

Emerging Insight

Panama Trip Notes – More negative risks than positive catalysts

Key takeaways

- There seem to be more negative risks than potential positive catalysts for the economy in the coming months.
- Negatives: loss of IG, arbitration, weaker confidence, anti-mining sentiment, pension deficit, fragmented presidential race.

By Alexander Müller and Lucas Martin

Chart of the Day: Projected funding needs and sources of the Non-Financial Public Sector

Funding needs are much larger than last year (US\$ 4.8bn, 5.8% of GDP). If Panama loses investment-grade, it will be tougher to cover the funding needs in the years to come

	2024		2025	
	US\$ bn	% of GDP	US\$ bn	% of GDP
Funding needs (= I + II + III + IV)	6.544	7.7	5.648	6.3
I) Fiscal deficit	3.839	4.5	3.591	4.0
II) Amortizations (= a + b)	2.465	2.9	2.057	2.3
a) External	1.079	1.3	2.057	2.3
i) Bonds	0.352	0.4	1.250	1.4
ii) Multilaterals	0.727	0.9	0.807	0.9
b) Domestic	1.386	1.6	0.000	0.0
III) Arrears	0.239	0.3	0.000	0.0
IV) Financial investment	0.000	0.0	0.000	0.0
Funding sources (= V + VI)	6.544	7.7	5.648	6.3
V) External (= c + d)	4.744	5.6	4.600	5.1
c) External bonds	3.500	4.1	3.500	3.9
d) Multilaterals	1.244	1.5	1.100	1.2
VI) Domestic	1.800	2.1	1.048	1.2
Nominal GDP (US\$ bn)	85.314		89.769	

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

Panama in Focus

More negative risks than potential positive catalysts

We spent one day in Panama City meeting with local analysts and people from various sectors (business community, public sector, multilaterals, politics, pension system). Overall, we came back with the impression there are more negative risks than potential positive catalysts for the economy in the coming months.

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GEM Fixed Income Strategy & Economics
Global

Alexander Müller
Andean(ex-Ven) Carib Economist
BofAS
+1 646 855 5750
alexander.muller@bofa.com

Lucas Martin, CFA
Sovereign Debt FI Strategist
BofAS
+1 646 855 1731
lucas.martin@bofa.com

David Hauner, CFA >>
Global EM FI/FX Strategist
MLI (UK)

Claudio Irigoyen
Global Economist
BofAS

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Six negatives vs. two positives

On the list of negatives, we highlight: significant chances of Panama losing investment grade in 2024; a giant arbitration claim against the sovereign; the toxicity of the cancellation of the mining contract for the business environment; anti-mining social sentiment (Gallup poll says ~90%); a growing pension deficit that will reduce the degrees of freedom of the next administration; and a very fragmented presidential race (which casts uncertainty on future economic policies). Conversely, the only good news we learned are the Panama Canal is doing very well (impact of drought seems overblown) and presidential candidates may be open to reconsider their views on mining.

Fitch downgrade seems likely for 2H2024

Fitch was bearish on Panama even before the Supreme Court cancelled the mining contract. In September, they revised the rating outlook from stable to negative, and projected the Non-Financial Public Sector's deficit at 4.5% of GDP for 2024. With the government's mining revenues going to zero in 2024 (both taxes and social security contributions) and the drag of the GDP slowdown, we think Fitch will downgrade. They currently rate Panama at the last notch of investment grade (BBB-). The downgrade should happen after the May elections. Rating agencies usually avoid downgrades in the middle of electoral campaigns, presumably to avoid the risk of getting politicized. Also, waiting until 2H2024 would give the new president an opportunity to react. The new president will assume office on July 1st. We believe it would take a large fiscal consolidation pledge to convince the rating agencies not to downgrade. No presidential candidate has done that yet. Romulo Roux sounds the most hawkish on fiscal policy.

A giant arbitration claim, to be revealed

The arbitration process is supposed to advance on two tracks: The Panama-Canada Free Trade Agreement and the International Chamber of Commerce's arbitration court in Miami. Only the investment in the mining operation (US\$ 10bn) is equivalent to 12% of GDP. The Mining Chamber of Panama (CAMIPA) estimates the arbitration claim could be US\$ 50bn once other concepts such as foregone profits are added. In January, we published a report that showed this will likely be the largest investor-state dispute in LatAm in the 21st century (topping Conoco Phillips vs. Hugo Chavez's Venezuela, 13% of GDP).¹ We expect the revelation of the size of the arbitration claim to exacerbate the uncertainty.

Toxicity of mining dispute for business environment

Locals have split views on this matter. Some see mining as an island, alien to the identity of the Panamanian economy. Panama is about the Canal, other services exports (financial, logistics, free trade zone), and vibrant construction; its economic prospects do not depend on mining at all, the argument goes. Another group of people, in contrast, think the Supreme Court's ruling puts under risk every contract law signed between the government and private companies (mainly in ports and energy). Inter alia, the ruling says environmental, health, and national interests are always above economic interests. Panama's largest port, Balboa, is operated by a Hong Kongese company (Hong Kong is a special administrative region of China). In a future, more geopolitically fractured world, is it farfetched to think Panama would want to take back control of the port? There is nothing that suggests this will happen now. But one cannot help to wonder about the risk of more investor-disputes after the mining precedent. In our January report we estimated that large investor-state disputes in LatAm tend to have a large negative effect on private investment.²

¹ See the report here, [Mine Closure will likely hurt potential GDP](#).

² See the report here, [Mine Closure will likely hurt potential GDP](#).

Recent poll says anti-mining sentiment is persistent

A few days ago, the Director of CID Gallup in Panama, Ana Patricia Alfonso, was interviewed in NEX, a local tv channel. She commented the results of CID Gallup's recent poll, which – among other things – showed almost 90% of the surveyed people said they are against mining.³ We haven't seen the way the question was phrased though. But it suggests any future president of Panama that wants to reopen the mining industry will face an uphill battle. This is contrary to comments we heard from business leaders in the trip, that there might be a large silent majority in favor of the mining industry.

Growing pension deficit will be a headache in next years

The growing pension deficit will force the next government to take action and consume part of its political capital. This week the press leaked figures from the 2022 financial statements of the Social Security Institute (CSS).⁴ The news say the operational deficit of the defined-benefit ("pay-as-you-go") regime rose to US\$ 654mn (0.8% of GDP) in 2022, up from US\$ 464mn in 2021 (last published financial statements). The reserves of the defined-benefit regime stood at US\$ 347mn in year-end 2022, according to the news article. Looking ahead, the government will be on the hook for financing that deficit. In our view, it has three main alternatives: 1) invest the surplus of the mixed pension regime (defined contribution) into government bonds and triangulate that money into the "pay-as-you-go" fund; 2) kick the can for a few more years by using the US\$ 1.3bn in the sovereign wealth fund; or 3) pension reform (politically painful).

Fragmented presidential race creates uncertainty

Political analysts believe former president Ricardo Martinelli is highly likely to be disqualified from the presidential race by the Supreme Court. Martinelli has been convicted for a corruption case and is now in the process of appeal. But the appeals are being rejected by local courts. Shockingly, despite of the corruption accusations, he is leading all polls. The recent CID Gallup poll (January 2024) has the following results: Ricardo Martinelli (right-wing conservative), 33%; Ricardo Lombana (centrist, independent candidate), 8%; Martin Torrijos (former president who quit the ruling party, PRD), 7%; Zulay Rodriguez (congress member of PRD, but running as independent), 5%; Romulo Roux (right-wing conservative), 4%; Jose Gabriel Carrizo (currently Panama's VP and candidate of the PRD), 2%; Maribel Gordon (radical leftist), 1%; and Meliton Arrocha, 0.4%. The point is that with Martinelli out, the race would become very open. We perceive there are wide differences in the views of the presidential candidates on at least two issues that are critical for the economy: i) the pace and size of fiscal consolidation (which we think is the only hope for Panama to retaining investment grade); and ii) the mining industry. The current 2024 budget, approved by Congress, seems insufficient to defend the investment grade.

Exhibit 1: BofA's macroeconomic forecasts for Panama

We foresee GDP growth hovering around 3.6% in 2025 and thereafter, hindered by the investor-state dispute shock

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023f	2024f	2025f
Nominal GDP (US\$ bn)	55.2	59.8	64.0	68.8	67.3	69.7	57.1	67.4	76.5	82.2	85.3	89.8
GDP growth (%)	5.1	5.7	5.0	5.6	-2.4	3.3	-17.7	15.8	10.8	6.0	2.0	3.6
Inflation (end-of-period, %)	1.0	0.3	1.5	0.5	0.2	-0.1	-1.6	2.6	2.1	1.9	1.7	1.5
Non-Financial Public Sector primary balance (% of GDP)	-1.3	-0.4	-0.1	-0.1	-1.0	-0.9	-7.2	-4.2	-2.2	-0.8	-1.8	-1.3
Non-Financial Public Sector overall balance (% of GDP)	-2.8	-2.0	-1.6	-1.7	-2.8	-2.7	-9.7	-6.4	-3.9	-3.3	-4.5	-4.0
Non-Financial Public Sector gross debt (% of GDP)	37.1	37.4	37.3	37.6	38.2	44.5	64.7	60.1	57.9	57.2	60.1	61.2
Current account balance (% of GDP)	-12.2	-7.1	-7.2	-5.4	-7.4	-4.8	-0.3	-3.0	-3.9	-3.1	-4.9	-5.4
Gross international reserves (US\$ bn) ^{1/}	5.0	5.1	5.7	4.7	4.0	6.5	11.8	9.2	8.1	7.0	7.4	7.9

^{1/} **Note:** Panama doesn't have a central bank. International reserves are not reported. However, we estimate a proxy by adding the financial assets of the Non-Financial Public Sector and the liquid external assets of the National Bank of Panama (government-owned commercial bank).

Source: Statistics Institute (INEC), Ministry of Finance (MEF), Superintendence of Banks of Panama (SBP), Haver, BofA Global Research

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³ See minute 5' here, <https://www.youtube.com/watch?v=ExFoDIOSZtg>.

⁴ See <https://www.prensa.com/economia/desentranando-el-deficit-del-sistema-de-pensiones-ivm-con-deficit-de-unos-654-millones/>.

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Claudio Irigoyen
Global Economist
BofAS
+1 646 855 1734
claudio.irigoyen@bofa.com

Antonio Gabriel
Global Economist
BofAS
antonio.gabriel@bofa.com

Global EM FI/FX Strategy

David Hauner, CFA >>
Global EM FI/FX Strategist
MLI (UK)
+44 20 7996 1241
david.hauner@bofa.com

Asia FI/FX Strategy & Economics

Helen Qiao
China & Asia Economist
Merrill Lynch (Hong Kong)
+852 3508 3961
helen.qiao@bofa.com

Claudio Piron
Emerging Asia FI/FX Strategist
Merrill Lynch (Singapore)
+65 6678 0401
claudio.piron@bofa.com

Jojo Gonzales ^^
Research Analyst
Philippine Equity Partners
jojo.gonzales@pep.com.ph

Abhay Gupta
Emerging Asia FI/FX Strategist
Merrill Lynch (Singapore)
abhay.gupta2@bofa.com

Pipat Luengnaruemitchai
Emerging Asia Economist
Kiatnakin Phatra Securities
pipat.luen@kkpfg.com

Miao Ouyang
China & Asia Economist
Merrill Lynch (Hong Kong)
miao.ouyang@bofa.com

Xiaoqing Pi
China Economist
Merrill Lynch (Hong Kong)
xiaoqing.pi@bofa.com

Benson Wu
China & Korea Economist
Merrill Lynch (Hong Kong)
benenson.wu@bofa.com

Ting Him Ho, CFA
Asia Economist
Merrill Lynch (Hong Kong)
tinghim.ho@bofa.com

Janice Xue
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
janice.xue@bofa.com

Chun Him Cheung, CFA
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
chunhim.cheung@bofa.com

Kai Wei Ang
Asia & ASEAN Economist
Merrill Lynch (Singapore)
kaiwei.ang@bofa.com

EEMEA Cross Asset Strategy, Econ

Mai Doan
CEE Economist
MLI (UK)
+44 20 7995 9597
mai.doan@bofa.com

Zumrut Imamoglu
Turkey & Israel Economist
MLI (UK)
zumrut.imamoglu@bofa.com

Vladimir Osakovskiy >>
EM Sovereign FI/EQ strategist
Merrill Lynch (DIFC)
vladimir.osakovskiy@bofa.com

Jean-Michel Saliba
MENA Economist/Strategist
MLI (UK)
jean-michel.saliba@bofa.com

Merveille Paja
EEMEA Sovereign FI Strategist
MLI (UK)
merveille.paja@bofa.com

Mikhail Liluashvili
EEMEA Local Markets Strategist
MLI (UK)
mikhail.liluashvili@bofa.com

Tatonga Rusike
Sub-Saharan Africa Economist
MLI (UK)
tatonga.rusike@bofa.com

LatAm FI/FX Strategy & Economics

David Beker >>
Bz Econ/FI & LatAm EQ Strategy
Merrill Lynch (Brazil)
+55 11 2188 4371
david.beker@bofa.com

Jane Brauer
Sovereign Debt FI Strategist
BofAS
+1 646 855 9388
jane.brauer@bofa.com

Carlos Capistran
Canada and Mexico Economist
BofAS
+1 646 743 2921
carlos.capistran@bofa.com

Ezequiel Aguirre
LatAm FI/FX Strategist
BofAS
ezequiel.aguirre2@bofa.com

Pedro Diaz
Caribbean Economist
BofAS
pdiaz2@bofa.com

Christian Gonzalez Rojas
LatAm Local Markets Strategist
BofAS
christian.gonzalezrojas@bofa.com

Lucas Martin, CFA
Sovereign Debt FI Strategist
BofAS
lucas.martin@bofa.com

Alexander Müller
Andean(ex-Ven) Carib Economist
BofAS
alexander.muller@bofa.com

Natacha Perez
Brazil Economist
Merrill Lynch (Brazil)
natacha.perez@bofa.com

Sebastian Rondeau
LatAm FI/FX Strategist
BofAS
sebastian.rondeau@bofa.com

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