

# PANAMA

## Key conditions and challenges

**Table 1** **2020**

Population, million	4.3
GDP, current US\$ billion	54.8
GDP per capita, current US\$	12701.4
International poverty rate (\$ 19) <sup>a</sup>	1.2
Lower middle-income poverty rate (\$3.2) <sup>a</sup>	4.6
Upper middle-income poverty rate (\$5.5) <sup>a</sup>	12.1
Gini index <sup>a</sup>	49.8
School enrollment, primary (% gross) <sup>b</sup>	94.4
Life expectancy at birth, years <sup>b</sup>	78.3

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2019), 2011 PPPs.

(b) Most recent WDI value (2018).

Panama experienced the highest COVID-19 case count in Latin America and a GDP contraction of 17.9 percent in 2020, as its economy relies on sectors severely affected by the pandemic such as air transportation, retail, tourism, and construction. Poverty increased by two percentage points, while public debt shot up by almost 20 percentage points of GDP. Panama is facing the challenge of reigniting growth and poverty reduction, while balancing its fiscal accounts to maintain its coveted investment grade sovereign rating.

Panama's high growth was driven by construction of large infrastructure projects and real estate as well as logistics, retail, and tourism. In these sectors, labor income grew by 62.1 percent from 2010 to 2018, and the headcount of workers living under US\$ 5.5 (PPP) a day was reduced to 3.2 percent. In 2019, however, construction was already slowing down due to oversupply, the completion of large infrastructure projects, and reduced fiscal space for public investment.

Panama has been the most affected country by the COVID-19 pandemic in LAC with an infection rate almost 50 percent higher than Brazil's, the second most affected country. Mobility restrictions and the economic fallout from the COVID-19 crisis accelerated the downturn in the construction sector and significantly disrupted the logistics, retail, and tourism sectors. The concentration of jobs in the most affected sectors of the economy make households vulnerable to the crisis. Despite recent growth, workers in the high-growth sectors remained vulnerable, with over one-fifth of them living under US\$ 13 (PPP) a day in 2018. In addition, inequality remained among the highest in the world (as indicated by a Gini coefficient of 49.8 in 2019).

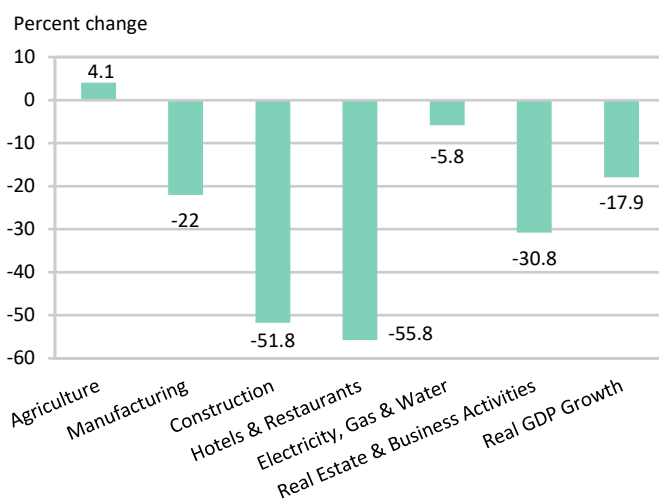
The main challenge for Panama is to rekindle growth. The government is resorting to measures that had a positive growth impact before the pandemic, such

as tax expenditures to attract foreign direct investment (FDI) as well as public investment. However, it is not clear if this strategy will be sufficient to sustain the high-growth levels of the past. The oversupply of real estate, the work-from-home trend and the government's fiscal space limit the construction sector growth potential, while tourism is likely to take longer to recover. While the logistics sector showed some resilience, new tendencies such as reduced outsourcing and nearshoring might reduce the demand for transportation.

## Recent developments

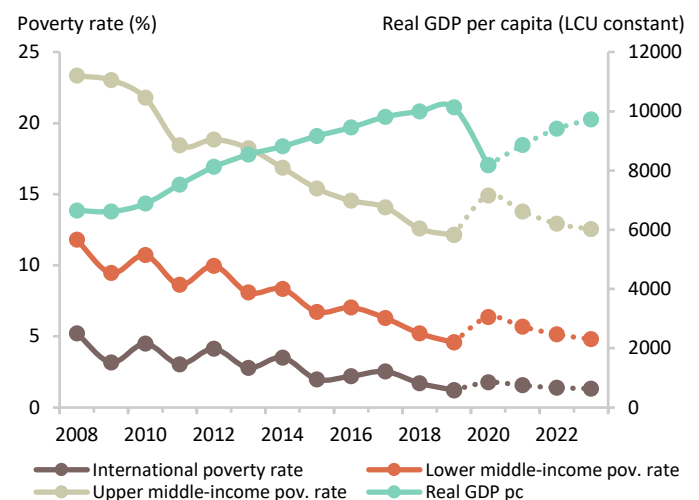
The structural forces shaping growth were amplified by the effects of the COVID-19 crisis, which led Panama to post a GDP decline of 17.9 percent in 2020. This performance reflects both a lack of demand but also a restriction on supply because of COVID-19. For example, construction, which declined by 51.8 percent, was halted from March to September, and the Panamanian airports were closed from March to mid-October. Retail activities contracted 19.4 percent led by a decline of 21 percent in the reexports from the Colón Free Trade Zone. There were some bright spots such as the increase in agriculture led by rice, corn, and banana crops and on mining, with copper exports posting a record output. Although energy output declined by 5.8 percent, renewable energies output increased by 37.9 percent. Those bright spots, however, were not sufficient to

**FIGURE 1 Panama / Sectoral and real GDP growth, 2020**



Sources: Dirección de Estadística y Censo.

**FIGURE 2 Panama / Actual and projected poverty rates and real GDP per capita**



Sources: World Bank. Notes: see Table 2.

counterbalance the negative effects of COVID-19 in other sectors.

As a result, unemployment reached 18.5 percent in 2020, and near 130,000 people are expected to fall under the poverty line of US\$ 5.5 (PPP) a day, which implies an increase in the poverty headcount to 14.9 percent in 2020 from 12.1 percent in 2019. Government policies, which include transfers to households (*Panama Solidario*) for an amount equivalent to 1.3 percent of GDP, played a critical role in mitigating the adverse effects of the crisis. It is estimated that without it, poverty would have increased to 20.8 percent. The crisis has hit urban areas the hardest. Among the most affected are workers in the construction sector and women in retail and hotels and restaurants—two of the most female-intensive sectors.

The abrupt decline in GDP in 2020 together with the lower revenues (20 percent decline) and higher expenditures (four percent growth from an already high level in 2019) yielded a fiscal deficit of almost ten percent of GDP, leading the

three major rating agencies to downgrade the country, putting it closer than ever to losing its investment grade.

## Outlook

Panama is projected to see a strong rebound in GDP in 2021 helped by base effects, increased mining output, and new public investments being initiated such as the extension of metro line 2 and construction of line 3. The rebound, coupled with the continued support to the vulnerable through mitigation policies, would reduce poverty to pre-pandemic levels by 2023.

On the fiscal side, there does not seem to be consensus to increase taxes to balance the fiscal accounts more aggressively. The country will likely resort to containment of current expenditure, while resorting to more tax expenditures and public investments, including through Public Private Partnerships to boost growth, which in turn could increase their capacity to carry

more debt sustainably. This strategy has risks and could face challenges under a more fragile fiscal situation.

The main risks are the fiscal accounts and impacts from Panama's standing in adhering to international standards on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) on FDI inflows. On the fiscal side, the main sources of risk are the pace of fiscal consolidation and the pension system. Panama has chosen a more backloaded consolidation relaying more on growth to sustainably increase its capacity of carrying debt, instead of relying more on revenues. This strategy is risky as growth might not materialize and Panama might lose its investment grade. The pension system is structurally unbalanced and in 2020 had a cash deficit of nearly US\$500 million. It is expected that cash reserves will not last more than three years. Finally, partial adherence and compliance to international standards on AML/CFT can prevent Panama from exiting international lists, negatively impacting FDI recovery.

**TABLE 2 Panama / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
<b>Real GDP growth, at constant market prices</b>	3.6	3.0	-17.9	9.9	7.8	4.9
Private Consumption	3.2	3.4	-18.5	12.0	7.5	5.2
Government Consumption	7.7	4.5	1.5	-1.4	3.7	1.8
Gross Fixed Capital Investment	0.9	0.0	-37.1	16.8	11.9	6.3
Exports, Goods and Services	5.1	-0.1	-22.0	9.5	6.0	4.5
Imports, Goods and Services	4.1	-3.3	-29.3	12.0	7.0	4.8
<b>Real GDP growth, at constant factor prices</b>	3.6	3.2	-17.9	9.9	7.8	4.9
Agriculture	2.3	2.5	4.1	1.7	0.8	1.0
Industry	2.8	3.4	-32.1	14.2	9.0	5.2
Services	4.1	3.2	-12.7	8.9	7.7	4.9
<b>Inflation (Consumer Price Index)</b>	0.8	-0.4	0.0	0.2	1.1	2.0
<b>Current Account Balance (% of GDP)</b>	-7.6	-5.4	-0.7	-2.2	-2.8	-3.3
<b>Net Foreign Direct Investment (% of GDP)</b>	7.6	5.5	3.3	5.4	5.8	6.0
<b>Fiscal Balance (% of GDP)</b>	-2.9	-3.5	-10.0	-8.2	-6.7	-5.3
<b>Debt (% of GDP)</b>	39.6	46.4	64.4	63.3	61.3	60.3
<b>Primary Balance (% of GDP)</b>	-1.1	-1.6	-7.3	-5.5	-4.1	-3.1
<b>International poverty rate (\$1.9 in 2011 PPP)<sup>a,b</sup></b>	1.7	1.2	1.8	1.6	1.4	1.3
<b>Lower middle-income poverty rate (\$3.2 in 2011 PPP)<sup>a,b</sup></b>	5.2	4.6	6.4	5.7	5.1	4.8
<b>Upper middle-income poverty rate (\$5.5 in 2011 PPP)<sup>a,b</sup></b>	12.6	12.1	14.9	13.8	12.9	12.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate. f = forecast.

(a) Calculations based on SEDLAC harmonization, using 2019-EH. Actual data: 2019. Nowcast: 2020. Forecast are from 2021 to 2023.

(b) Projection using neutral distribution (2019) with pass-through = 0.7 based on GDP per capita in constant LCU.