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# Supplementary Analysis: Republic of Panama

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This report supplements our research update "Republic of Panama 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable," published on Oct. 3, 2014. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

### Rationale

## Sovereign Credit Rating

BBB/Stable/A-2

**Ratings Detail**

The ratings on the Republic of Panama reflect the country's strong economic growth, increasing economic diversification, and moderate net general government debt burden. The ratings also take into account the sovereign's vulnerability to sharp swings in global economic conditions, an underdeveloped but growing domestic capital market, and developing political institutions. Panama is fully dollarized and therefore lacks an independent monetary policy and has no formal lender of last resort for the financial system.

Rapid growth, and investment in physical infrastructure, has helped to diversify Panama's economy in recent years. GDP growth averaged 9.8% during 2010-2013, boosting per capita GDP during that period to nearly $10,000 from $7,800. A high level of investment, about 30% of GDP in recent years, is likely to continue driving economic growth rates that are higher than in most of Latin America. The development of new sectors such as tourism, and eventually mining, could gradually strengthen Panama's economic resilience. We expect that GDP growth will decline toward 6% on average over the next four years and per capita GDP growth will remain above 4%.

Many years of rapid economic growth have helped moderate the government's debt burden despite a pro-cyclical fiscal policy. General government debt is likely to be 35% of GDP in 2014 and may decline toward 33% in another two years. Net general government debt, which includes assets in Panama's sovereign wealth fund and other government liquid assets, is likely to be 15% of GDP in 2014 and stable in the coming years.

Steady inflows of foreign direct investment (FDI) should continue financing most, if not all, of the current account deficit (CAD) in 2014 and beyond. The CAD may decline toward 11% of GDP in 2014, from nearly 13% in the previous year, and fall below 10% over the next couple of years, still largely reflecting imports related to FDI projects and the country's massive investment in infrastructure.

Panama has a small, open economy that depends on global conditions. Its banking sector has a net external asset position but remains exposed to an unexpected deterioration in external conditions. Panama has no central bank or formal lender of last resort, nor does it have a deposit insurance system or other explicit mechanisms to provide temporary liquidity to distressed financial institutions, illustrating one of its rating vulnerabilities.

Additionally, the Financial Action Task Force recently placed Panama back on its "grey list" of countries with legal and regulatory shortcomings. We expect that the government will take steps to address regulatory shortcomings in the coming year.

The expansion of the Panama Canal, which will almost double its capacity, is 78% complete. The authorities estimate that the project will be finished in late 2015 or early 2016, setting the stage for higher economic activity through the canal. Delays and disputes with the canal's contractor over cost overruns have hampered the expansion project. The consortium briefly stopped work in early 2014 and sought an added $1.6 billion due to claimed cost overruns. Work has resumed on the project and the overrun claims have been filed with dispute adjudication bodies for resolution, as specified in the canal expansion contract.

We expect continuity in key economic policies following the elections in 2014. However, the new Administration of President Juan Carlos Varela lacks a majority in Congress, potentially weakening its ability to implement economic policies. The Varela Administration inherits a slowing economy and a deteriorating fiscal balance. It has to balance the need to contain fiscal slippage with a desire to maintain GDP growth and fulfill campaign promises to boost public services and physical infrastructure. Panama's central government spends more than 10% of GDP on capital projects, giving it more flexibility compared with most governments to reduce the pace of future investments without materially weakening long-term growth prospects or failing to provide basic public services.

## Outlook

The stable outlook incorporates our expectation that the Varela Administration will maintain Panama's generally pro-business, pragmatic approach to economic policies, which has served it well in recent years in attracting investment and sustaining high rates of economic growth. We expect the government to moderately tighten fiscal policy in the next couple of years in line with somewhat lower GDP growth prospects, resulting in a stable debt burden.

Strong private investment could largely compensate for a gradual decline in public-sector investment over the next three years. That, along with economic benefits of an expanded Panama Canal (likely starting in early 2016), would sustain high GDP growth over the coming decade. We could raise the rating if continued favorable GDP growth prospects result in a more resilient and prosperous economy with a declining debt burden and diminished vulnerability to external shocks.

On the other hand, an unexpected shock to the financial system could damage confidence in the country. Such an event, or other developments that hurt the country's growth prospects, could weaken its credit profile. Deterioration in the management of public institutions, especially if it affects perceptions about the autonomy of the Panama Canal, would also hurt confidence. The resulting slower medium-term growth prospects or an eroding fiscal and debt profile could result in a lower credit rating.

## Summary Statistics:

### Table 1

**Panama (Republic of)--Selected Indicators**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014e | 2015f | 2016f | 2017f |
|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP (bil. US$) | 24.9 | 25.9 | 28.8 | 33.3 | 38.0 | 38.0 | 41.5 | 45.7 | 50.4 | 55.6 |
| GDP per capita (US$) | 7,305 | 7,489 | 7,830 | 8,896 | 9,988 | 9,833 | 10,434 | 11,333 | 12,321 | 13,421 |
| Real GDP growth (%) | 9.2 | 0.1 | 9.9 | 10.8 | 10.3 | 8.4 | 5.6 | 5.9 | 6.0 | 6.0 |
| Real GDP per capita growth (%) | 4.5 | (1.5) | 3.4 | 9.0 | 8.5 | 6.7 | 2.5 | 4.4 | 4.5 | 4.5 |
| Change in general government debt/GDP (%) | (0.1) | (2.5) | 1.0 | 1.9 | 2.7 | 4.1 | 3.0 | 2.6 | 2.1 | 1.7 |
| General government balance/GDP (%) | (0.7) | (1.9) | (2.5) | (2.6) | (1.8) | (3.5) | (3.5) | (3.2) | (2.6) | (2.3) |
| General government debt/GDP (%) | 41.9 | 37.8 | 35.0 | 32.2 | 30.9 | 35.1 | 35.1 | 34.5 | 33.3 | 31.9 |
| Net general government debt/GDP (%) | 20.6 | 15.8 | 15.3 | 13.7 | 12.2 | 13.3 | 15.2 | 16.4 | 16.9 | 17.1 |
| General government interest expenditure/revenues (%) | 12.6 | 12.1 | 10.7 | 9.7 | 8.4 | 8.4 | 8.4 | 8.3 | 8.0 | 7.6 |
| Other dc claims on resident nongovernment sector/GDP (%) | 81.4 | 79.5 | 80.9 | 81.2 | 81.9 | 74.6 | 74.6 | 74.6 | 74.6 | 74.6 |
| CPI growth (%) | 8.7 | 2.4 | 3.5 | 5.9 | 5.7 | 4.0 | 3.5 | 4.0 | 4.0 | 4.2 |
| Gross external financing needs/CARs plus usable reserves (%) | 131.9 | 112.7 | 122.4 | 136.1 | 132.2 | 136.2 | 138.7 | 135.6 | 133.0 | 128.5 |
| Current account balance/GDP (%) | (10.9) | (0.7) | (9.6) | (15.0) | (10.1) | (12.7) | (11.1) | (9.8) | (8.0) | (6.2) |
| Current account balance/CARs (%) | (14.8) | (0.9) | (13.0) | (18.1) | (12.4) | (15.8) | (14.0) | (12.6) | (10.4) | (8.3) |
| Narrow net external debt/CARs (%) | 62.5 | 60.2 | 83.0 | 77.2 | 74.8 | 94.4 | 93.3 | 94.4 | 92.7 | 95.3 |
| Net external liabilities/CARs (%) | 101.9 | 62.6 | 50.3 | 50.9 | 58.4 | 72.5 | 75.9 | 80.0 | 80.2 | 83.7 |

Note: Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor’s own calculations, drawing on national as well as international sources, reflecting Standard & Poor’s independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CARs--Current account receipts. e--Estimate. f--Forecast.

### Institutional And Governance Effectiveness: Continuity In Economic Policies But A More Divided Political Arena

We expect continuity in key economic policies following recent elections in 2014.
The new president lacks a majority in Congress, potentially weakening his ability to implement his economic policies.
There is a widespread public perception that public institutions were weakened during the last Administration, diminishing checks and balances and posing a challenge for the new Administration.
We expect that Panama will maintain its generally pro-business, pragmatic approach to economic policies, which has served it well in recent years in attracting investment and sustaining high rates of economic growth. The political risk in Panama is less of a dramatic change in policies from one Administration to another than it is of potentially acrimonious partisan politics, combined with weak public institutions, hurting the effectiveness and stability of government policies.

Former Vice President Juan Carlos Varela narrowly won the presidential elections in 2014 against the candidate promoted by former president Ricardo Martinelli. Varela's Partido Panamenista holds only around a dozen seats in the 71 member Congress, forcing the president to seek an understanding with the center-left Partido Revolucionario Democratico (PRD), which won the second-most seats in the Congress even though its presidential candidate fared poorly in the polls. The party of former president Martinelli, Cambio Democratico, has the largest presence in the new Congress but lacks a majority.

Varela is likely to face greater difficulties than his predecessor in getting legislative support for his policies, introducing some risk in the implementation of both fiscal and other policies. Lacking a majority in Congress, he will be forced to negotiate with other parties. Although this could reduce the speed of decision-making and block some initiatives, it might also bolster checks and balances in the political system. Varela has entered into a pact with the PRD to advance his proposals in the Congress. However, the PRD is divided after its loss, and a substantial segment of the party may not cooperate with the Varela Administration, potentially resulting in a stalemate in Congress. Varela's weakness in Congress could affect appointments of powerful public officials who influence the quality of governance. Congress has to choose a new attorney general and a new comptroller by the end of 2014.

The Varela Administration inherits a slowing economy and deteriorating fiscal balance. One of its challenges is to balance the need to contain fiscal slippage with a desire to maintain GDP growth and fulfill campaign promises to boost public services. Panama's central government spends more than 10% of GDP on capital projects, giving it more flexibility than most governments to reduce the pace of future investments without materially weakening long-term growth prospects or failing to provide basic public services. We expect the government will reduce capital spending, focusing on projects with a greater impact, and contain current spending. It is unlikely to boost current revenues other than through administrative measures because there is strong opposition to new taxes. Political debate in Panama has shifted to issues such as crime, health, education, and housing, following many years of rapid growth and high employment.

Panama's public institutions are weaker than those of more advanced countries with similar characteristics (such as Singapore or Hong Kong, both small open economies serving as a regional logistical hub and financial center). Panama is high in global rankings (such as the World Economic Forum Global Competitiveness Index) of physical infrastructure (such as ports and airports) but very low in rankings of institutional quality (such as independence of judiciary). Weak institutions contribute to poor or uneven implementation of government policies as they are less anchored in rules and procedures. There is a widespread public perception that public institutions were weakened during the last Administration, with fewer checks and balances within government. This is consistent with a fall in 2013 in Panama's ranking in Transparency International's survey of perceptions of corruption in the public sector. Panama fell to 102nd place from 83rd out of 177 countries (a higher number indicates more corruption).

The country's economic boom has attracted a large inflow of foreigners in recent years, mainly from Colombia, Venezuela, Costa Rica, Spain, and Nicaragua. The immigration includes poor, middle-class and wealthy people, providing cheap labor, skilled labor, and entrepreneurship to the economy. However, despite low unemployment (about 4% since 2011), public opinion has forced the government to gradually tighten the rules for hiring foreign labor. Rules for giving work permits may become more restrictive in the coming year, but immigration is likely to continue because of strong demand for labor.

### Economic Analysis: Moderating GDP Growth But Growing Diversification

GDP growth is likely to decelerate toward 5%-6% in 2014 and remain around 6% in the next three years.
The economy continues to diversify with new growth in sectors such as tourism and eventually mining.
Sustaining long-term growth depends on boosting human capital.
Panama's small, open economy is dependent on global conditions but has become increasingly resilient and diversified over the past decade. No single sector of the economy accounts for more than 8% of GDP. Panama relies on global and regional economic activity to fuel growth, particularly for canal and transshipping transit. Exports include international banking, Panama Canal transit, transshipping and port activities, logistics services, and the Colón Free Zone (CFZ). More than 110 multinational companies have set up their regional headquarters in Panama, underscoring the country's continued diversification.

Panama's per capita GDP more than doubled in the past decade to over $10,000, and the poverty rate fell to 26.5% in 2012 from 33.4% in 2009. The economy grew 8.3% in 2013 but is likely to decelerate in 2014 toward 5%-6%, hurt in part by disruption of payments from Venezuela (due to foreign exchange restrictions) and from trade tariffs imposed on some exports to Colombia from the CFZ. Election year uncertainty also contributed to a deceleration of private-sector investment growth.

We expect that GDP will grow, on average, by 6% annually over the next four years (compared with 9.8% during 2010-2013), assuming stable growth in the U.S. and Asia. Per capita GDP growth was 8% in 2011-2013 and will likely remain above 4% in the next three years. A substantial investment in physical infrastructure has laid the foundations for long-term growth. Panama City's airport has become a growing hub for travel within the Western Hemisphere. The first line of a new subway system in Panama City started in early 2014, and the government plans to soon start work on a second line.

Total investment has been approximately 30% of GDP in 2013-2014, of which 16%-17% of GDP has been from the public sector. However, the domestic savings rate remains below 20% of GDP, similar to the level in much of Latin America. FDI was about 11% of GDP in 2013, illustrating Panama's reliance on global trends as a small, open economy.

Public-sector investment (outside the Panama Canal) will remain comparatively high in the coming years, despite a moderate deceleration. The new Administration plans to improve infrastructure in the Caribbean city of Colon, whose development has lagged behind the boom in Panama City. Overall public-sector investment may decline as a share of GDP because of fiscal pressures but is likely to remain higher than in most Latin American sovereigns.

The expansion of the canal, which will almost double its capacity, is likely to finish in late 2015 or early 2016. This will set the stage for higher economic activity through the canal as well as through new and expanded facilities around the canal, including new ports, logistics centers, and other services. The expansion project has been hampered by delays and disputes with its contractor over cost overruns. The contractor briefly stopped work in early 2014 and sought an added $1.6 billion due to claimed cost overruns. The final cost escalation for the canal authority will depend on the rulings of various dispute resolution mechanisms governing the project. The expansion project is approximately 78% complete.

Gradual diversification of the economy augurs well for long-term growth. Tourism inflows have been growing 7%-8% in recent years. Total tourist spending was $3.3 billion in 2013, compared with $2.2 billion in total revenues from the canal. The biggest greenfield copper project under construction globally is in Panama. The over $6 billion Cobre Panama copper and gold mine, a bigger investment than the Panama Canal expansion, is scheduled to begin production in 2017. Although we do not incorporate mining in our growth projections, these projects have the potential to create more jobs, diversify the economy, and provide royalties to the government. Strong private investment in mining, as well as in energy, tourism and housing, could largely compensate for the gradual decline in central government investment over the next five years, and sustain high GDP growth.

Human capital is a long-term constraint on Panama's growth. Less than 30% of the labor force has completed secondary education, and about one-third of the workforce is in marginal jobs earning less than the minimum wage and not enrolled in social security. The energy sector could also constrain growth, absent changes in regulatory and pricing policies to encourage investment in generation and transmission.

### External Analysis: FDI Should Continue To Largely Fund The CAD

The CAD may decline toward 11% of GDP in 2014 and approach 10% in 2015.
We expect steady flows of FDI to continue financing most, if not all, of the CAD in 2014 and beyond.
The financial sector is likely to remain a net external creditor.
We expect the CAD to decline but remain high in the coming couple of years. A booming economy and high levels of investment contributed to a reported CAD exceeding 12% of GDP in 2013, nearly fully funded by FDI. The trade deficit was nearly 18% of GDP in 2013, similar to its level in the previous year. A slight widening of the trade deficit reflected decelerating exports, especially from the Colon Free Zone.

Panama's trade deficit is likely to decline toward 16% of GDP in 2014 and fall slightly in following years. The CAD may decline toward 11% of GDP and then fall below 10%, still largely reflecting imports related to FDI projects and the country's massive investment in infrastructure.

Panama typically runs a large reported deficit in trade and factor income (reflecting dividend outflows) and a surplus in services, including tourism, air travel, and revenues from the Panama Canal. Last year, Panama incurred a small deficit in transfers, reflecting rising outward remittances from its foreign-born workforce. The CAD may be overstated because official statistics do not capture inflows of profits and dividends from investments held abroad by Panamanian residents.

Both FDI inflows and service exports are likely to rise in the next three years. FDI was more than 11% of GDP in 2013, and we expect it to largely fund the CAD in 2014 and 2015. About 25% of FDI comes from the U.S. and 34% from Latin America and the Caribbean. Re-invested earnings comprised about 60% of FDI in 2013, up from approximately 40% two years earlier. A recent expansion in tourism infrastructure, including new regional airports as well as hotels and convention facilities, should sustain earnings from that sector. Panama signed a free trade agreement with Mexico in early 2014, complementing earlier such agreements with the U.S., Canada, and a similar trade deal with the EU (along with Central America).

Panama is vulnerable to a sudden external shock. As an open economy, Panama depends on foreign savings to finance much of its investment and is vulnerable to external shocks. In the event of a global economic slowdown, we expect that FDI would drop sharply (it fell by 5 percentage points of GDP in 2009), along with prices of imported commodities. The CAD is likely to contract as a consequence (it fell to 1% of GDP in 2009 from 12% in 2008), along with economic growth.

External debt is stable. Narrow net external debt as a share of exports of goods, services, factor income, and transfers (current account receipts) is projected to be 94% in 2014 and stable in the coming three years. Gross external financing requirements as a share of current account receipts and usable reserves are likely to hover around 130%-140%.

Panama does not have registration requirements for the private sector. Official data show a large liability position for the nonfinancial private sector but does not capture much of its external assets. However, Standard & Poor's estimates that Panama's nonfinancial private sector is a net creditor. Official statistics capture only a small share of FDI outflows (data from recipient countries indicate higher levels of Panamanian outward FDI). The International Monetary Fund (IMF), using data from other countries, estimates that the stock of Panamanian FDI held abroad was 78% of GDP in 2011. The local capital markets have been able to finance some large investment projects.

The external assets and liabilities of the banking sector are about 100% of GDP. We estimate that the financial sector is in a net external creditor position of 7% of current account receipts.

### Fiscal Analysis: Fiscal Policy Is Likely To Tighten Moderately While The Debt Burden Remains Stable

The public-sector deficit is likely to be just over 3% of GDP in 2014 and in 2015.
The government's ambitious investment program has contributed to fiscal deficits in recent years despite very high GDP growth rates.
The government's debt burden is likely to remain stable over the next three years.
Panama has pursued a pro-cyclical fiscal policy in recent years to boost investment and set the stage for long-term development and growth. We expect the Varela Administration to moderately tighten fiscal policy in the next couple of years, in line with somewhat lower GDP growth prospects, resulting in a stable debt burden.

Spending overruns at the central government level are likely to boost the nonfinancial public-sector deficit to 3.2% of GDP in 2014. This surpasses the 2.7% limit set in Panama's Social Fiscal Responsibility Law (whose limits have been waived by Congress several times in recent years). The central government deficit (measured according to the government's methodology, which excludes social security) may be about 3.7% of GDP. Fiscal slippage is largely due to increased spending, mainly for capital projects and an added subsidy for electricity. The Varela Administration plans to reduce slippage during the second half of the year, mainly through constraining capital spending, as well as minor revenue measures.

A slower rate of growth in capital spending should help contain the nonfinancial public-sector deficit at about 3% of GDP in 2015 and 2%-3% of GDP in the following three years (and the central government deficit around 3% of GDP). Panama's social security system is projected to incur moderate deficits from 2017, absent changes in its program parameters. The government has flexibility to reduce capital spending in the event of a major shock that portends a larger fiscal deficit. Total central government capital spending has been about 10% of GDP in 2014, compared with 6.3% of GDP in 2009.

General government debt is likely to be 35% of GDP in 2014 and may decline toward 33% in another two years. Net general government debt (which nets out assets in Panama's sovereign wealth fund and other government liquid assets) is likely to be 15% in 2014 and stable in coming years. We expect general government interest payments to remain below 10% of revenues in 2014 and following years.

Several public enterprises are not consolidated within the public-sector data, and some of them have ambitious investments underway financed by debt. The data exclude the Panama Canal, which made a profit of $1.2 billion in 2013 (3.2% of GDP). The other three most important of such entities that are not included in the official data (companies operating highways, electricity distribution, and the airport) are all profitable, commercially run enterprises.

The fiscal contribution to the government from the Panama Canal has been revised down to reflect more pessimistic projections of shipping traffic, as well as delays in its expansion. The canal is likely to contribute 1.7%-1.8% of GDP to the government (both through tolls and dividends) in 2015 and 2016, rising toward 2.5% of GDP in the following three years. Panama's sovereign wealth fund (Fondo de Ahorro Panameno) was designed to receive any contributions from the canal above 3.5% of GDP. It currently has assets of $1.4 billion, mostly transferred to it from a previous government fund, but it is not likely to receive new contributions based on recently revised projections of canal revenues.

The accumulation of higher reserves in the sovereign wealth fund would anchor economic policies and help contain political pressure for more spending once the canal generates higher dividends. It would alleviate inflationary pressures and, by providing funds for counter-cyclical fiscal policy, boost the government's fiscal flexibility and potentially contribute to a higher credit rating.

As of mid-2014, about 83% of government debt was with fixed interest rates, up from 73% in 2004. The share of government debt issued in the local capital market rose to 19% (and another 6% is from other internal sources), up from only 9% in 2004. The government's amortization profile is light, with less than $4 billion due in 2015-2010 and nearly three-quarters of its debt maturing after 2020.

Contingent liabilities pose moderate risks. Nonfinancial public entities, including Electricity Transmission Co. and National Water and Sewerage Co., typically make a small surplus. The Panama Canal Authority is constitutionally independent from the government and cannot, by law, carry a government guarantee. Standard & Poor's estimates that the cost of recapitalizing the banking system could be 8% of GDP, under our base-case stress scenario.

### Monetary Analysis: The Use Of The U.S. Dollar Will Continue To Anchor Monetary Stability

As a dollarized country, Panama has no financial safety net or formal lender of last resort.
A gradual deepening of domestic capital markets, along a stronger sovereign balance sheet, would strengthen economic resilience in Panama.
Panama's presence on the "grey list" of countries for reported shortcomings in controls over money laundering and inadequate sharing of data with other countries highlights regulatory vulnerabilities.
Panama adopted the U.S. dollar as its national currency in 1904 and has historically enjoyed price stability, which is unique in Latin America. The inflation rate declined to 4% in 2013 and may reach 3% in 2014. Inflation may hover around 4% in 2015-16.

Panama has no central bank or formal lender of last resort. However, the government-owned Banco Nacional de Panama (BNP) set up a liquidity facility available to financial institutions during the recent global crisis. We expect a similar mechanism could be introduced if there were another external crisis. We do not expect that Panama will have an effective deposit insurance system or other mechanisms to provide temporary liquidity to distressed financial institutions in the next couple of years.

Panama has had an open, globally integrated banking system since 1996. The sector has changed significantly over the past decade--from a relatively fragmented system dominated by local players to a more global system. About half the banking system (by assets) is foreign-owned. Foreign banks account for about 80% of external deposits and about 80% of external loans. The local banks are net external creditors, with foreign assets (mainly loans to Latin American countries) at 79% of GDP and foreign liabilities at 64% of GDP in 2013, according to IMF calculations. The local banks depend largely on local funding (deposits), and foreign banks often raise funding abroad for local operations.

Panama was recently put back on the Financial Action Task Force's "grey" list of countries for legal and regulatory shortcomings, including in controlling money laundering and for inadequate sharing of financial data. Much of the legal framework for meeting global standards has been approved by law (including phasing out the use of "bearer shares," physical shares of ownership), but implementation has been ineffective. Moreover, the IMF has identified gaps in monitoring systemic risk across the entire financial sector, as well as gaps in data. We expect that the government will take steps to address regulatory shortcomings, likely moving soon to end the use of bearer shares and enlarging financial reporting requirements to more institutions.

Domestic credit to the private sector and nonfinancial public sector reached 72% of GDP in 2013 in Panama, much higher than in most of Latin America. A growing and stable economy as well as long-standing dollarization has facilitated an uninterrupted increase in the deposit base to facilitate such a level of lending. The reported ratio of capital to risk-weighted assets is more than 15%, and liquid assets exceed 20% of total deposits. Nonperforming loans (NPLs) are below 1% of total loans, and loan loss provisions equal 170% of NPLs. About one-quarter of loans are for mortgages, and one-quarter are for commerce.

The Panamanian banks have typically followed conservative limits on loan-to-value ratios for mortgages, as well as low thresholds for valuing each square foot of real estate that they finance. That has effectively transferred the bulk of the risk to borrowers who have to finance much of the purchase with their own funds. Nevertheless, we believe that the system remains marginally vulnerable to the real estate market because of its heavy exposure to residential and commercial mortgages and construction loans. House prices have risen rapidly in recent years and sectors such as tourism and high-end residences suffer from moderately excess supply.

The local capital market is gradually developing. In contrast with many investment-grade sovereigns, Panama has comparatively weak local capital markets, despite its large banking sector. Domestic capital markets have been growing in recent years and will gradually provide more local funding at favorable rates and terms to both sovereign and non-sovereign borrowers. There are currently four market makers and more are likely soon, facilitating more trading of sovereign bonds. The volume of secondary market trading, which has risen rapidly recently, albeit from a very low base, is likely to rise further now that Panama is part of Euroclear and Latinclear settlement systems, making it easier for foreign investors to trade in local debt. A gradual deepening of financial markets, along with a stronger sovereign balance sheet, would strengthen economic stability in Panama.

### Local Currency Rating And T&C Assessment

As a fully dollarized economy, Panama's monetary and exchange rate policy authority largely rests with the U.S. In our opinion, the likelihood of the Panamanian government ceasing to use the U.S. dollar as its local currency is low. Therefore, our transfer and convertibility (T&C) assessment is 'AAA', the same as that of the U.S.

### Table 2

**Panama (Republic of)--Selected Indicators**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014e | 2015f | 2016f | 2017f |
|---|---|---|---|---|---|---|---|---|---|---|
| **Economic indicators** | | | | | | | | | | |
| Nominal GDP (bil. US$) | 24.9 | 25.9 | 28.8 | 33.3 | 38.0 | 38.0 | 41.5 | 45.7 | 50.4 | 55.6 |
| GDP per capita (US$) | 7,305 | 7,489 | 7,830 | 8,896 | 9,988 | 9,833 | 10,434 | 11,333 | 12,321 | 13,421 |
| Real GDP growth (%) | 9.2 | 0.1 | 9.9 | 10.8 | 10.3 | 8.4 | 5.6 | 5.9 | 6.0 | 6.0 |
| Real GDP per capita growth (%) | 4.5 | (1.5) | 3.4 | 9.0 | 8.5 | 6.7 | 2.5 | 4.4 | 4.5 | 4.5 |
| Real investment growth (%) | 9.2 | 0.1 | 9.9 | 10.8 | 10.3 | 8.4 | 5.6 | 5.9 | 6.0 | 6.0 |
| Gross domestic investment/GDP (%) | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 | 21.5 |
| Gross domestic savings/GDP (%) | 10.6 | 20.9 | 12.0 | 6.5 | 11.5 | 8.9 | 10.4 | 11.7 | 13.6 | 15.3 |
| Real exports growth (%) | 9.2 | 0.1 | 9.9 | 10.8 | 10.3 | 8.4 | 5.6 | 5.9 | 6.0 | 6.0 |
| Unemployment rate (average %) | 4.7 | 4.5 | 4.5 | 5.0 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| **External indicators** | | | | | | | | | | |
| Narrow net external debt/CARs (%) | 62.5 | 60.2 | 83.0 | 77.2 | 74.8 | 94.4 | 93.3 | 94.4 | 92.7 | 95.3 |
| Gross external financing needs/CARs plus usable reserves (%) | 131.9 | 112.7 | 122.4 | 136.1 | 132.2 | 136.2 | 138.7 | 135.6 | 133.0 | 128.5 |
| Net external liabilities/CARs (%) | 101.9 | 62.6 | 50.3 | 50.9 | 58.4 | 72.5 | 75.9 | 80.0 | 80.2 | 83.7 |
| Current account balance/GDP (%) | (10.9) | (0.7) | (9.6) | (15.0) | (10.1) | (12.7) | (11.1) | (9.8) | (8.0) | (6.2) |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Current account balance/CARs (%) | (14.8) | (0.9) | (13.0) | (18.1) | (12.4) | (15.8) | (14.0) | (12.6) | (10.4) | (8.3) |
| Trade balance/GDP (%) | (18.3) | (8.4) | (15.8) | (21.7) | (17.2) | (17.8) | (16.0) | (14.4) | (12.5) | (10.7) |
| Net FDI/GDP (%) | 8.8 | 4.9 | 8.2 | 8.9 | 8.3 | 11.5 | 11.4 | 10.6 | 9.8 | 9.1 |
| Short-term external debt by remaining maturity/CARs (%) | 30.9 | 25.6 | 26.8 | 31.4 | 29.7 | 31.4 | 36.7 | 33.9 | 32.4 | 32.7 |
| **Fiscal indicators** | | | | | | | | | | |
| Change in general government debt/GDP (%) | (0.1) | (2.5) | 1.0 | 1.9 | 2.7 | 4.1 | 3.0 | 2.6 | 2.1 | 1.7 |
| General government balance/GDP (%) | (0.7) | (1.9) | (2.5) | (2.6) | (1.8) | (3.5) | (3.5) | (3.2) | (2.6) | (2.3) |
| General government primary balance/GDP (%) | 2.2 | 0.9 | 0.0 | (0.3) | 0.1 | (1.3) | (1.3) | (1.0) | (0.6) | (0.4) |
| General government revenue/GDP (%) | 23.1 | 22.8 | 23.2 | 22.9 | 23.4 | 25.8 | 25.9 | 25.8 | 25.9 | 26.1 |
| General government expenditures/GDP (%) | 23.8 | 24.6 | 25.6 | 25.4 | 25.2 | 29.3 | 29.4 | 29.0 | 28.5 | 28.4 |
| General government interest expenditure/revenues (%) | 12.6 | 12.1 | 10.7 | 9.7 | 8.4 | 8.4 | 8.4 | 8.3 | 8.0 | 7.6 |
| General government debt/GDP (%) | 41.9 | 37.8 | 35.0 | 32.2 | 30.9 | 35.1 | 35.1 | 34.5 | 33.3 | 31.9 |
| Net general government debt/GDP (%) | 20.6 | 15.8 | 15.3 | 13.7 | 12.2 | 13.3 | 15.2 | 16.4 | 16.9 | 17.1 |
| General government liquid assets/GDP (%) | 21.4 | 22.0 | 19.7 | 18.5 | 18.8 | 21.8 | 19.9 | 18.1 | 16.4 | 14.9 |
| **Monetary indicators** | | | | | | | | | | |
| CPI growth (%) | 8.7 | 2.4 | 3.5 | 5.9 | 5.7 | 4.0 | 3.5 | 4.0 | 4.0 | 4.2 |
| GDP deflator growth (%) | 7.9 | 4.1 | 1.1 | 4.2 | 3.5 | (7.7) | 3.5 | 4.0 | 4.0 | 4.2 |
| Other dc claims on resident nongovernment sector growth (%) | 15.8 | 1.8 | 13.1 | 15.9 | 15.0 | (8.9) | 9.3 | 10.1 | 10.2 | 10.5 |
| Other dc claims on resident nongovernment sector/GDP (%) | 81.4 | 79.5 | 80.9 | 81.2 | 81.9 | 74.6 | 74.6 | 74.6 | 74.6 | 74.6 |

Note: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. e--Estimate. f--Forecast.

**Chart 1**

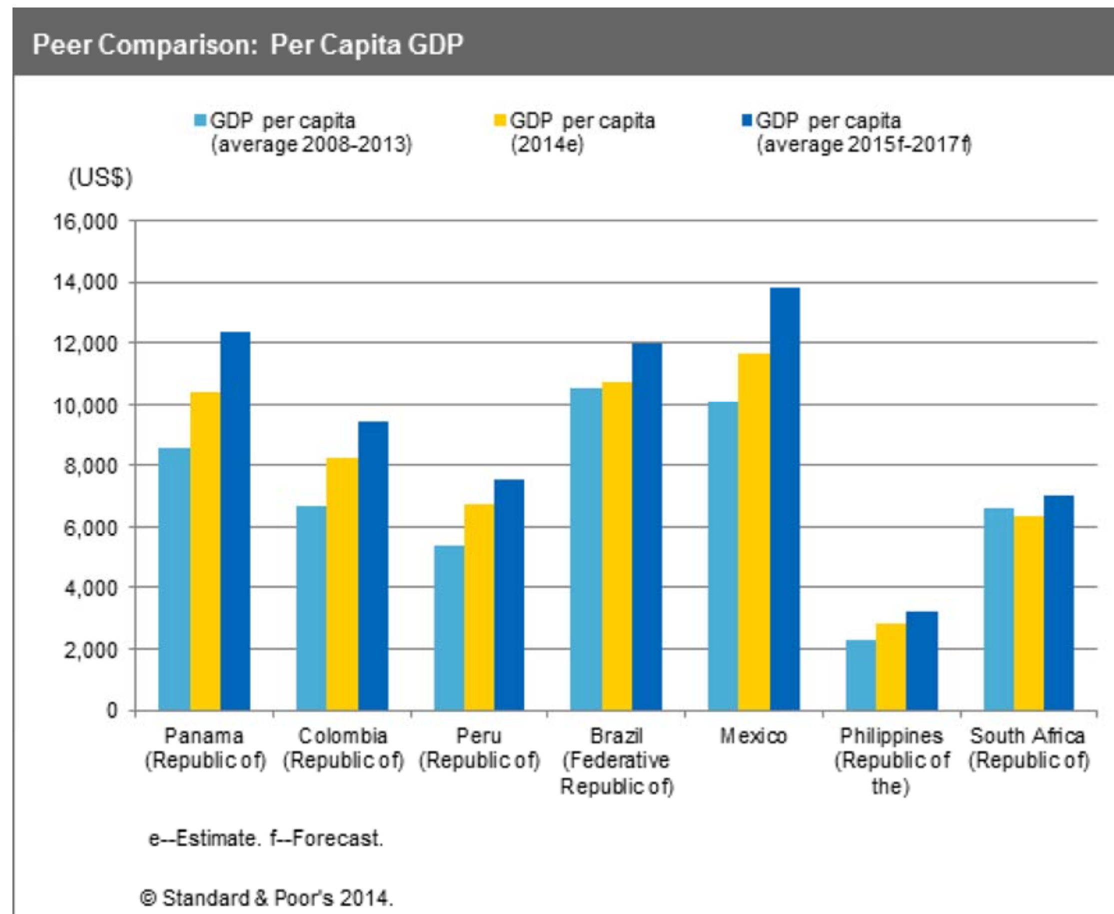


**Chart 2**

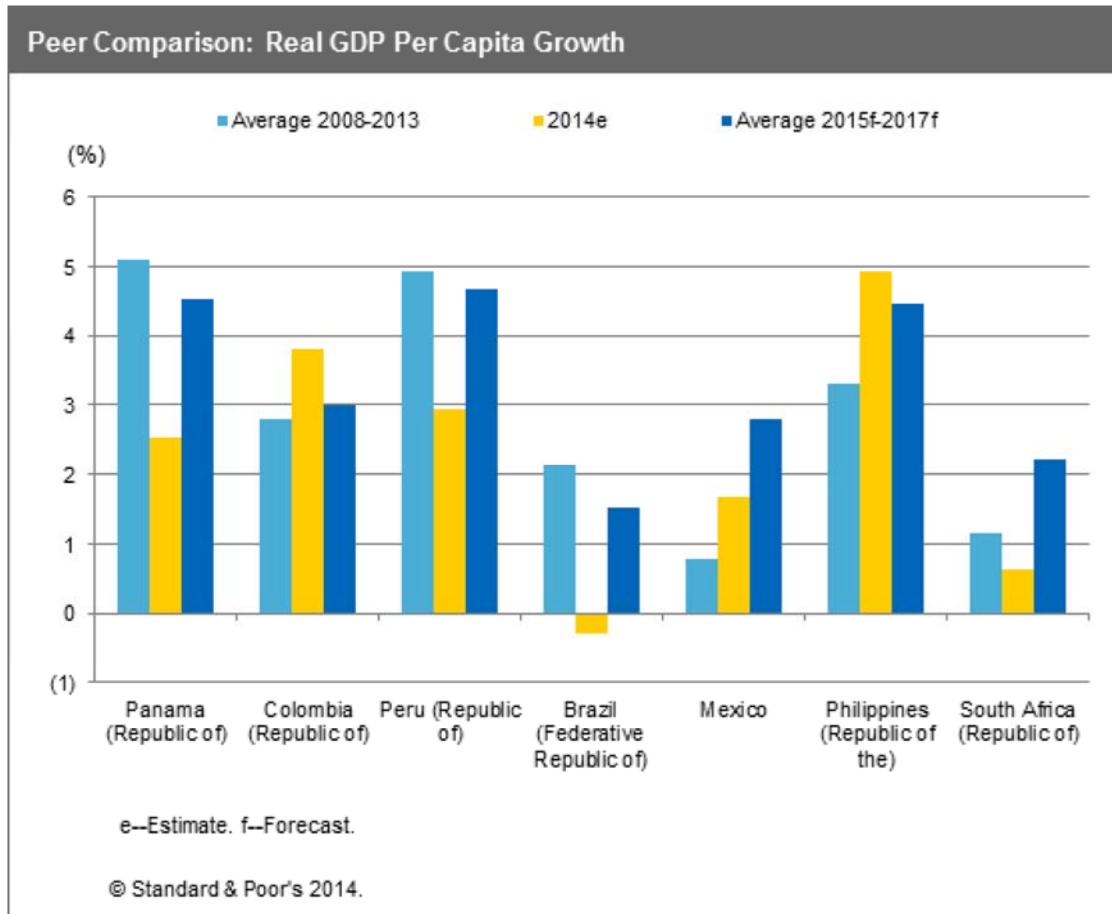


**Chart 3**

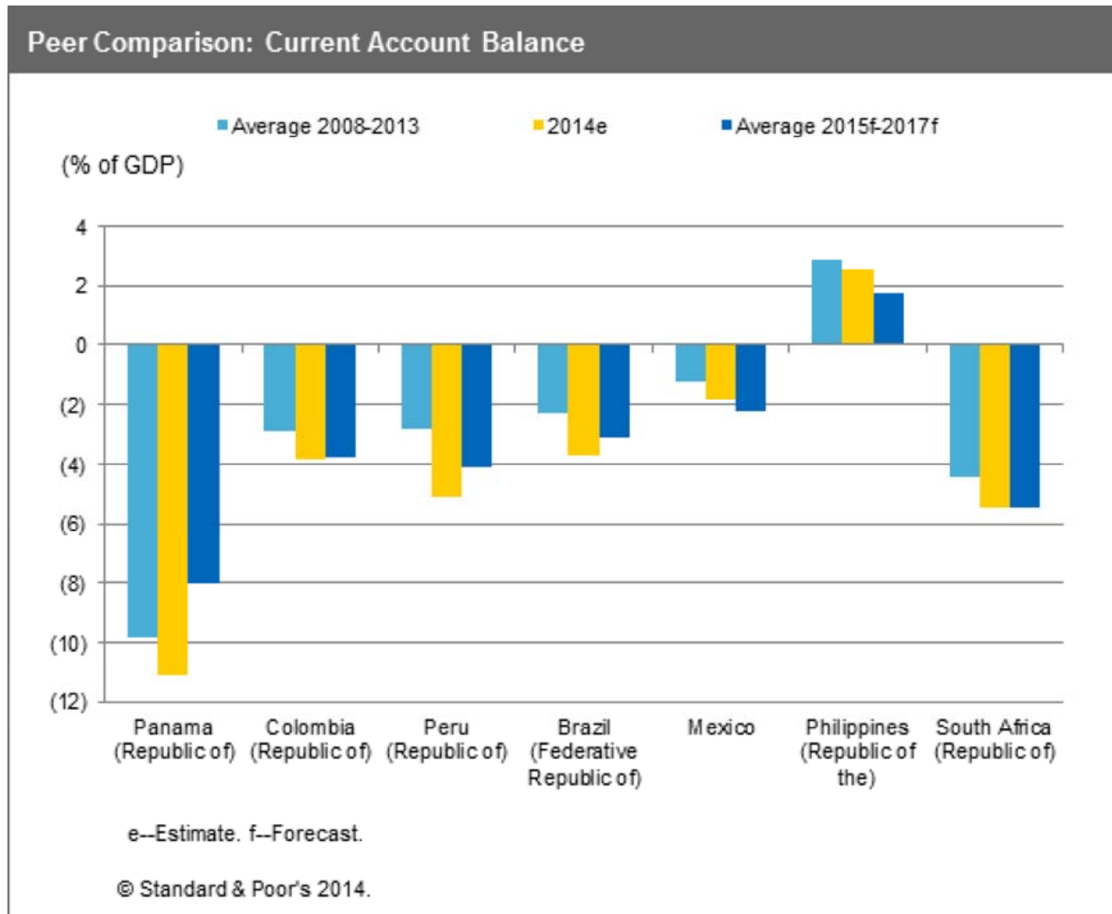


**Chart 4**

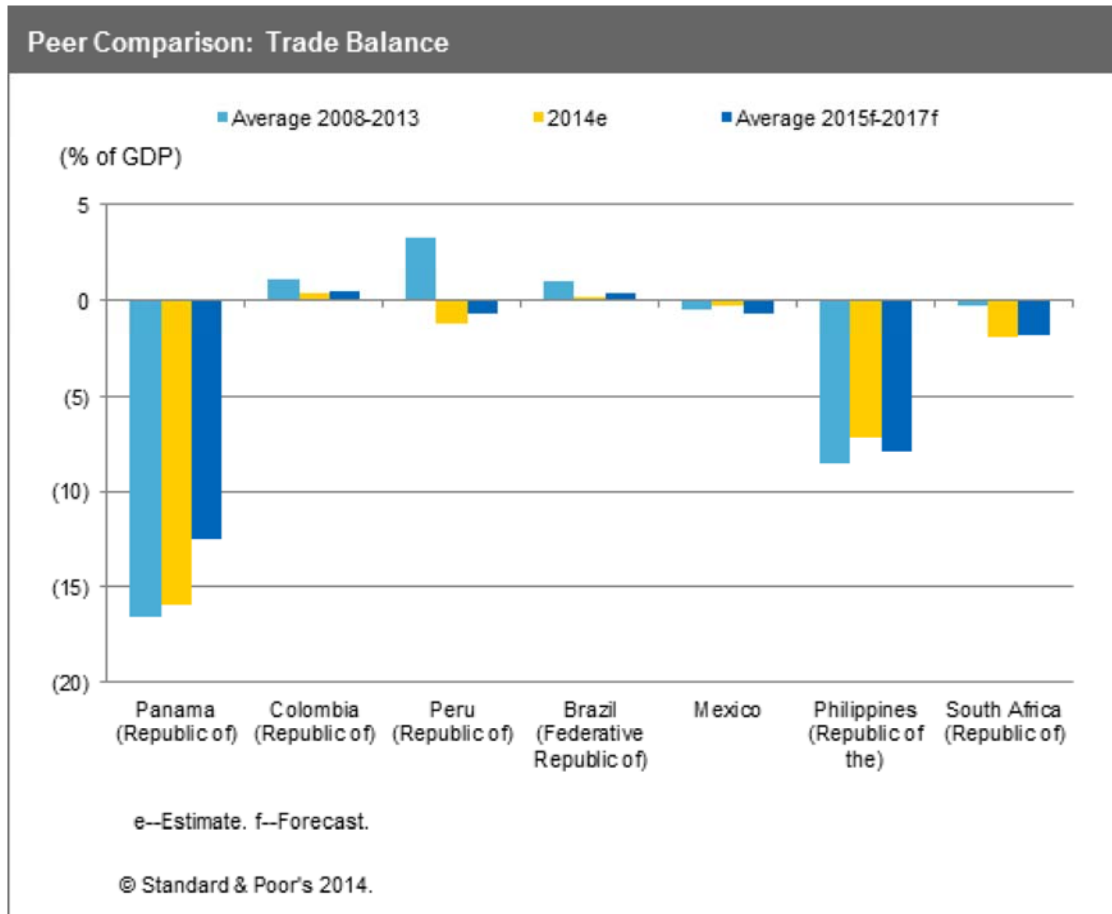


**Chart 5**

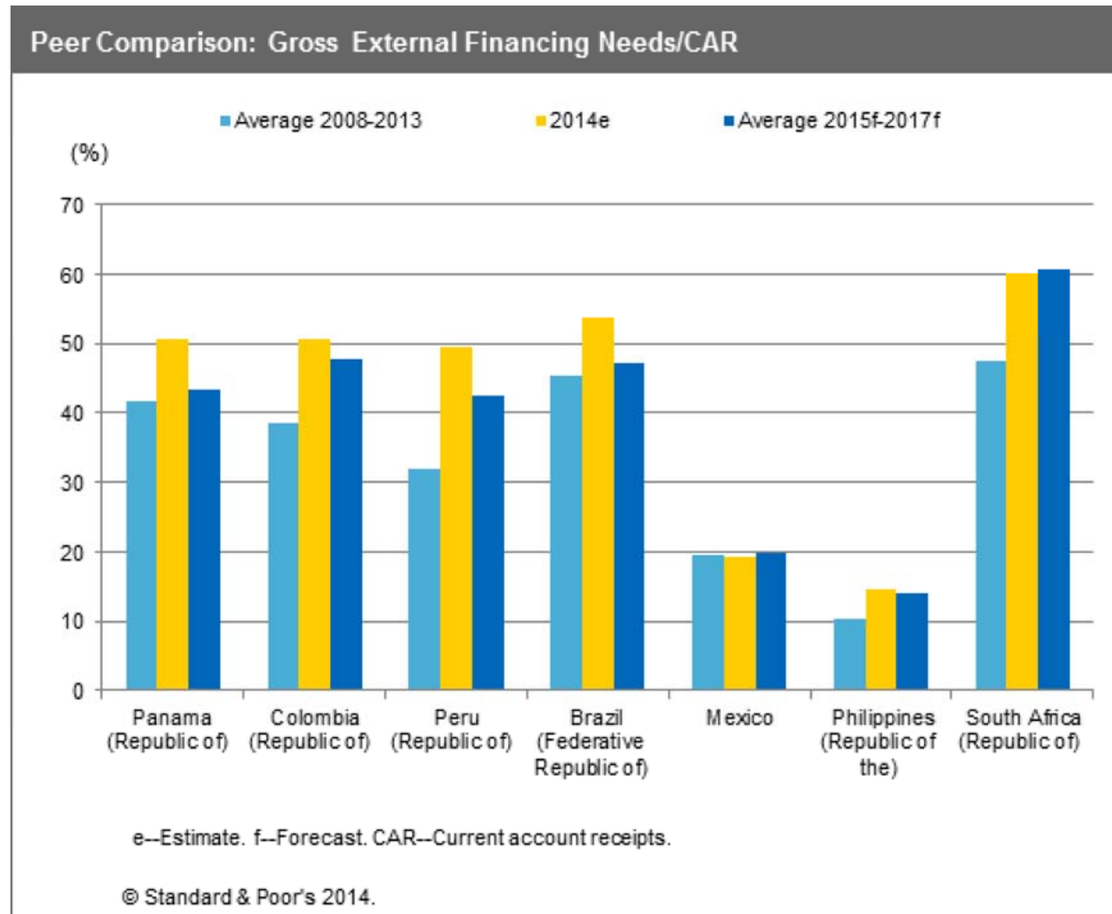


**Chart 6**

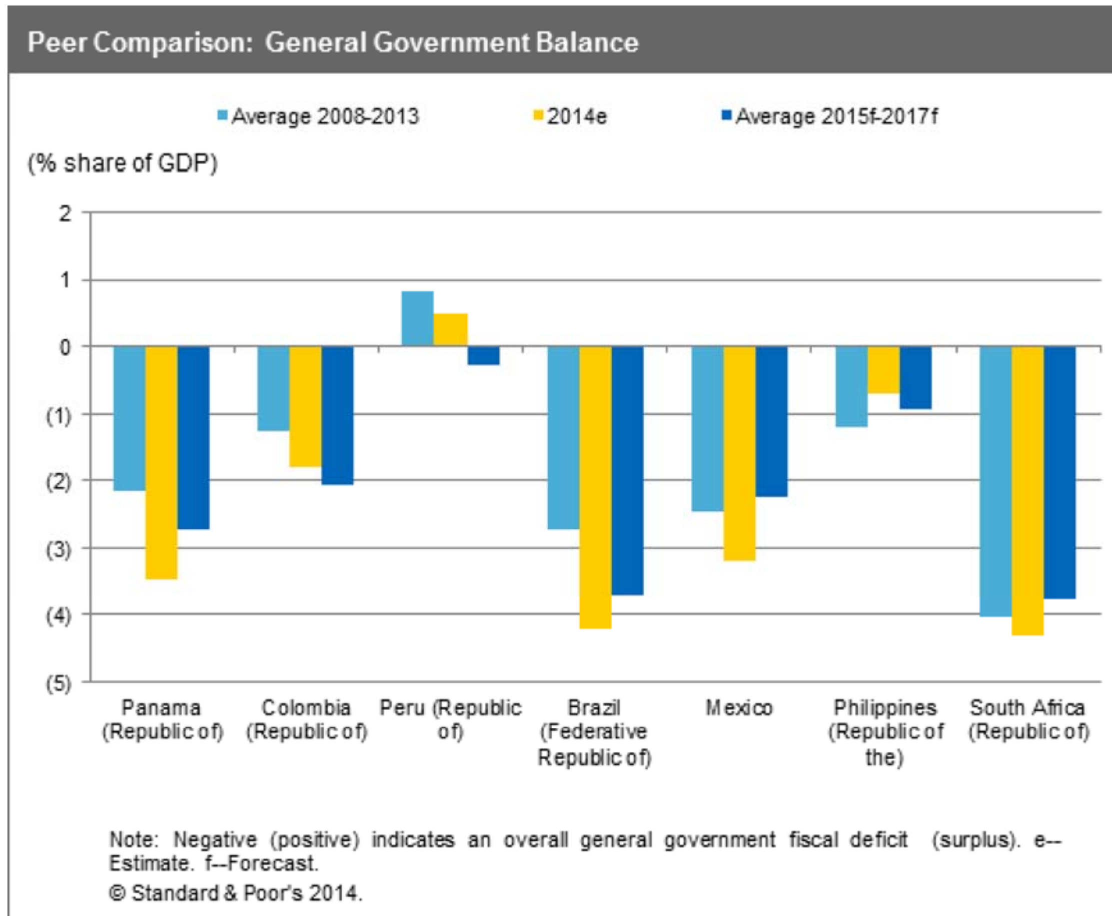


**Chart 7**

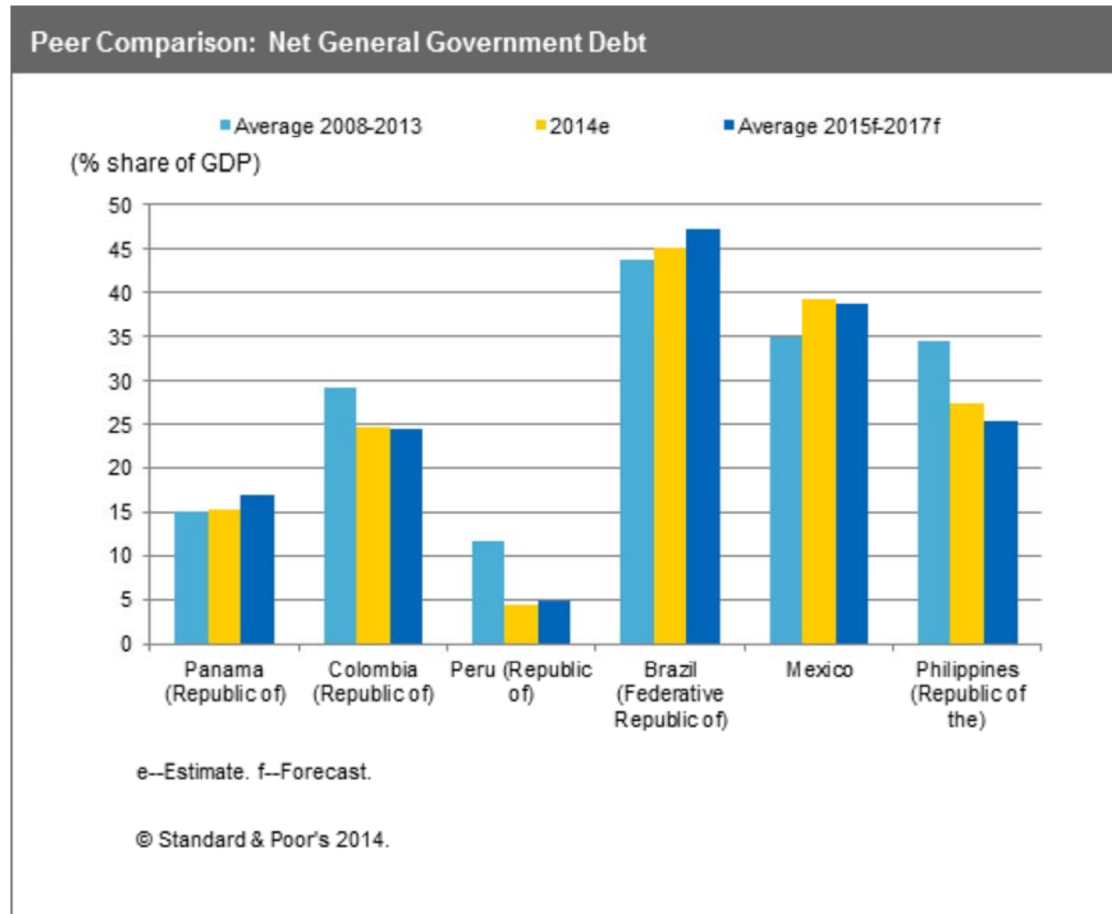


**Chart 8**

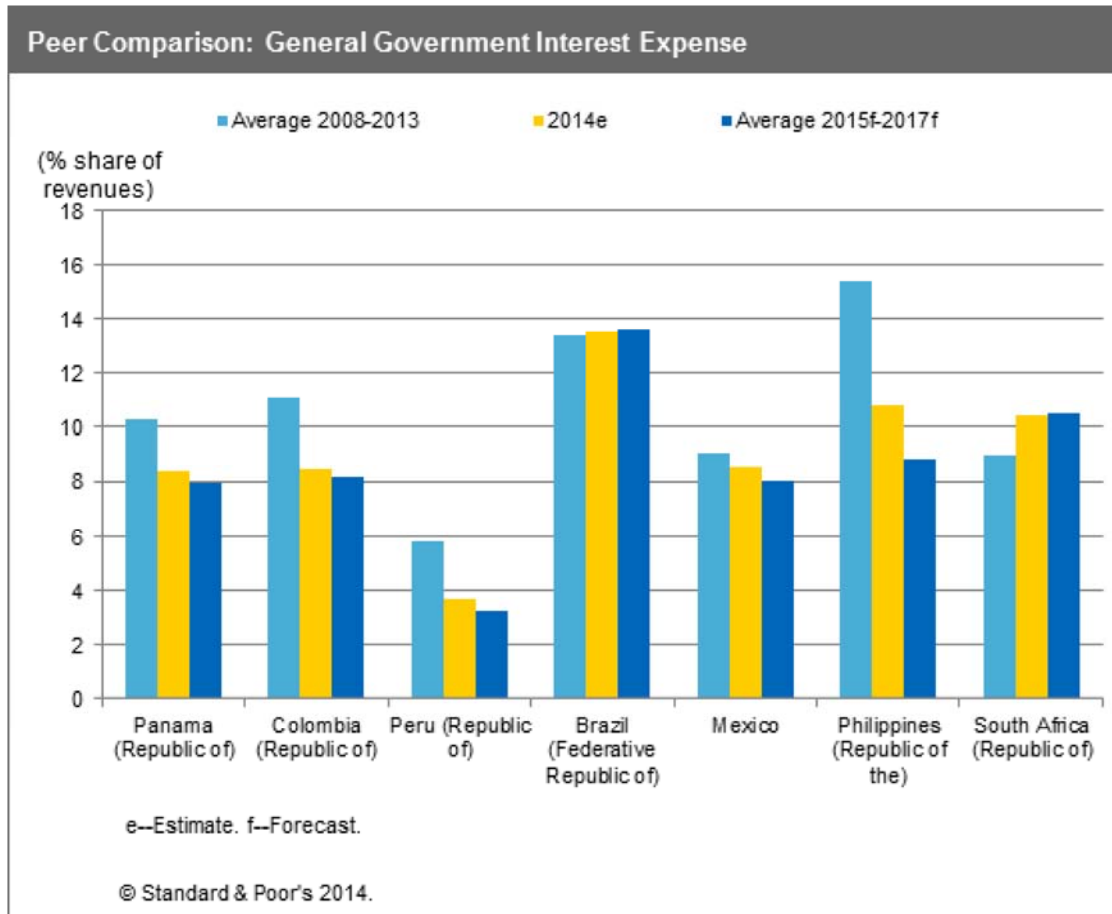
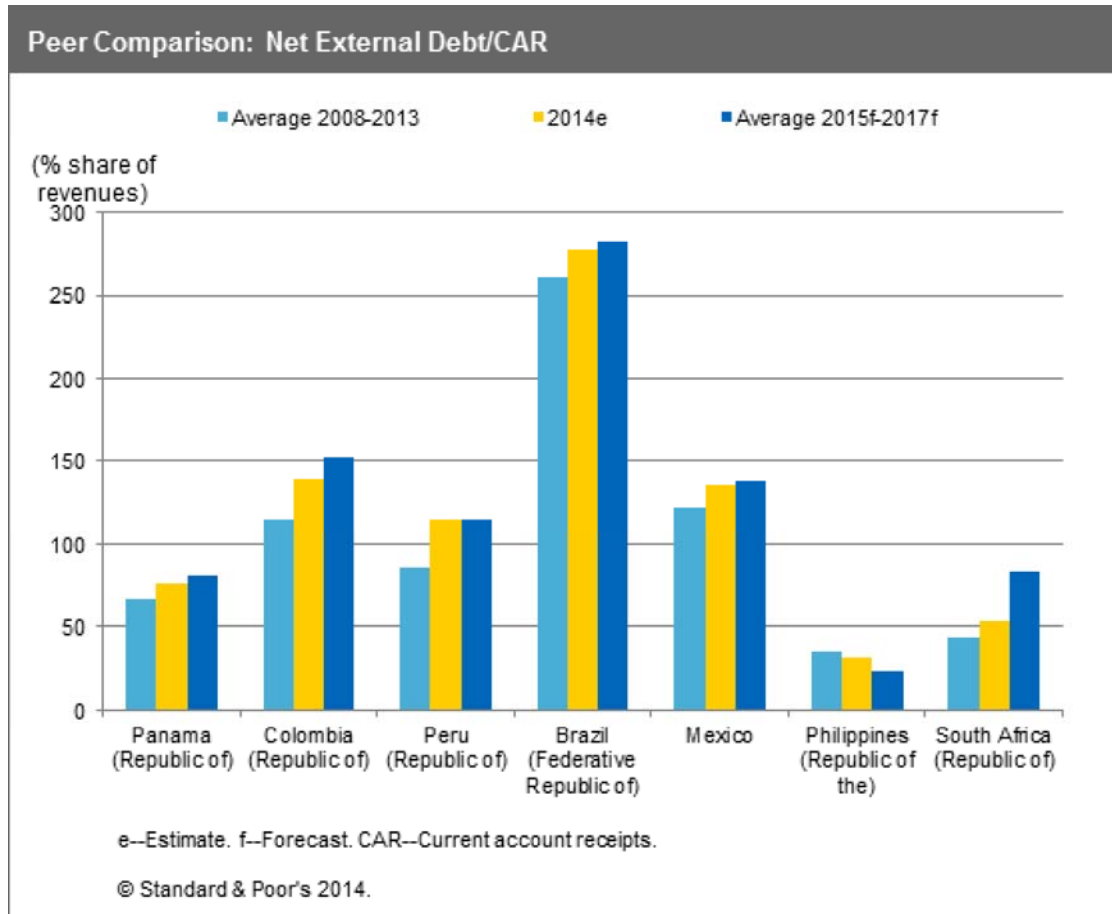


**Chart 9**




## Related Criteria And Research

### Related Criteria

Sovereign Government Rating Methodology And Assumptions, June 24, 2013

Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

### Related Research

Republic of Panama, Sept. 5, 2013

The Sovereign Rating on Panama: A Comparative Perspective With Singapore, March 4, 2013

| **Ratings Detail (As Of 22-Oct-2014)*** | |
|---|---|
| **Panama (Republic of)** | |
| Sovereign Credit Rating | BBB/Stable/A-2 |
| Transfer & Convertibility Assessment | |
| *Local Currency* | AAA |
| Senior Unsecured (0 Issues) | BBB |
| **Sovereign Credit Ratings History** | |
| 02-Jul-2012 | BBB/Stable/A-2 |
| 21-Jul-2011 | BBB-/Positive/A-3 |
| 25-May-2010 | BBB-/Stable/A-3 |
| 09-Nov-2009 | BB+/Positive/B |

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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