

Emerging Insight

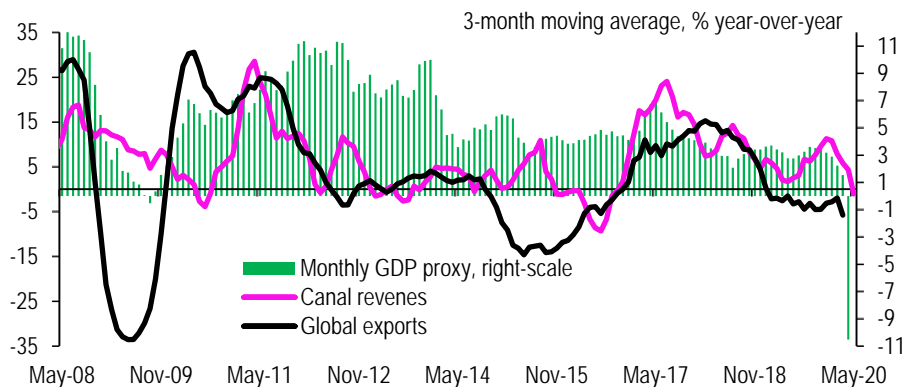
Panama – Glass half full

Key takeaways

- Given the nosedive in Q2 and the prolongation of the lockdown, we are revising our GDP forecast for 2020 to -10% (from -4%).
- Nevertheless, the government is doing a good job at covering funding needs and preventing the fiscal deficit from ballooning.
- We are constructive for 2021. Growth prospects remain favorable and the sovereign will likely retain its IG credit rating.

By Alexander Müller and Pedro Diaz

Chart of the day: Panama's cycle is strongly correlated to global trade, as roughly 5% goes through the Canal. If there is any sector in the world that can have a v-shaped recovery, that is foreign trade



Source: BofA Global Research, Statistics Institute (INEC), IMF

Panama in Focus

Economic outlook, beyond 2020, is positive

Panama does not exist in vacuum. 2020 will be a tough year, but it will tough for all countries in the world. In our view, Panama is likely to emerge stronger from the crisis than the vast majority of LatAm peers. Growth prospects for the coming years are propitious, and the public debt ratio will remain at moderate levels compared to other emerging markets. The government has moved fast to cover its funding needs, in contrast with many LatAm countries that are struggling, and the fiscal deficit is unlikely to balloon to double-digit levels because of prudent expenditures management. Although a credit rating downgrade might happen within the next twelve months, we expect the sovereign to retain its investment grade status, supported by an increasingly diversified economy, market-friendly policies, and stable governability conditions.

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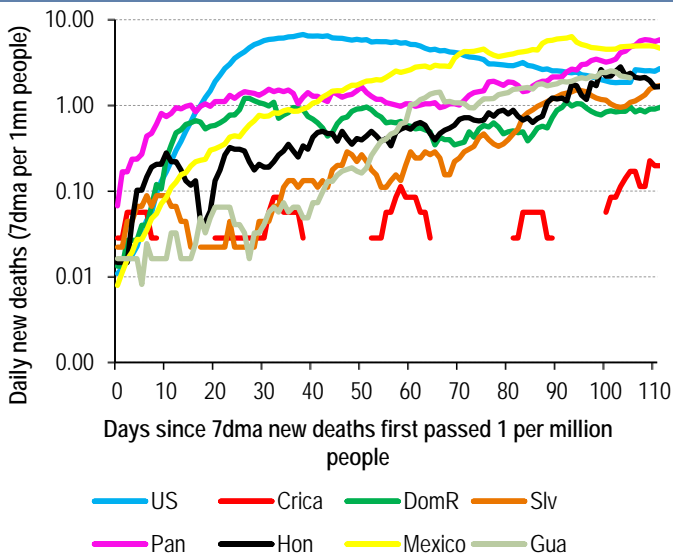
2020 is a lost year, but this shouldn't be a surprise

According to the monthly GDP proxy, Panama contracted at a significant 34.7% yoy, standing out as one of the three economies in LatAm that suffered the sharpest contraction in April – the first full month of lockdown – along with Ecuador (34.4%) and Peru (40.5%). Ecuador is whole different story. It defaulted in March and is doing fiscal austerity at a time that all the rest of countries in the region are pumping-in stimulus in varying sizes. But Panama and Peru were both healthy economies prior to the crisis – from a macro perspective – and share another interesting commonality in 2020, a very prolonged and tight lockdown that depresses activity.

The lockdown, as in other parts of the world, is a government response to the spiraling of the virus. Panama's Covid-19 pictures still look stark (charts 2 & 3). The cases curve has picked up again, and deaths per capita are the sixth highest in the region. After the beginning of the economic re-opening on 13 May – with the lifting of restrictions on “block 1” activities (ie, electronic commerce, auto repair businesses, electric & plumbing services, fishing) – and the step forward to “block 2” activities (public infrastructure projects, mining, industrials, parks, churches) on 1 June, the government halted the process¹. Moreover, starting on 17 July, mobility restrictions in the two most populated provinces of the country – Panama (including the capital city) and West Panama (La Chorrera) – got tightened. In the same spirit, the resumption of international travel was postponed to 21 August from 23 July previously.

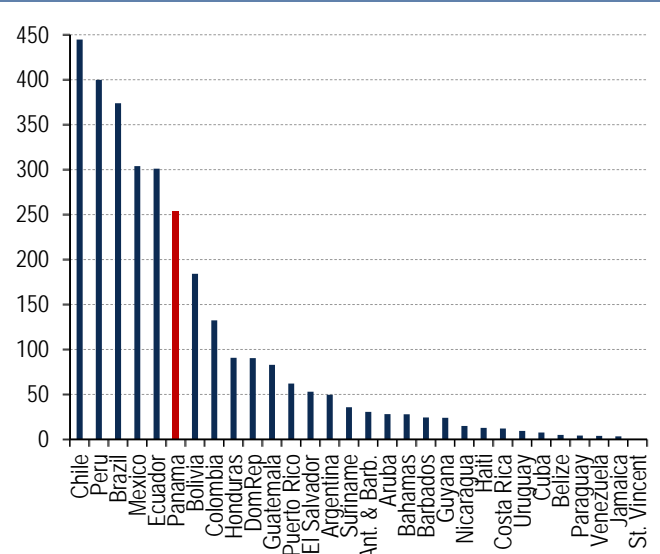
Coincident indicators for May – with the exception of electricity production & consumption, port activity, and liquidity in the financial system (particularly relevant for dollarized economies) – don't look any better.

Chart 1: Panama's Covid-19 cases curve looks stark compared to regional neighbors



Source: Bloomberg

Chart 2: And deaths per capita are among the highest in Latham
(Deaths associated to Covid-19 per million people)



Source: Our World in Data from Oxford University

¹ The government's plan is to re-open the economy in six steps/blocks: blocks 1 and 2 are described above; block 3 includes retail, construction, auto sales, as well as professional and administrative services; block 4 refers to air travel, hotels and restaurants; block 5 encompasses education, recreational transportation, sports, some entertainment activities and bars; and block 6 is for concerts, nightclubs and lifting of sanitary restrictions in all sectors. It is important to point out that the value chains of food (agriculture) and medicines, medical services, financial services, the Canal, oil storage, ports, and most government services were never subject to the lockdown restrictions.



Canal volumes, imports & exports, fuel consumption, banking credit, vehicles sales, and indirect tax revenues suggest that May will be almost as bad as April. But we believe activity will start rebounding a bit in June. In a nutshell, given the apparent magnitude of the contraction in 2Q20, we have revised down our GDP forecast for 2020 to -10% from -4% in the previous scenario. For 2021, nevertheless, we expect a rebound to 5.5% (from 3.8% previously).

Constructive for 2021 and beyond

Looking forward, we believe Panama will emerge from the crisis in a stronger macroeconomic position than LatAm peers and with greater capacity to recover more quickly the production that was lost in 2020. As the most open economy to trade in the region, Panama is well-positioned to reap the benefits of a rebound in global trade, in contrast with the inward-looking countries whose domestic markets will remain depressed for a while because of firm & job destruction.

Moreover, the Panamanian economy has been diversifying, with the entry into operations of Cobre Panama (large copper & gold mine). Notably, last year mining contributed one full percentage point to GDP growth, from virtually zero in the previous years. We see this diversification of the country's production matrix as positive, even if it's into a commodity sector.

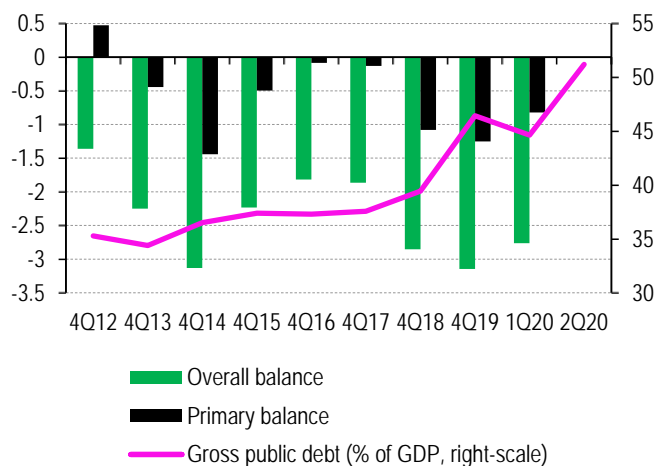
Panama is an export-led economy. Unlike the vast majority of Central American & Caribbean countries, which have huge trade deficits (in the double digits as a percent of GDP), Panama usually has a trade surplus when considering both goods and services. This represents a structural strength for the balance of payments.

Also worth pointing out, ever since the fall of the (de-facto) military dictatorship in the late 80s, power has alternated between three parties – PRD, Cambio Democrático, and Partido Panameñista – which have market-friendly views. Currently, the ruling party (PRD) has a working majority in Congress with its allied party, Molirena, which is positive for governability. Even though the Covid-19 crisis has brought some intra-party tensions in the PRD, we still see relatively strong governability conditions in Panama; especially when compared to many other LatAm countries, where politics are much more fractured. This facilitates the implementation of policies.

On the fiscal side, we highlight that the fiscal deficit narrowed in 1Q20 (chart 3), as the government delivered on its pledge to curb expenditures (down 12% yoy in Q1).

Chart 3: Non-Financial Public Sector balances and debt

(Rolling four quarters, % of GDP)



Source: BofA Global Research, Ministry of Finance (MEF), Statistics Institute (INEC)

Table 1: Panama debt dynamics

	2019	2020F	2021F
Public debt (% of GDP)	46.4	57.8	59.5
Change in public debt (= -I + II + III)		11.4	1.6
I) Primary balance (% of GDP)	-1.3	-5.5	-2.7
II) Automatic debt dynamics (a + b)		8.3	-1.1
a) Real interest rate		3.1	1.9
b) GDP growth		5.2	-3.0
III) Other debt creating flows (= c + d)		-2.4	0.0
c) Use of cash balances		-1.9	0.0
d) Panama Savings Fund		-0.5	0.0
Parameters			
Effective interest rate (%)		4.55	4.55
GDP growth (%)		-10.0	5.5
Inflation (%)		-1.5	1.0

Source: BofA Global Research, Ministry of Finance (MEF), Statistics Institute (INEC)

The Ministry of Finance announced that revenues fell by US\$537mn (year-over-year), almost 1% of GDP, in 1H2020, which will definitely make the fiscal deficit wider. In fact, given the downward revision in the GDP forecast, we have also revised the Non-Financial Public Sector deficit forecasts for 2020 (7.6% of GDP, from 6.7%) and 2021 (4.9% of GDP, from 4.3%).

Given the cash surplus from last year (ie, bond issuance in November to pre-fund 2020 budget), the US\$ 2.5bn external bond issuance in March, the US\$ 300mn that can be tapped from the Savings Fund of Panama, and around 1.5bn from multilaterals (510mn from IMF rapid financing facility, 700mn IDB, and the rest from World Bank and CAF), the funding gap is small, only a bit above US\$ 1bn according to our estimates.



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