. The country's USD16.1billion project pipeline is greater than the rest of Central America combined and will boost the construction sector as well as employment in the coming years offsetting any slowdown resulting from the completion of the Canal.

*First Citizens Research & Analytics holds a Stable view on Panama but notes the effects of volatile global growth as well as the negative effects of the appreciating U.S dollar on its exports.*



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