Panama

Economic Watch

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Economic Analysis

Colombia
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Economic performance in 2010 and outlook for the future

- **We forecast economic growth of the Panamanian economy at 7.1% in 2010,** based on the strong increase in internal demand driven, in turn, by government investments and the expansion of the Panama Canal. This strong output dynamic should extend to 2011 and 2012 with growth rates coming in over 6% for both years.
- **Private consumption and infrastructure investment are set to be the growth engines** in coming years.
- **Credit is seeing a high growth rate** (13.3% y/y in 2010), boosting the dynamics of key sectors of the economy.
- **The upturn in international trade has led to higher traffic volumes in the Panama Canal,** after the annual decreases seen for most of 2010. This has created a positive boost for activity in the Colón free trade zone.
- **Higher domestic demand and international prices for primary goods** have caused greater inflationary pressures. After ending 2010 with an average 3.5%, levels nearer 4% are expected for 2011 and 2012, depending on the influence of oil and food prices.
- **Finance for infrastructure projects has been met with foreign and domestic resources,** with no effect on compliance with targets set in the Social and Fiscal Responsibility Law.
- **The current account will continue to show a high deficit,** mainly due to the higher capital expenditure. This deficit will largely be financed by foreign direct investment and medium- and long-term borrowing.

Growth outlook improves due to dynamic consumption and infrastructure investment

Panama Canal expansion and investment in other infrastructure megaprojects set bases for future growth

We expect growth of the Panamanian economy of 7.1% y/y in 2010, driven by dynamic consumption and the ambitious public works investment program both for the Panama Canal expansion and for investments in other infrastructure projects by the non-financial public sector (NFPS). Growth was boosted in the second half of the year due to the higher performance in works contracted by the NFPS. This good moment for the Panamanian economy was confirmed by the gross domestic product results (GDP) for the third quarter 2010, coming in at 8.4% y/y (2.5% q/q). This high growth remained until the end of 2010 and will extend over 2011-2012 (see Chart 1), supported by the continuing investment program in infrastructure, sustained consumer growth and a recovery in service exports supported by the recovery in the global economy and international trade.

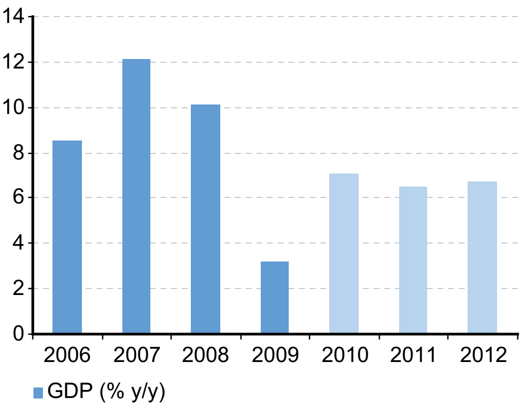
Service sector leads economic growth

The monthly economic output index (IMAE) reached 9.5% y/y growth in November – the largest annual increase throughout the year – showing the good performance of the service sector. Indeed, the transport and telecommunications, retail and hotel sectors are presently the driving force for growth (see Chart 2). In terms of demand, indicators show higher consumption driven in part by tourism. In turn, investment in machinery and capital goods is strengthening with 31.9% growth in capital goods imports, while the construction sector continues on the path to recovery according to the positive trend in permits, which registered 47.4% y/y growth in October.

It should be stated that economic output was stimulated by credit expansion, with 13.3% y/y growth in 2010, supporting the performance of different economic sectors. The best performance is concentrated in consumer loans and mortgages and in the manufacturing and retail sectors. This was due to the low interest rates, fruit of higher competition in the financial sector.

Chart 1

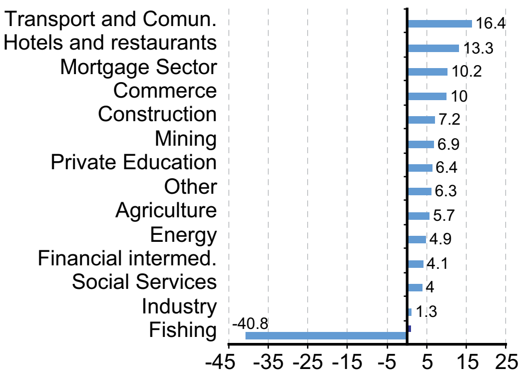
Gross Domestic Product (% y/y)



Source: Comptroller General and BBVA Research

Chart 2

Gross Domestic Product by sectors in third quarter 2010 (% y/y)



Source: Comptroller Generaland BBVA Research

Further, the recovery in international trade has increased activity at the Panama Canal, with 3.9% y/y growth in transits. Toll revenues are growing at rates near 8% y/y and should continue to see growth in the future based on the rate increases (see Chart 3). Given this favorable result, the ACP transferred resources to the Government of $814.8 million in the tax year (running to September), 8.1% above forecasts for the year.

In general, the dynamism in service exports with higher activity in the Colón free trade zone and in ports and logistics, favored the trade balance result by compensating the slowdown in goods exports. The trade balance has registered positive figures since 2006, reaching a maximum in 2009 thanks to the contraction in imports. As exports gain traction in 2011-2012, and in spite of the growth in imports driven by strong domestic demand and increasing capital investments, the trade balance should continue to show positive results.

Higher domestic demand generates pressures on prices and the current account

As is to be expected, the major growth in domestic demand and international price increases for primary goods have generated inflationary pressures, taking the rate to 4.9% y/y at end-2010, equivalent to average yearly inflation of 3.5% y/y (compared with 2.4% in 2009). In coming years, annual inflation should hover around 4% y/y depending on the behavior of oil and food prices, which have a major impact on the general price level due to the sizeable weight of imports in the consumer price index.

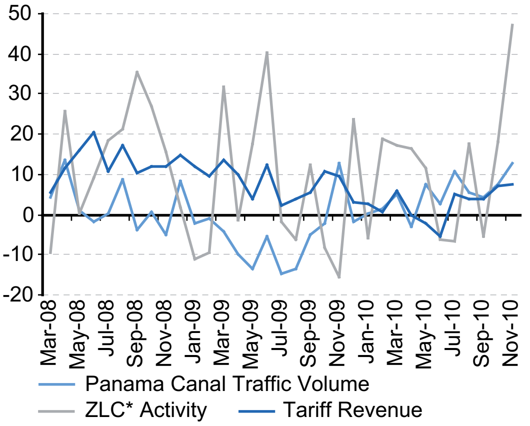
As the major spending drive is concentrated on extending output capacity, the Panamanian economy is not expected to experience over-heating pressures that could affect the sustainability of growth. In turn, although high deficit levels for the current account are forecast for the coming years, these will mainly be determined by the higher capital spending and will be widely financed by foreign direct investment and medium and long-term borrowing.

With regard to public finances, results point to an improvement over 2009, in line with the limit set out in the Law on Social and Fiscal Responsibility. Specifically, the NFPS deficit should come in at 0.8% of GDP in 2010 and show a slight worsening in 2011, to be curbed in the following years. This is in line with the NFPS investment program and the growth expected in tax receipts, supported by the positive growth outlook and higher employment levels. With regard to infrastructure megaprojects, these will see appropriate finance through global issuances, multilateral loans and domestic borrowing. In this sense, government efforts to diversify funding sources should be highlighted, with a successful samurai bond placement on the Japanese market in January this year for US$500 million.

In this context, it is worth to note that the steps the government takes in areas of cooperation and exchange of tax information, including a possible wider agreement on this issue with the US (which could help the ratification of the longed-for Free Trade Agreement), would increase the appeal for investment in the country, strengthening the range of possibilities created with the attainment of the investment grade.

Chart 3

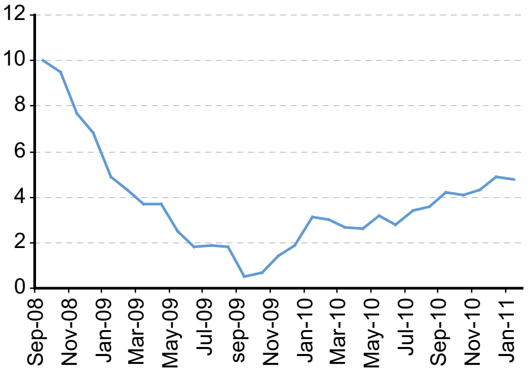
Panama Canal and Colón Free Trade Zone Activity Indicators (% y/y)



* Sum of imports and re-exports
Source: Comptroller Generaland BBVA Research

Chart 4

Inflation (% y/y)



Source: Comptroller Generaland BBVA Research

Table 1

Macroeconomic forecasts

	2009	2010p	2011p	2012p
GDP (% y/y)	3.2%	7.1%	6.5%	6.7%
Inflation (% y/y, avg.)	2.4%	3.5%	4.3%	4.0%
3-month deposit interest rate (% eop)	2.5%	2.1%	3.0%	3.6%
Fiscal deficit (% GDP)	-1.0%	-0.8%	-1.0%	-0.7%
Current account (% PIB)	-0.2%	-8.5%	-7.9%	-8.0%

Source: Comptroller General and BBVA Research

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