PANAMA — “Copper Mining Controversy, Downgrade & Negative Outlook…But Still Strong Growth Prospects”

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

ECONOMIC RECOVERY, PUBLIC PROTESTS, RATING ACTIONS

Following a 17.9% contraction in GDP in 2020 due to the covid-19 pandemic, Panama’s economy has experienced a robust recovery. A 15.8% expansion in GDP in 2021 followed by 10.8% GDP growth in 2022 saw Panama’s economy exceed pre-pandemic levels (***Table 1***). For 2023 growth is estimated at 6.5% which highlights Panama’s position as one of the fastest growing economies in Latin America… and within the “BBB” peer group. The strong recovery led to an improved outlook by Standard & Poor’s (S&P), from negative to stable on August 11, 2023, the “BBB” rating was also affirmed.

Panama Sovereign Debt Ratings		
S&P	**Moody's**	**Fitch**
BBB / Negative	Baa3 / Stable	BBB- / Negative

However, by November 7, 2023, **Panama’s outlook was revised back to negative**, and the S&P rating again confirmed at “BBB” due to **unprecedented public protests against a copper mining project**. Panama’s Supreme Court, on November 28, ruled that the legislation granting a mining concession to First Quantum / Minera Panama, was unconstitutional. **Moody’s Investor services went one step further (October-31-2023) than S&P and downgraded Panama from “Baa2 to Baa3” and changed the outlook from “Negative to Stable”**. Fitch also assigned a negative outlook to Panama while maintaining its “BBB-“ rating. The ruling by the Panama Supreme Court combined with the rating actions are likely to damage investor sentiment and, at least in the near term, private investment and GDP. **Political opposition has further led to a moratorium on new mining projects.**

The expected reduction in revenue inflows to government coffers as a result of the mining moratorium will further increase fiscal challenges. Recall that Panama's fiscal deficit widened to 9.6% of GDP in 2020 and 6.5% of GDP in 2021 following a pre-covid 4-year average of 2.35%. The outlook further solidifies the fiscal challenges point given that Panama's deficit is projected to remain stubbornly high at between 3.8% and 3.6% between 2024 and 2026.

Similar to the fiscal balance, the debt has been stubborn in returning to pre-pandemic levels. Panama's Debt/GDP climbed to 58.3% in 2020 and though it has now declined, it is projected to hover in the 52+% range between 2025 & 2026.

ECONOMIC DIVERSITY TO OFFSET CHALLENGES

Despite the challenges to growth and revenue inflows, it is projected that **Panama's diversified economy will help to offset most of the challenges**. Panama's geographical position as a global logistic hub, its robust pipeline of private and public sector projects outside of mining and potential nearshoring opportunities are projected to boost growth in the near to medium term.

Panama-Selected Economic & Fiscal Indicators

Table1	2018	2019	2020	2021	2022	2023F	2024F	2025F	2026F
Economic indicators (%)									
GDP per capita (000s $)	17.6	18	14.5	16.9	18.8	20.2	21.2	22.1	23.1
Real GDP growth	4.4	3.3	-17.7	15.8	10.8	6.5	4.4	4.4	4.4
Real investment growth	0.7	-1.3	-48	31	10.8	6.5	4.4	4.4	4.4
Investment/GDP	43.7	39.3	26	37.4	36.9	31.4	30.8	30.3	29.9
Savings/GDP	36.4	34.5	25.7	34.3	33	27.4	26.7	25.9	25
Exports/GDP	42.4	40.3	36.1	41.1	45.1	47.1	50.2	53.7	57.4
Real exports growth	5.3	1.6	-21.6	29.6	22	9	9	9	9
Unemployment rate	6	7.1	18.5	11.3	9.9	8.9	8.9	8.9	8.9
Usable reserves (mil. $)	2121	3424	9614	8832	6876	6463	6023	5557	5063
Fiscal indicators (general government; %)									
Balance/GDP	-2.7	-2.9	-9.6	-6.5	-3.9	-3.3	-3.8	-3.7	-3.6
Primary balance/GDP	-1	-1.1	-6.9	-4.2	-1.7	-0.9	-1.3	-1.1	-0.9
Revenue/GDP	19	17.6	17.4	17.3	17.5	18	18.6	19.3	20
Expenditures/GDP	21.7	20.5	27	23.7	21.4	21.3	22.4	23	23.7
Interest/revenues	9	10.3	15.6	13.2	12.6	13.1	13.3	13.6	13.8
Debt/GDP	33.7	39.2	58.3	54.6	53.2	51.9	52.2	52.7	53.1
Monetary indicators (%)									
CPI growth	0.8	-0.3	-1.6	1.6	2.9	2	2	1.5	1.5
Exchange rate, year-end (LC/$)	1	1	1	1	1	1	1	1	1

Source: Standard & Poor's / Capitaliq as @ Nov-7-2023

Panama's economic recovery has been driven by recovery in tourism and public/private construction combined with the lifting of restrictions on trade and its major trading partner, the US, avoiding a recession (US GDP growth est. at 1.7% in 2023). Major construction projects include a fourth bridge over the canal, a third metro-line and a major partnership with the **US driven by the US CHIPS and Science Act of 2022**. The US CHIPS act will explore the possibility of expanding the global semi-conductor manufacturing space. The CHIPS Act creates a fund totaling US$500 million ($100 million per year over five years, starting in fiscal year 2023).

Panama also benefits from a very welcoming investment climate driven by favourable tax laws. The Multinational Headquarters Law, the Multinational Manufacturing Services Law and Panama's Free Trade Zones are a testament to its open arms policy. Panama's real investment growth is projected at 4.4% over the medium term despite the setback due to the challenges in the mining industry. Investment / GDP and exports / GDP are also forecasted to remain healthy over the forecast period (2024 – 2026) coming in at about 30% and 53% on average respectively.

Panama's dynamic and robust economy helps to contain its debt ratios by boosting nominal GDP and consequently restraining any significant deterioration of the numbers in the near term.

ELECTIONS, DROUGHT, DOLLARIZATION & DECLINING SOCIAL SECURITY RESERVES

General elections in Panama are to be held in May, 2024. This however, is viewed as a low volatility event given the sovereign's history of stable democracy, evolving political institutions plus predictable and cautious macroeconomic policies. The sovereign's main political parties share a broad consensus on economic policies. This is further strengthened by the US' overarching presence and the importance of political stability to the Canal's operations.

While policy continuity after changes in administration is not an issue, political and economic reforms are still needed. There are social challenges; this includes a stubbornly high unemployment rate which is skewed due to a lack of opportunities for the indigenous population combined with poor standards of governance that has led to several protests. There are also challenges relating to a growing financing gap facing the state-run pension system, water shortages and demands for greater expenditure on education. Another key issue is that **Panama also remains on the European Union's blacklist of noncooperative jurisdictions for tax transparency and financial information.**

Drought conditions have begun to negatively affect the viability of the Panama Canal. The canal authorities announced in the last quarter of 2023, that they will gradually reduce the number of guaranteed booking slots to 18 transits per day by February-2024. This is coming down from the previous cap of 31 and significantly down from the Canal's maximum sustained capacity of 38-40 transits per day. Revenues from the Canal came in at approximately US$2.53 billion in 2022 or 19% of general government revenue. While a falloff in revenues is projected because of the drought, the canal's dynamic pricing policies should allow it to nonetheless keep revenues above US$2.0 billion as at the end of 2023.

A growing concern for the Panamanian authorities is the **deteriorating finances of their social security fund (CSS). The CSS covers many areas of social support including death, pension, healthcare and disability benefits for approximately 80% of the population**. The fund began facing challenges from as early as 2018 when it began running small deficits. This prompted the government to begin making transfers from its coffers. Based on government calculations, the CSS' reserves will be depleted by 2025 barring fiscal reforms.

Suggested reforms include increasing the retirement age, raising workers' contributions, and reducing the benefits to workers and their families. **These suggested reforms, however, have been met with mass protests driven by the trade unions and union members**. The unions have cited corruption and mismanagement as the major reasons for the fund's poor performance. The CSS receives funding thru payroll taxes (by employers & employees) and transfers from mining companies (including Minera Panama). The citizens argue that if corruption was controlled, there would be no need for any reforms.

Panama is a **dollarized economy** and has effectively adopted the USD as its official legal tender. **The sovereign has no central bank nor does it have a formal lender of last resort**. There is also no effective deposit insurance system to support distressed financial institutions. This effectively renders monetary policy useless, forcing the government to rely on fiscal policy for economic management. Further, during periods of distress, devaluation of the currency and other short-term policy measures cannot be used to ease economic challenges. This is a key constraint to Panama's sovereign rating.

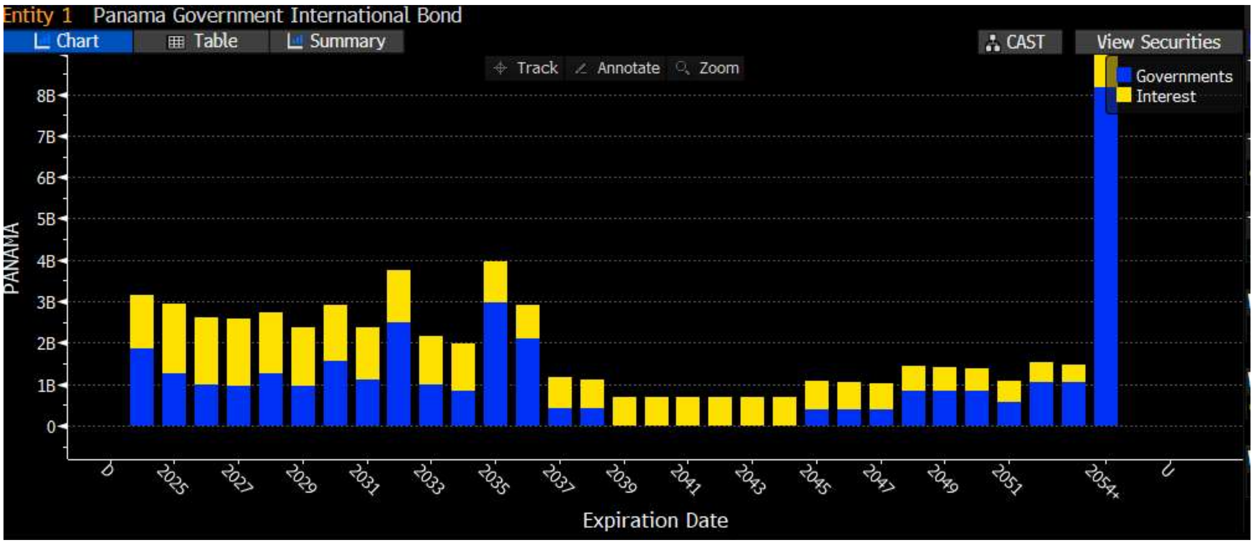
To combat this challenge, at least in part, the **government has utilized its publicly owned bank,** Banco Nacional de Panama, as a vehicle to support distressed banks in the past. Liquidity support in the form of low-cost loans, moratoriums on interest and principal, debt forgiveness and in some cases, extension of maturities are all options available in distressed scenarios.

KEY POSITIVES FOR INVESTORS

Panama's Sovereign Wealth Fund, *the Fondo de Ahorro de Panama*, as at the end of March, 2023 had assets totaling US$ 1.29 billion. The fund was established on the 5th of June, 2012, to act as a stabilization mechanism in case of a state of emergency (declared by the Cabinet's Council) and in case of economic slowdowns. In 2020 the fund transferred US$ 105 million to the National Treasury to support the National Government in response to the COVID-19 pandemic.

The Sovereign Wealth Fund allows Panama to maintain a certain level of real GDP growth by disseminating funds to boost economic activity. This is a key positive from an investor confidence perspective. Consequently, while we are concerned about the cancellation of the latest mining contract and the hiatus of mining contract approvals in general… Panama still has a source of funding to draw down on to boost economic activity in case of any major fallout.

Panama also has access to funding via the **IMF’s Precautionary and Liquidity line**. This liquidity facility was originally made available between January-2021 and January-2023, however it was never utilized, a testament to Panama’s resilience. The sovereign is still under regular surveillance by the IMF and on January 9, 2024, concluded a financial system stability assessment. It is our view that whether needed or not, another precautionary and liquidity line could be made readily



available by the IMF in short order.

Panama’s interest burden remains manageable. Interest payments as a percentage of tax revenues peaked at 15.6% in 2020 before declining to 13.1% in 2023. The forecast is for the interest burden to come in at 13.8% for the forecast period (2024-2026). The forecasted interest burden is above the average of about 9% pre-covid. However, higher global interest rates combined with a hit to government revenues from the cancellation of the Minera mining contract and the shortfall in dividends from the Panama Canal due to the drought conditions….have been incorporated in the forecast.

A look at Panama’s debt distribution schedule above shows a slight bunching up of near-to-medium term maturities. Panama has a sovereign debt maturity every year between 2024 and 2030. In terms of total payout (interest + principal), the sovereign has debt financing needs of about USD 3 to 4 billion per year (2024 to 2030). The maturity burden however is considered manageable, representing approximately 3.4% of nominal GDP (est. as @ 2024).

Despite the bunching up of maturities, Panama’s current fundamentals ensure access to the international capital markets. This is clearly exemplified by the sovereign’s recent **(Feb-22-2024)** tapping of the global bond markets for a **record US$3.1 billion in financing.** The Central American country **sold US$1.1 billion of notes due in 2031, US$1.25 billion** worth of **bonds maturing in 2038 and $750 million notes due in 2057.** **At the time of issuance, the bond deal had the 2031’s yielding 7.5%, the 2038’s yielding 8% and the 2057’s yielding 8.25%.**

Combining the recent debt raise with an estimated fiscal deficit of about 3.8% (2024) suggests that, as at March, Panama has already prefunded half of its estimated liquidity needs for 2024.

Panama has traditionally had challenges with money laundering and counterterrorism financing as noted above. The “Panama Papers” scandal and numerous other challenges regarding the inability of international bodies to access financial and banking data is testament to the challenges. However, **on Oct. 27, 2023, the Financial Action Task Force (FATF) removed Panama from its grey-list** after the country strengthened its anti-money-laundering and counterterrorism financing prevention system. This is a key contributor to long-term investor confidence for a country with a checkered past in terms of money-laundering.

Finally, despite the rating actions Moody’s, Fitch & S&P, Panama remains an investment grade sovereign. For Moody’s & Fitch, the sovereign is at the last rung of investment grade (Baa3) while for S&P, Panama is two notches above non-investment grade. Retaining its investment grade status is important for any sovereign as this ensures enhanced liquidity and attractiveness.

CONCLUSION

Panama’s fundamentals and prospects remain attractive despite the recent setbacks. The challenges associated with the Minera mining project, reduced revenues due to drought conditions and the moratorium on the issuance of mining licenses plus declining social security reserves could all be transitory. Panama’s stabilization fund, economic diversity, welcoming investment laws, proximity and close ties to the US and position as a global trading hub make it an attractive prospect.

We further acknowledge the deterioration in the fiscal due to covid-19, the negative outlook from S&P and FITCH plus the downgrade by Moody’s as a result of protests, potentially reduced revenue inflows and the temporary halting of mining licenses. However, we note that the recovery has been good and prospects for growth remain attractive. We also note that Panama remains at investment grade despite the rating actions. Access to global capital markets remains and with the IMF precautionary facility, in our view, readily available, Panama should be able to comfortably fund its financing needs.

That said, we cannot ignore the rating actions and the fact that Panama remains on the final rung / cusp of the investment grade rating scale for Moody’s & FITCH. A one notch downgrade by Moody’s or FITCH puts Panama at “non-investment grade”. The problem with a downgrade, is that the IPS (Investment Policy Statement) of many large global bond funds, do not allow portfolio managers to hold non-investment grade debt. Hence a downgrade could lead to the unwinding / sell-down/off of Panamanian sovereign debt. This could potentially lead to lower prices, higher yields and reduced profitability for those funds which hold on to the debt during the sell-off / down.

On the fiscal side, there has been strong recovery from covid but the medium-term deficit target post covid is about a percentage point wider than pre-covid levels. The debt/ GDP has also deteriorated, from 33% pre-covid to about 52% post covid, which is expected. However, we note again that the dynamic nature of Panama’s growth (4.4% - medium term) should contain any significant widening of the debt/GDP ratio, at least in the short term.

Taking all the above into consideration, we revise downward our recommendation on Panama from **HOLD** / **MARKETWEIGHT** (5% of your portfolio) **TO UNDERWEIGHT** / **UNDERPERFORM** (2.5% to 4.9% of your portfolio) AT THIS TIME.

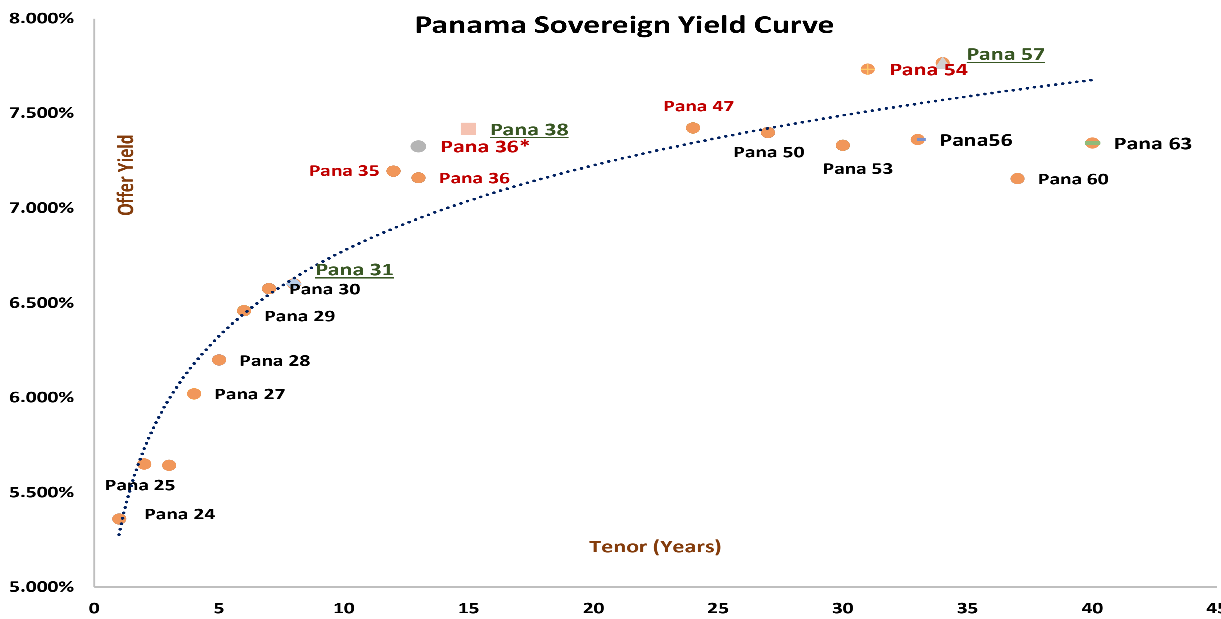
BOND YIELDS / SOVEREIGN DEBT EXPOSURE

A look at Panama’s bonds across the curve indicates that offer yields range from 5.36% for the 2024’s on the short end to 8.25% on the recently listed 2057’s at the long end. Notably, the 2057’s offer higher yields when compared to the longer dated 2060’s and 2063’s.

The most actively traded bonds, according to Bloomberg, are the recently issued USD denominated, 7.5%-2031’s with an issue size of US$1.1 billion followed by the USD-denom. 8.0% 2038’s with an issue size of US$1.25 billion and the 7.875% - 2057’s with an issue size of US$750 million. A cursory look at the sovereign debt curve below indicates that the recently issued 2038’s, the 2057’s and the “old” 2036* trade widest to the extrapolated yield curve and consequently offer the most value. The 2035’s and the 2054’s also trade wide to the curve and offer value.

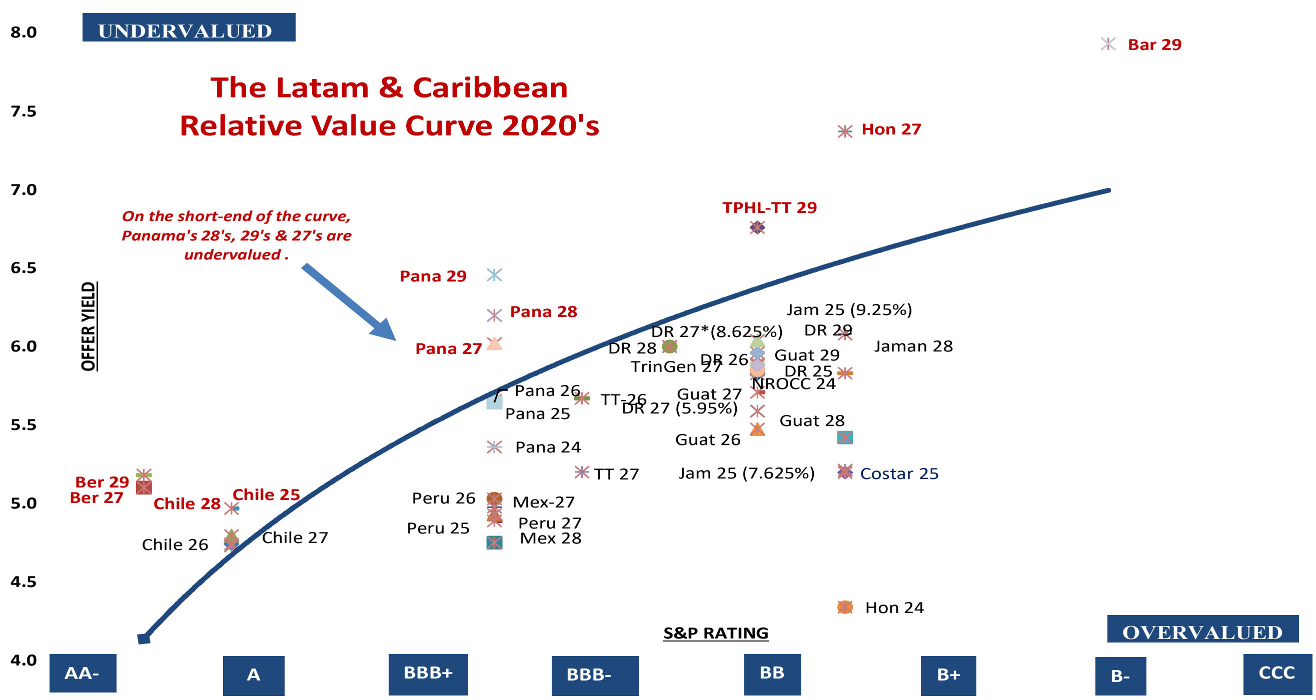
	Panama Sovereign Debt								
Country	Maturity	Coupon	S&P	Moody's	Fitch	Bid Price	Offer Price	Bid Yield	Offer Yield
Panama	9/22/2024	4.000%	BBB	Baa3	BBB-	98.800	99.300	6.345%	5.360%
	3/16/2025	3.750%	BBB	Baa3	BBB-	97.650	98.150	6.183%	5.650%
	1/29/2026	7.125%	BBB	Baa3	BBB-	101.600	102.600	6.205%	5.643%
	9/30/2027	8.875%	BBB	Baa3	BBB-	108.000	109.000	6.322%	6.020%
	3/17/2028	3.875%	BBB	Baa3	BBB-	91.250	91.850	6.380%	6.199%
	4/1/2029	9.375%	BBB	Baa3	BBB-	111.400	112.400	6.678%	6.458%
	1/23/2030	3.160%	BBB	Baa3	BBB-	83.000	83.600	6.714%	6.575%
	3/1/2031	7.500%	BBB	Baa3	BBB-	104.369	104.922	6.690%	6.600%
	2/14/2035	6.400%	BBB	Baa3	BBB-	93.450	94.050	7.279%	7.195%
	1/31/2036	**6.875%**	**BBB**	**Baa3**	**BBB-**	**95.850**	**96.450**	**7.405%**	**7.326%**
	1/26/2036	6.700%	BBB	Baa3	BBB-	95.950	96.550	7.244%	7.161%
	3/1/2038	**8.000%**	**BBB**	**Baa3**	***BBB-***	**104.381**	**105.005**	**7.488%**	**7.418%**
	5/15/2047	4.500%	BBB	Baa3	BBB-	67.450	68.450	7.546%	7.423%
	4/16/2050	4.500%	BBB	Baa3	BBB-	66.150	67.150	7.519%	7.399%
	4/29/2053	4.300%	BBB	Baa3	BBB-	63.100	64.100	7.453%	7.332%
	3/28/2054	**6.853%**	**BBB**	**Baa3**	**BBB-**	**88.900**	**89.900**	**7.826%**	**7.733%**
	4/1/2056	4.500%	BBB	Baa3	BBB-	64.250	65.250	7.478%	7.362%
	03/012057	**7.875%**	**BBB**	**Baa3**	***BBB-***	**100.718**	**101.276**	**7.814%**	**7.767%**
	7/23/2060	3.870%	BBB	Baa3	BBB-	56.900	57.900	7.279%	7.156%
	1/19/2063	4.500%	BBB	Baa3	BBB-	62.800	63.800	7.460%	7.344%

Source: Jeffries LLC as@ Mar-8-2024; Bloomberg

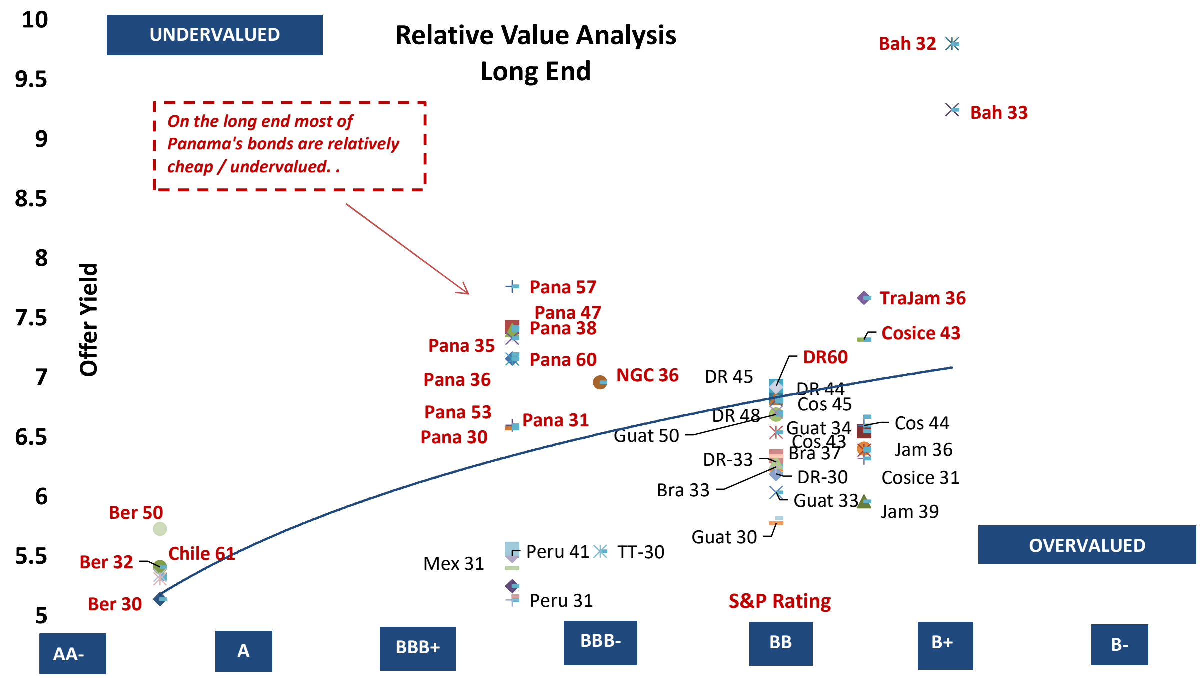


RELATIVE VALUE

On the short end of the curve, Panama's 27's, 28's and 29's trade wide to the curve and are considered undervalued. This is no surprise as the rating actions by all three rating agencies (S&P, Moody's & Fitch) would have dampened investor appetite. Further, the moratorium on the issuance of mining contracts, reduced revenue inflows, drought conditions and its impact on Panama Canal revenues and public protests would have further led to investor concerns.



On the long end of the curve, the Panama story is the same, … most of the bonds are undervalued.



CONCLUSION

Panama’s bonds are relatively attractive both on the short and long end of the curve. It is clear that investors have responded negatively to the possibility of Panama losing its investment grade status. However, in a worse case scenario, if Panama is downgraded to non-investment grade, we do believe that its fundamentals make default an unlikely scenario. Hence holding the bonds to maturity is a viable option.

In terms of short-term positioning and trading of the bonds, we are of the view that the economy’s dynamism could lead to a rebound to investment grade in short-order. Also, there is room on the S&P rating scale, as the number one rating agency has Panama two notches above non-investment grade, though with a negative outlook.

Source: Standard & Poor’s / www.capitaliq.com, FITCH Solutions / www.businessmonitor.com, www.imf.org, US department of State, Moody’s Investor Services, CIA Factbook.

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY, THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

STRONGLY UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 2.5% FOR THIS PARTICULAR ASSET

UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETPERFORM—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OUTPERFORM/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

COPYRIGHT INFRINGEMENT

The investments referred to in this report may not be suitable for you should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.

Disclosure Under The Securities Act

This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.

As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in or interest in the acquisition or disposal of the securities other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.