COUNTRY RISK ANALYSIS

Panama

CREATING CONFIDENCE IN YOUR EXPORTS

COUNTRY RISK CATEGORY

3/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S POLICY

Sovereign risks: Normal risk assessment

Other public risks: Normal risk assessment

Bank risks: Normal risk assessment

Corporate risks: Normal risk assessment

See “EKN'S POLICY” section

EKN'S OUTSTANDING GUARANTEES IN THE COUNTRY

Short-term transactions: SEK 34.4 million

Medium and long-term transactions: SEK 1,274.6 million

DATE

12/02/2014

High debt and strong growth

Panama's democratic and institutional development is slow, but economic development has been favourable with a high rate of growth, substantial investment and an increasingly diversified economy. The Panama Canal and the resulting stability following the dollarisation of the economy are two foundations that have contributed to the country's appeal as a regional, financial and logistical hub. When public infrastructure projects are wound down and the rate of growth starts to slow in the coming years, it will be a challenge to ensure that debt levels are kept in check. The ability to comply with applicable budgetary rules has proven to be weak, but economic policy is otherwise stable and investment-friendly, and it is expected to remain so even after the spring 2014 elections. Political polarisation is significant ahead of the election. Re-ignited protests and allegations of corruption and lack of transparency may influence the election campaign.

STRENGTHS

- The Panama Canal and a relatively well-diversified economy strengthens resilience
- Macroeconomic stability and an economic orientation that promotes investment
- Good relations with the US, the IMF and the international capital markets

WEAKNESSES

- Weak budgetary discipline and lack of monetary policy tools
- The economy is facing a shift to lower growth
- High levels of corruption and deficiencies in the legal system

POLITICS

Polarised political scene

Since the military dictatorship and the US invasion of the 1980s, Panama has established itself as a relatively stable democracy, albeit immature and with major deficiencies. Corruption, a dominant elite and weaker sections of the population having trouble making their voices heard characterise the political scene. In the 2009 presidential election, wealthy businessman Ricardo Martinelli prevailed with his fledgling party Cambio Democrático (CD), which has frequently been described as populist, after having challenged the two main parties that had hitherto dominated Panamanian politics. Martinelli has directed some support to needy groups, but has primarily sought to strengthen Panama's competitiveness by making substantial investments in infrastructure and pursuing business-friendly policies.

The political climate is polarised ahead of the presidential and parliamentary elections in May 2014. Splits have been exacerbated by Martinelli being accused of having an aggressive leadership style which has resulted in power being centralised in the presidency. Politicians frequently changing parties and rapidly changing their convictions has shown that self-interest often outweighs ideology. The criticism of the current administration's lack of transparency is an important area of conflict ahead of the election. Otherwise differences between the parties are essentially about the role of the state in politics, working conditions and about taking into account vulnerable groups and the environment. CD's candidate Arias is predicted to win, but even with a power shift, political continuity is very likely. The ruling party and the opposition largely agree on a free-market political stance and on promoting a business environment that stimulates investment and develops Panama's role as a regional hub.

On several occasions in recent years, political protests have flared up and resulted in violence. The demonstrations have often been aimed at decisions made without adequate transparency, and have forced the government to backtrack or amend laws. The security situation is better than in many neighbouring countries, but its geographical position makes Panama appealing as a transit country for drug trafficking and related organised crime. Both Mexican and Colombian cartels are reported to be well established and the homicide rate is comparable to Mexico. Continuing regional cooperation is expected in order to address this problem.

Panama Canal extended

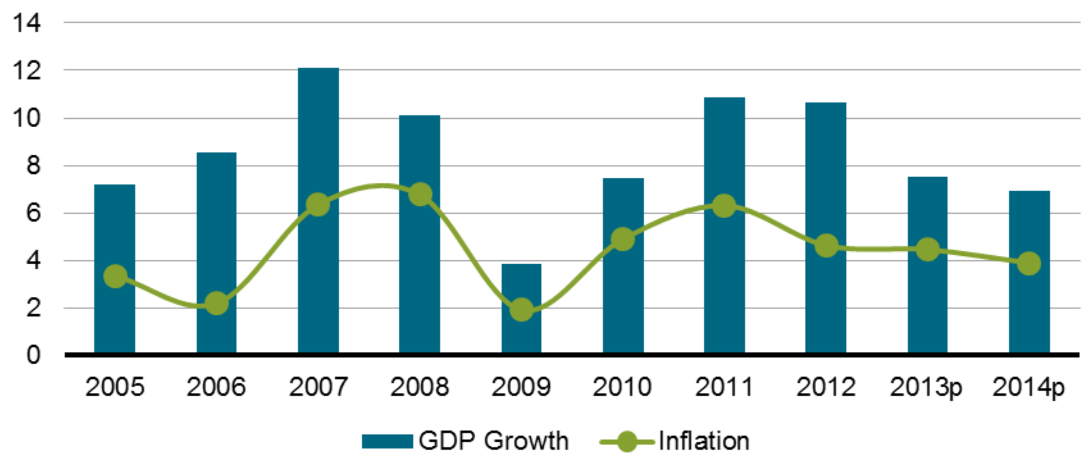
Panama's foreign relations are characterised by the Panama Canal. For historical, economic and strategic reasons, the ties between Panama and the US are strong. Continued US political and economic backing is therefore likely. The US is the largest customer of the canal and still has the right to intervene if its neutrality is threatened, even though Panama took control in 2000. The administration of the Canal has worked well to date and has been free from accusations of corruption. An extension of the canal was approved in 2006 following a referendum. The investment of over USD 5 billion represents a doubling of the canal’s capacity and will allow the passage of Post-Panamax ships which in the current situation are too large to pass. The plan is that the expansion will be completed in 2015, but in early 2014 a conflict arose with the Spanish construction company, which could delay the project.

ECONOMY

Favourable economic growth

Economic growth has been very strong over the past decade. With an annual growth rate of over 8.5 per cent, the Panamanian economy has been one of the fastest growing in the world. This is being driven principally through investment. By far the greatest factor bolstering the economy has been the expansion of the canal, along with investments in a metro system, an airport and hospitals. When investments are complete in the coming years, the growth rate is expected to drop slightly, but remain at just over six per cent. The previous tendency to overheat has dissipated, but the lack of skilled labour could represent an obstacle to Panama's economic development. One challenge in coming years will therefore be the shift to an economy where public investment is directed towards institutions and the educational system while leaving room for private investment in other areas. This will most probably be manageable, even if it takes time and is not completely painless.

GDP – GROWTH AND INFLATION (%)



Strong growth even during times of financial turbulence

Public finances are in overall good condition. Despite the extensive infrastructure investments, the government debt to GDP ratio has fallen steadily from 66 per cent in 2006 to 39 per cent in 2013. This is due to both the high rate of growth and the lion's share of public investment being financed by revenues and not by loans. Revenues have risen thanks to strong growth, tax reforms and improved administration. Moreover, the debt profile is favourable with long maturities, mainly fixed interest rates and good access to funding via global and domestic bond markets.

The Panama Canal has previously contributed to nearly 20 per cent of budget revenues and a modest increase is expected following the widening of the canal. This generates a certain vulnerability, but revenues are relatively stable and the idea is that a revenue surplus will be invested in a sovereign wealth fund that can be used in the event of recessions or natural disasters. However, its value is difficult to assess, as budgetary discipline has proven to be wanting. Repeated exceptions have been made from the prevailing budget rules, which undermines credibility and causes problems not least due to the lack of monetary policy tools. Admittedly, the main scenario is that debt continues to decline, but one risk factor is that not all the investment costs have been charged to the budget yet.

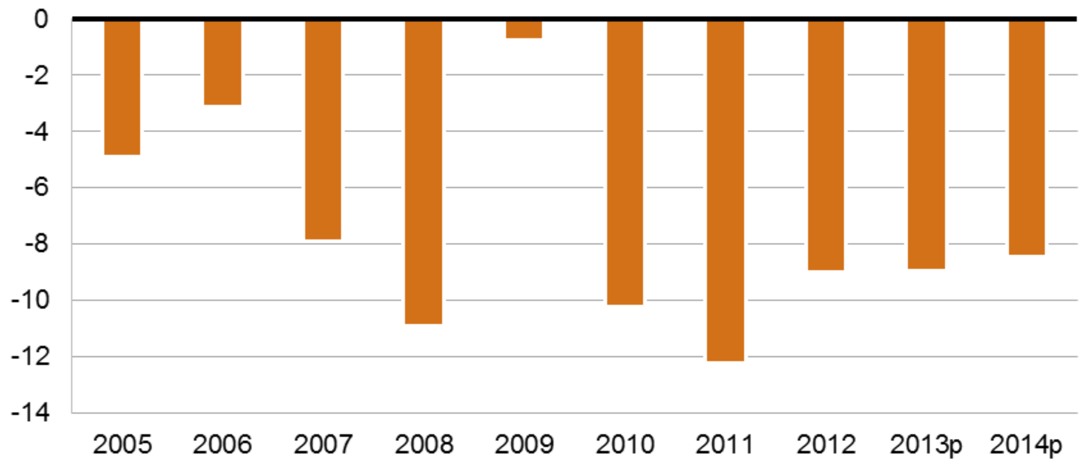
Panama's economy is small, open and dependent on international trends. The brighter outlook for both the US economy and world trade is expected to have a positive impact. Relative to its size, the economy is well diversified, which strengthens resilience. The investments have helped to improve competitiveness and productivity in several sectors. In addition to the canal and the construction industry, the financial sector, agriculture and the Colón free trade zone constitute important areas. In addition, the mining sector and tourism are growing strongly. The powerful political efforts to establish Panama as a regional centre for finance companies as well as other companies have started to generate results. New trade agreements with both the US and the EU are expected to increase trade and investment flows and strengthen Panama's role as a regional hub.

BALANCE OF PAYMENTS AND DEBT ISSUES

Sustainable external balance despite large deficits

For several years, the extensive investments have increased imports and resulted in substantial current account deficits. As the major infrastructure projects are completed, a deficit reduction to a structural level at just over seven per cent of GDP is forecast. It is expected that the current account deficit will continue to be financed by foreign direct investment. The high structural current account deficit is partly explained by the repatriation of profits and dividends related to these direct investments. Panama is not considered dependent on foreign portfolio investments and short-term loans, which are the flows that are most vulnerable to financial turmoil and reduced global liquidity. If a global slowdown were to occur, reduced investment, lower imports and thus a falling current account deficit are likely, which is very similar to what happened during the 2009 financial crisis.

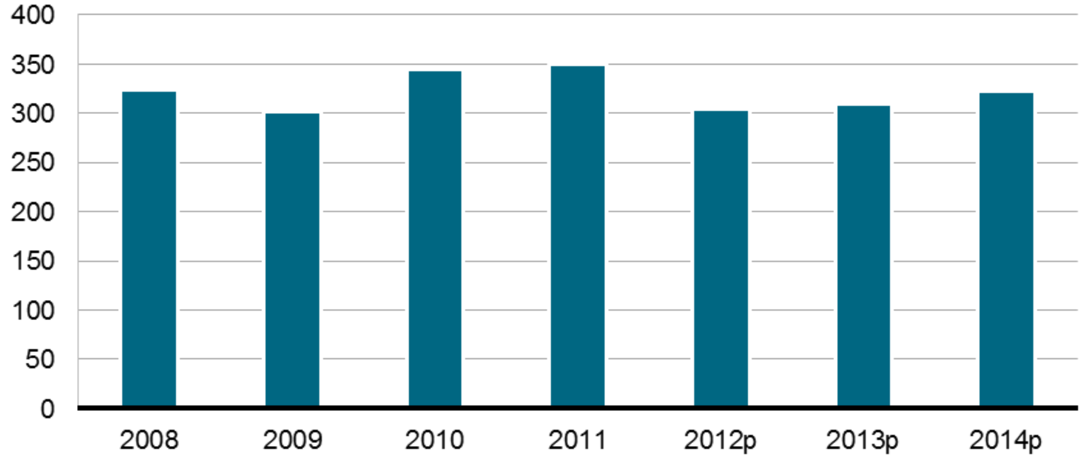
CURRENT ACCOUNT BALANCE (% OF GDP)



Extensive current account deficit due to investments

External debt is high at about 110 per cent of GDP, but is not rising and is deemed sustainable in the long term. Close to half is made up of international deposits in accounts in the domestic banking sector. The forecast indicates a slow de-escalation of the debt over the coming years. Exchange rate risks have been negated thanks to the dollarisation of the economy. Panama has good relations with the IMF and enjoys access to the international capital market for financing.

EXTERNAL DEBT (% OF EXPORTS)



The high level of debt is largely private and is typical for international banking centres. The figures exclude offshore banks but include the significant domestic banking sector.

CURRENCY POLICY

Dollarisation brings stability

The Panamanian economy has been totally dollarised for over a century and there are no exchange controls. Admittedly, there is the Panamanian coin - the balboa - but the country does not print any of its own bank notes and the risk of Panama abandoning the dollar as its currency is considered very low. This dollarisation has led to lower inflation, interest rates and trade transaction costs and virtually eliminated the risk of a balance of payments crisis. At the same time, the absence of monetary policy as an economic instrument makes the country more sensitive to fluctuations from the outside world, and puts greater demands on fiscal discipline. In recent years, dollarisation has provided certain benefits as currency inflows have not led to the appreciation and the deterioration of competitiveness that have been the fate of other strong emerging countries. With improved growth and tighter monetary policy in the US, the situation risks being reversed.

FINANCIAL SECTOR

Important regional financial centre

Panama has established itself as an important regional financial centre, with total assets equivalent to over 300 per cent of GDP. For the region, the sector is relatively mature and well developed, but small and shallow capital markets constitute a weakness. The banking sector is particularly significant, which is divided between a domestic section and an offshore one. The large offshore sector is a risk factor, but it is relatively isolated, and the likelihood that any problems will spread to the domestic banking sector is estimated to be low. The country's reputation as a financial centre is still partly questionable, but the country has made some progress in the fight against money laundering and has been removed from the OECD's list of “tax havens”. There are weaknesses with regard to the regulation and supervision of the financial system, but improvement efforts are underway in conjunction with the IMF. Transparency in ownership structures and details in accounting practices may be weak, but overall, financial transparency in the banking sector is adequate with quarterly reporting in compliance with IFRS.

The ratio of credit to GDP is high by regional standards at 89 per cent. Credit growth has been strong, but is in line with GDP growth. Overall, the risk of overheating and asset bubbles is estimated to have dropped, but rapidly rising prices and the construction of commercial properties, hotels and luxury apartments represent a concern. However, the exposure of Panamanian banks to this sector is limited.

The domestic banking system is judged to be well-equipped to respond to a possible credit bubble or external shocks; banks are well capitalised with a conservative lending policy and a low proportion of bad loans. Liquidity is good and funding is stable, with the exception of a few of the smaller banks among the fifty or so banks. Given that Panama lacks a lender of last resort, these factors are essential in order to continue to enjoy market confidence. During the 2008-2009 financial crisis, one state bank and two regional development banks created a temporary credit facility targeted at healthy banks with liquidity problems. Utilisation was limited, but the facility strengthened confidence in the financial system. That a similar arrangement is lacking today is an area of uncertainty for the system. However, it is likely that a credit facility would be reinstated if necessary, and the government is in the process of preparing this together with the IMF.

BUSINESS ENVIRONMENT

Business friendly but with institutional deficiencies

The business environment in Panama is generally good, and has benefited from the prevailing consensus on a policy that promotes investment. In comparison with other countries in the region, or at the same income level, Panama ranks better than average in terms of most indicators related to the business climate and regulatory environment. According to the World Bank's Doing Business rankings, the country is in 55th place out of a total of 189 countries, and number five in Latin America and the Caribbean. A series of business-friendly reforms has been introduced to attract foreign direct investment. Since 1998, a law has been in force that is intended to ensure equal treatment of foreign and domestic investors. In 2007 this was supplemented with “Act 41”, which also gives tax breaks and other benefits to multinational companies that set up regional offices in Panama. The country’s approach to free trade is positive and new agreements with the EU and the US are expected to further facilitate trade.

Despite these simplifications, improvements in other areas that could strengthen the business environment are conspicuous by their absence. Corruption is seen by companies as the greatest obstacle to investing in the country. Between 2010 and 2013, Panama fell from 73rd place to 102nd place (of 177) in Transparency International's Corruption Perceptions Index. The legal system is also deemed weak in international comparisons and progress is lacking. Members of the Supreme Court are appointed by the National Assembly following a proposal from the president and this politicisation characterises the entire system. The legal system is also deemed ineffective and ranks low in terms of the enforceability of agreements and managing bankruptcies. Insolvency laws are archaic and need to be updated in line with today's business conditions. Factors such as the lack of skilled workers and the weak administration, especially given the scale of current public infrastructure projects, is hampering business activity. Lack of transparency among companies may be a problem, especially when it comes to ownership and income from operations in other countries.

EKN'S EXPOSURE

Dominated by the transport sector

At the end of 2013, EKN had outstanding guarantees of around SEK 1.25 billion, giving Panama one of EKN’s largest exposures in Latin America, despite the limited size of its economy. This exposure mainly consists of guarantees for the export of buses for the public transport system in the capital, Panama City. Additionally, EKN is witnessing a smaller flow of transactions in areas such as the construction industry.

OFFERS & GUARANTEES AT DECEMBER 31, MSEK

EKN’s exposure consists largely of transactions in the transport and construction industries

PAYMENT EXPERIENCE

Good experience, but inertia in administration

EKN's experience of buyers in both the private and public sectors has been generally good. For transactions involving the public sector, the limited administration results in a certain degree of inertia, but payment experience has been good. There is a lack of experience of managing legal processes or recovering collateral.

EKN'S POLICY

No general restrictions

EKN has classified Panama in country risk category 3 since 2007, when the country was upgraded in a classification made in collaboration with other OECD countries. The stable dollarisation means that Panama belongs to the group of countries where more enterprises can be judged to be stronger than the state and consequently enjoy lower premiums. EKN has no specific, general restrictions on buyer categories or credit duration. Instead, each transaction is examined on its own merits.

SOURCES FOR THE GRAPHS: IMF, EKN's own assessments

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 75,517 km² (0.17 times Sweden)

Population: 3.8 million (2012)

Population growth: 1.4 % (2013)

GDP: USD 36 billion in 2012 (Sweden USD 524 billion in 2012)

GDP/capita: USD 9,026 in 2012 (Sweden USD 54,476 in 2012)

CREDIT RATING

	COUNTRY CEILING	SOVEREIGN RISK
Moody's:	A3	Baa2
S&P:	AAA	BBB
Fitch:	A	BBB

COUNTRY ANALYST

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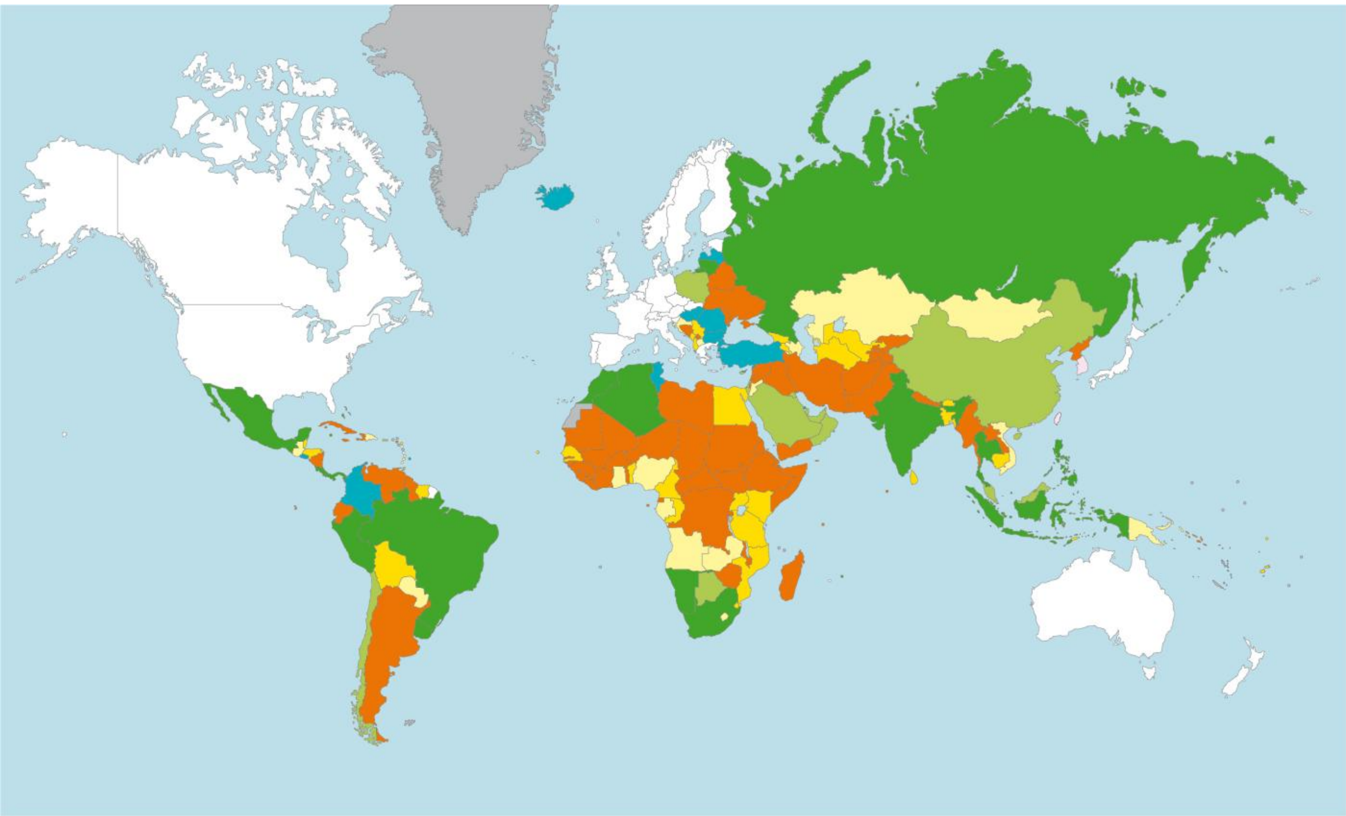
EKN'S VIEW OF THE WORLD



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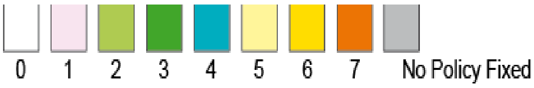

EKN – CREATING CONFIDENCE IN YOUR EXPORTS

EKN is an authority tasked with promoting Swedish exports and the internationalisation of Swedish companies. We do this by offering guarantees of payment and financing, together with advice on business structures and risk management. Our services provide you with greater security, increased competitiveness and more opportunities for successful export transactions.

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