

Research Update:

Panama Outlook Revised To Negative From Stable On Potential Risks To Investor Confidence And Economic Growth

November 7, 2023

Overview

- Public protests against a contract with Minera Panama, a large copper mining project, have created uncertainty about the fate of the project and led to the passage of a moratorium on new mining concessions.
- The uncertainty generated by these events could pose risks to the country's still favorable medium-term GDP growth prospects, potentially weakening its economic resilience.
- Therefore, we revised our rating outlook on Panama to negative from stable and affirmed our 'BBB' long-term foreign currency rating on the country.
- The negative outlook reflects the risk of a downgrade resulting from the potential fallout of these recent events on investor confidence, private investment, and economic growth prospects.

Rating Action

On Nov. 7, 2023, S&P Global Ratings revised the outlook on its long-term sovereign credit ratings on Panama to negative from stable. At the same time, we affirmed our 'BBB' long-term foreign currency rating on Panama and our 'A-2' short-term rating. Our transfer and convertibility (T&C) assessment remains 'AAA'.

Outlook

The negative outlook reflects the risk of potential damage to investor confidence and to future private investment stemming from the ongoing controversy over a mining contract with Minera Panama, which operates a large copper mining project. Strong political opposition to the project has raised uncertainty about its fate and led to a recent moratorium on new mining projects. Such developments could weaken private investment and negatively affect the country's long-term

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growth prospects, leading to a downgrade.

Downside scenario

We could lower the rating in the coming year if the recent political developments worsen investor confidence, weighing on the country's long-term economic resilience and GDP growth.

Upside scenario

We could revise the outlook to stable in the coming year if the current and the future administrations demonstrate cautious political and economic management that contains social unrest and reduces uncertainty. That, in turn, would sustain investor confidence and support the country's favorable long-term GDP growth prospects.

Rationale

We expect GDP growth over the next few years to average 4.4%--above peers--backed by a diversified economy and a robust pipeline of private- and public-sector projects. Factors such as Panama's geographic location as a logistics hub and potential nearshoring opportunities will support this growth. For example, the U.S. has partnered with Panama as part of the U.S. CHIPS and Science Act of 2022 to explore the possibility of expanding the global semiconductor manufacturing sector.

Panama's stable democracy and evolving political institutions have sustained predictable economic policies and cautious macroeconomic management for many years. Our view of Panama's institutional profile incorporates its consolidating democracy with developing checks and balances. The country's main political parties share a consensus on key economic policies. As a result, we expect broad continuity in policies following national elections in May of next year, when current President Laurentino Cortizo of the governing Democratic Revolutionary Party (PRD; its Spanish abbreviation) finishes his five-year term.

We expect Panama's general government deficit to remain slightly above 3% of GDP through 2026, and net general government debt to remain around 52% of GDP. We expect interest payments to average 13% of general government revenue during the same period amid higher interest rates.

Our forecasts incorporate the hit to government revenues from the potential cancellation of the contract with Minera Panama, as well as some potential shortfalls in dividends from the Panama Canal due to the impact of drought on the canal's own revenues. The canal recently announced it will gradually reduce the number of guaranteed booking slots per day, with 18 slots by February 2024, down from a previous expected cap of 31 slots (and compared with the canal's maximum sustainable capacity of 38-40 transits per day). Transfers from the Panama Canal Authority--which represented about 19% of general government revenue in 2022--are likely to remain resilient at over \$2 billion.

The risk of potentially lower economic growth could exacerbate the deteriorating finances of Panama's social security fund (Caja de Seguro Social [CSS]). The CSS began running small cash deficits in 2018, prompting transfers from the central government. Its reserves will be depleted in 2025, according to government estimates, resulting in growing government transfers over time, absent fiscal reform.

Panama's gross external financing needs have increased, and we expect them to remain above 150% of current account receipts and usable reserves over the next few years. Banks' short-term

external liabilities in the form of deposits have also jumped. We forecast these to remain elevated, with the increase coming mostly from neighboring countries such as Colombia, Venezuela, and the Dominican Republic. The rating also captures our view that the banking system poses a limited contingent liability to the sovereign.

Panama does not have a central bank or formal lender of last resort, nor an effective deposit insurance system to support distressed financial institutions, which constrains the rating. However, the government has used the publicly owned bank Banco Nacional de Panama as a vehicle to support banks with strained liquidity in the past. However, on Oct. 27, 2023, the Financial Action Task Force (FATF) removed Panama from its gray list after the country strengthened its anti-money-laundering and counterterrorism financing prevention system--a positive step for the long-term development of the financial market.

The country's current account deficit widened to 4% of GDP in 2022, from 0.3% in 2020, as imports recovered. We expect Panama to return to its historical pattern of current account deficits largely financed by foreign direct investment, which is likely to average 4.4% of GDP in the next three years, similar to the current account deficit.

We view contingent liabilities as limited. The main government-related entities, such as the Panama Canal Authority and Tocumen International Airport, do not rely on government funds. Moreover, the government does not formally guarantee their debt.

In our opinion, the likelihood of the Panamanian government ceasing to use the U.S. dollar as its local currency is low. Therefore, our T&C assessment for Panama is 'AAA', the same as for the U.S.

Key Statistics

Table 1

Panama--selected indicators

	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F	2026F
Economic indicators (%)											
Nominal GDP (bil. LC)	57.91	62.20	67.29	69.72	57.09	67.41	76.06	82.62	87.98	93.23	98.79
Nominal GDP (bil. \$)	57.91	62.20	67.29	69.72	57.09	67.41	76.06	82.62	87.98	93.23	98.79
GDP per capita (000s \$)	15.6	16.5	17.6	18.0	14.5	16.9	18.8	20.2	21.2	22.1	23.1
Real GDP growth	5.0	5.6	4.4	3.3	(17.7)	15.8	10.8	6.5	4.4	4.4	4.4
Real GDP per capita growth	3.5	4.1	2.9	1.8	(18.8)	14.2	9.2	5.0	2.9	2.9	2.9
Real investment growth	2.1	7.6	0.7	(1.3)	(48.0)	31.0	10.8	6.5	4.4	4.4	4.4
Investment/GDP	40.5	41.7	43.7	39.3	26.0	37.4	36.9	31.4	30.8	30.3	29.9
Savings/GDP	32.5	35.8	36.4	34.5	25.7	34.3	33.0	27.4	26.7	25.9	25.0
Exports/GDP	42.0	41.8	42.4	40.3	36.1	41.1	45.1	47.1	50.2	53.7	57.4
Real exports growth	(4.3)	5.0	5.3	1.6	(21.6)	29.6	22.0	9.0	9.0	9.0	9.0
Unemployment rate	5.5	6.1	6.0	7.1	18.5	11.3	9.9	8.9	8.9	8.9	8.9
External indicators (%)											
Current account balance/GDP	(8.0)	(5.9)	(7.4)	(4.8)	(0.3)	(3.0)	(3.9)	(4.0)	(4.0)	(4.4)	(4.9)
Current account balance/CARs	(16.5)	(12.2)	(15.7)	(10.5)	(0.9)	(7.0)	(7.7)	(7.7)	(7.3)	(7.6)	(7.9)

Table 1

Panama--selected indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F	2026F
CARs/GDP	48.4	48.7	47.2	45.4	38.3	43.7	51.4	51.7	54.8	58.4	62.2
Trade balance/GDP	(13.4)	(13.6)	(13.7)	(10.9)	(4.9)	(5.3)	(12.2)	(13.6)	(14.6)	(16.2)	(18.0)
Net FDI/GDP	9.3	6.6	7.3	5.3	0.1	2.4	3.5	4.0	4.1	4.6	5.2
Net portfolio equity inflow/GDP	(0.0)	(0.0)	0.1	0.0	(0.3)	(1.4)	0.5	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	190.7	182.7	177.7	181.2	189.1	148.9	147.9	164.0	159.3	155.3	151.7
Narrow net external debt/CARs	60.8	71.1	78.2	90.6	104.3	98.0	94.4	87.3	78.2	70.0	62.4
Narrow net external debt/CAPs	52.2	63.4	67.6	82.0	103.4	91.7	87.6	81.1	72.9	65.1	57.9
Net external liabilities/CARs	183.7	188.1	200.3	212.0	306.6	232.4	186.7	179.5	167.5	157.0	147.8
Net external liabilities/CAPs	157.6	167.6	173.2	191.8	303.9	217.3	173.4	166.8	156.0	145.9	137.0
Short-term external debt by remaining maturity/CARs	97.1	93.7	77.2	82.9	117.8	90.5	73.6	82.7	73.3	65.0	57.5
Usable reserves/CAPs (months)	1.2	1.4	0.9	0.7	1.9	3.7	2.5	1.8	1.5	1.2	1.0
Usable reserves (mil. \$)	3,847	2,703	2,121	3,424	9,614	8,832	6,876	6,463	6,023	5,557	5,063
Fiscal indicators (general government; %)											
Balance/GDP	(1.9)	(1.9)	(2.7)	(2.9)	(9.6)	(6.5)	(3.9)	(3.3)	(3.8)	(3.7)	(3.6)
Change in net debt/GDP	2.0	4.7	3.2	5.1	10.6	5.0	4.0	2.9	3.5	3.4	3.4
Primary balance/GDP	(0.2)	(0.1)	(1.0)	(1.1)	(6.9)	(4.2)	(1.7)	(0.9)	(1.3)	(1.1)	(0.9)
Revenue/GDP	20.0	20.0	19.0	17.6	17.4	17.3	17.5	18.0	18.6	19.3	20.0
Expenditures/GDP	21.9	21.9	21.7	20.5	27.0	23.7	21.4	21.3	22.4	23.0	23.7
Interest/revenues	8.7	8.7	9.0	10.3	15.6	13.2	12.6	13.1	13.3	13.6	13.8
Debt/GDP	32.8	32.7	33.7	39.2	58.3	54.6	53.2	51.9	52.2	52.7	53.1
Debt/revenues	164.2	163.6	177.0	222.9	334.5	315.8	303.9	288.1	280.6	272.8	264.8
Net debt/GDP	20.5	23.7	25.2	29.4	46.5	44.4	43.3	42.8	43.7	44.7	45.5
Liquid assets/GDP	12.4	9.0	8.5	9.8	11.7	10.2	9.8	9.1	8.5	8.0	7.6
Monetary indicators (%)											
CPI growth	0.7	0.9	0.8	(0.3)	(1.6)	1.6	2.9	2.0	2.0	1.5	1.5
GDP deflator growth	2.0	1.7	3.6	0.3	(0.6)	1.9	1.8	2.0	2.0	1.5	1.5
Exchange rate, year-end (LC/\$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Banks' claims on resident non-gov't sector growth	8.8	7.7	4.3	2.1	(1.9)	2.0	5.0	4.5	4.5	4.5	4.5

Table 1

Panama--selected indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F	2026F
Banks' claims on resident non-gov't sector/GDP	81.6	81.9	78.9	77.8	93.3	80.6	75.0	72.1	70.8	69.8	68.8
Foreign currency share of claims by banks on residents	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency share of residents' bank deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real effective exchange rate growth	(5.4)	(0.1)	6.7	(1.2)	(4.4)	7.3	(6.3)	0.0	0.0	0.0	0.0

Definitions: 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. Banks are other depository 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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. F--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Panama--ratings score snapshot

Key rating factors

Institutional assessment	3	Effective policymaking in recent years, promoting sustainable public finances and balanced economic growth. Evolving checks and balances.
Economic assessment	2	Based on GDP per capita (US\$) and growth trends as per Selected Indicators in Table 1. Weighted average real GDP per capita trend growth over a 10-year period expected to exceed the median in the forecast period.
External assessment	5	Based on narrow net external debt and gross external financing needs/(CAR + useable reserves) as per Selected Indicators in Table 1.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
Monetary assessment	5	Panama is a fully dollarized economy. It has had low and stable inflation. Panama does not have a central bank, nor a formal lender of last resort.
Indicative rating	bbb	bbb
Notches of supplemental adjustments and flexibility	0	0

Table 2

Panama--ratings score snapshot (cont.)

Key rating factors

Final rating		
Foreign currency	BBB	BBB
Notches of uplift		
	0	0
Local currency		
	BBB	BBB

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Ratings List

Ratings Affirmed

Panama

Transfer & Convertibility Assessment	
Local Currency	AAA

Panama

Senior Unsecured	BBB
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Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Panama		
Sovereign Credit Rating	BBB/Negative/A-2	BBB/Stable/A-2

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