Euler Hermes Economic Research

Country Risk Analysis

Panama

Canal channel

General information

GDP	USD26.8bn (World ranking 93, World Bank 2011)
Population	3.57 millions (World ranking 130, World Bank 2011)
Form of state	Constitutional Democracy
Head of government	Ricardo MARTINELLI Berrocal (CD)
Next elections	2014, presidential and legislative

Strengths

- Trade hub through Panama Canal and large Colon free trade zone
- International banking centre/regional financial hub
- Strong economic growth
- USD as currency.
- Moderate fiscal deficit
- Above average business environment
- Durable, democratic political system in past 20 years.

Weaknesses

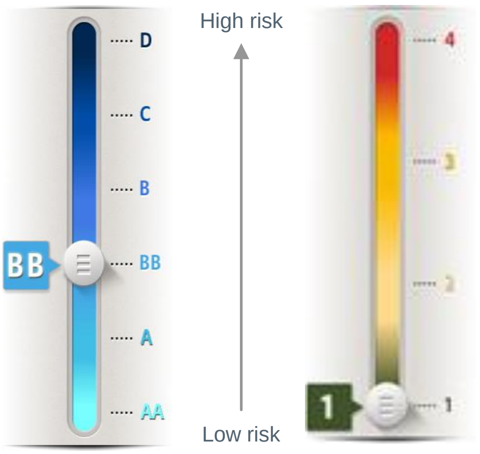
- Disparity of incomes between Canal zone and rest of country where poverty levels high.
- Large current account deficit, though strong FDI flows.
- Vulnerability to external shocks (global trade and financial links)
- Moderately high debt ratios
- Rule of Law and control of corruption are below average

Country Rating

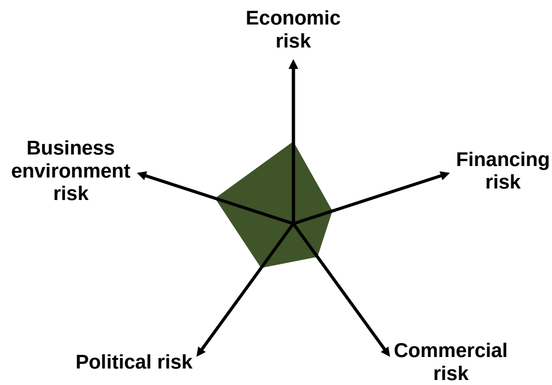
BB1

Country Grade

Country Risk Level

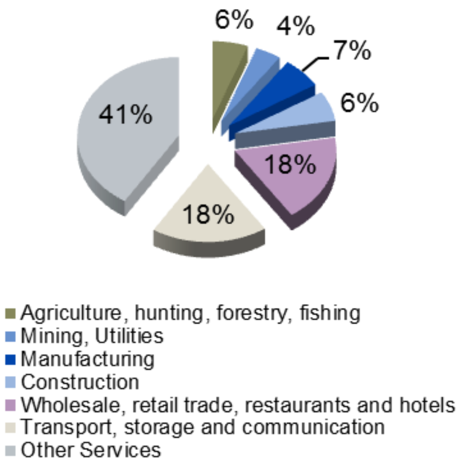


Risk Dimensions



Economic structure

GDP breakdown (% of total, 2010)



Trade structure (% of total, 2010)

By destination/origin

Exports		Rank		Imports
Venezuela (Bolivarian Republi	16%	1	23%	Japan
United States	16%	2	23%	China
Ecuador	10%	3	18%	Singapore
Colombia	7%	4	13%	United States
Guatemala	4%	5	6%	Korea, Republic of
Costa Rica	4%	6	3%	Colombia

By product

Exports		Rank		Imports
Medicinal and pharmaceutical products	23%	1	31%	Other transport equipment
Articles of apparel & clothing accessories	9%	2	13%	Petroleum, petroleum products and related materials
Petroleum, petroleum products and related	9%	3	7%	Organic chemicals

Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Economic Forecast

	Average 2000-08	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	6.1	3.9	7.7	10.6	10.7	7.8	6.8
Inflation (%, end-year)	2.5	1.9	4.9	6.3	4.6	5.0	4.8
Fiscal balance (% of GDP)	-1.6	-1.1	-1.8	-2.3	-2.1	-2.8	-2.7
Public debt (% of GDP)	60.1	43.5	39.6	39.8	41.8	41.0	41.0
Current account (% of GDP)	-5.3	-0.7	-10.6	-12.2	-9.2	-10.4	-10.7
External debt (% of GDP)	53.0	46.5	42.1	40.2	47.4	45.0	44.0

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

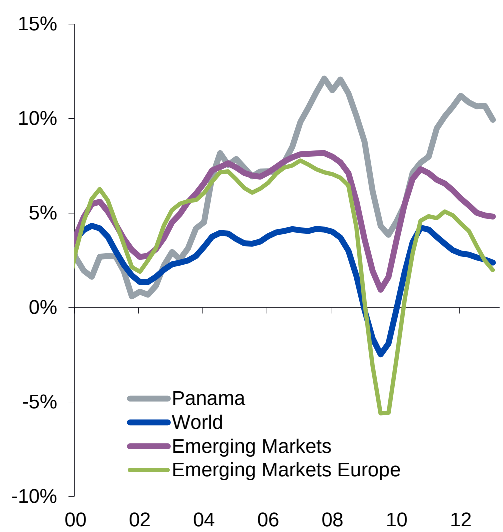
Strong growth

The economy has expanded strongly in recent years. GDP growth averaged 8.6% in the five years to 2012, supported by expansion of the Panama Canal and large public sector infrastructure projects. Per capita income has doubled over the past decade. With a strong reliance on the country's role as an international banking centre and regional financial hub, canal and free zone trade the economy is highly vulnerable to external shocks, particularly those emanating from the US, though generally sound policies have underpinned a good degree of resilience to the global crisis.

To be maintained through 2013-14

Growth may moderate in 2013 and 2014, removing residual concerns about overheating but, nonetheless, remain strong at 7.5% and 6.8% respectively. Canal expansion is expected to be completed in early 2015 (about 6 months behind schedule). A number of Free Trade Agreements will also help to maintain growth and encourage FDI.

GDP growth (y/y, 4 qtrs cumulated %)



Sources: IHS Global Insight, Euler Hermes

Policies underpin strong growth

Strong growth has been underpinned by generally sound policies, anchored by the use of the USD as the currency

No independent monetary policy

The US dollar is the legal currency and as a result Panama does not have an independent monetary policy, central bank or a lender-of-last resort, though sufficient liquidity was provided to enable the banking system to survive the 2008-9 financial crisis intact.

Inflation is generally correspondingly low (aligned with the US) but tends to be somewhat higher and more volatile under pressure of food and energy prices. Inflation eased to 4.6% y/y at end-2012 (from 6.8% in November 2011) and, though it might accelerate slightly in the next few months on a y/y basis shoud end 2013 at 5% and ease to 4.8% by end-2014.

Credit expansion has been very strong, though the pace slowed in the latter part of 2012. The banking system is regarded as relatively strong, however, as there is a diversified ownership structure, high reliance on deposit funding and low exposure to European banks. Capital ratios are high and Non-performing loans low.

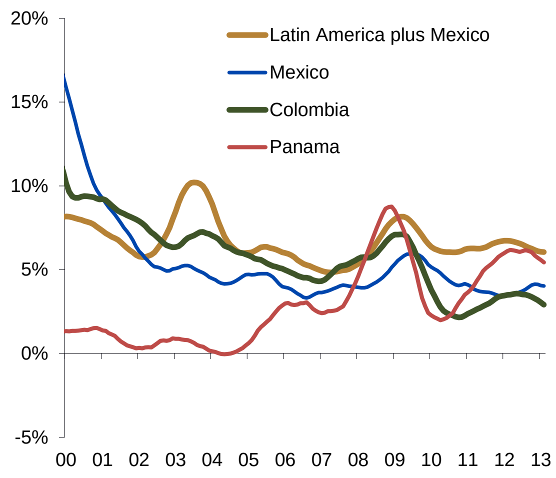
Fiscal deficit moderate, declining public debt-GDP ratio

The fiscal deficit widened to -2.3% of GDP in 2011 but in the first nine months of 2012 had narrowed from the same period the previous year, as tax reforms boosted revenues, and for the full year 2012 should be in the 2-2.5% range, within the revised budget target of 2.9%.

The budget operates within the framework of a Social and Fiscal Responsibility Law. The fiscal limits in the Law were revised in 2012 when the Sovereign Wealth Fund was created (June) the objectives of which are to introduce a stabilisation mechanism for emergencies and economic slowdowns and create a long-term savings instrument. Starting in 2015 yearly contributions of the Panama Canal Authority above 3.5% of GDP will have to be transferred to the fund. Although the Law and the Fund add to medium-term stability, there have been frequent changes to the parameters, including a higher deficit target of 2.8% of GDP in 2013 and an earlier start than 2015 for withdrawals from the fund to allow reconstruction after recent floods and mud-slides.

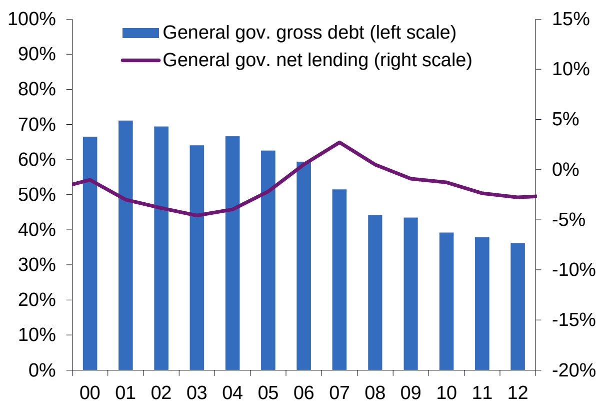
Nonetheless, the fiscal deficit is manageable and has been consistent with a downward trend in the public debt-GDP ratio, though the ratio is still on the high side.

Inflation (%)



Sources: IHS Global Insight, Euler Hermes

Fiscal balance and debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Large current account deficit but strong coverage by FDI flows

There is a large domestic trade deficit, widened by imports of goods associated with spending on Canal expansion and infrastructure. The free trade zone is in surplus, however, as are net earnings from the services sector. Nonetheless, the current account deficit was a large -9.2% of GDP in 2012, following an even larger deficit of -12.6% in 2012 and is likely to remain above -10% of GDP in both 2013 and 2014.

The current account deficit is more than 90% covered by net FDI inflows, which have more than tripled since the nadir in 2009 during the global financial crisis. Although foreign exchange reserves and import cover are relatively low, the use of the USD mitigates convertibility and transfer risk.

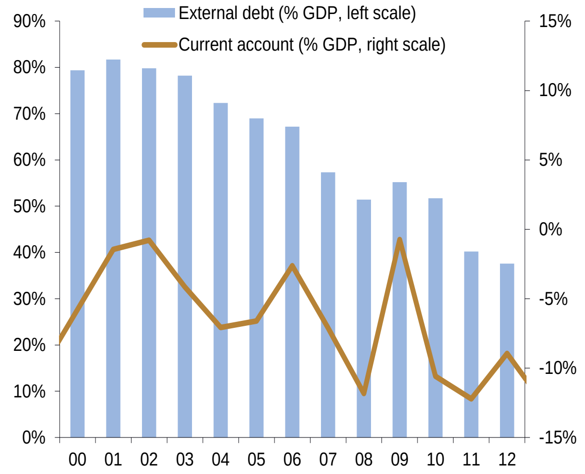
External debt ratios downward trend

External debt ratios are on a downward trend. The external debt-GDP ratio (excluding the ST liabilities of the banking sector) at end-2011 was 49%, but like the public debt ratio is on a downward trend and should be around 45% at end-2013.

Moreover, measured against exports of goods and services (XGS) external debt is low at around 60% and interest payments due-XGS is just 3.5%.

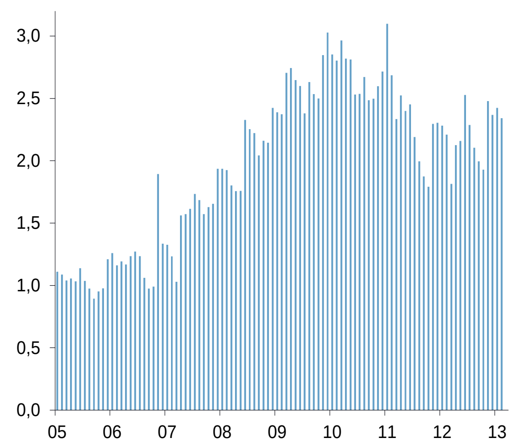
Total external liabilities, including ST liabilities of the the banking sector) are 176% of GDP, though excluding offshore banks is less than 130%, which poses some risk, but is on a downward trend and as noted above the banking system, while vulnerable to sharp stop in capital flows such as might occur in a global financial crisis has shown a good degree of resilience.

External debt and current account (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

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