Fitch Upgrades Panama's Ratings to BBB; Outlook Revised to Stable

2 de junio de 2011

Fitch Ratings-London-02 June 2011: Fitch Ratings has taken the following rating actions on the Issuer Default Ratings (IDRs) and Country Ceiling for Panama: --Foreign currency IDR upgraded to 'BBB' from 'BBB-'; --Local currency IDR upgraded to 'BBB' from 'BBB-'; --Foreign currency short-term IDR affirmed at 'F3'; --Country ceiling upgraded to 'A' from 'A-'. The Rating Outlook is revised to Stable from Positive. The upgrade reflects Panama's solid economic growth prospects and favorable government debt dynamics. Panama's highly favorable investment cycle is underpinned by the Canal expansion, an ambitious public investment program and strong foreign direct investment flows. Favorable economic growth combined with continued fiscal discipline has allowed for a sustained decline in government indebtedness, with debt to GDP of 43% nearly converging with the 'BBB' median. Panama's ratings are also supported by the country's stable banking system, political stability and the consensus among political parties on the main thrust of macroeconomic policies. The country's demonstrated resilience to external shocks is also noteworthy. 'Panama's growth momentum has outshined that of most of its rating peers and this trend is expected to continue' said Shelly Shetty, Head of Latin America Sovereigns. In fact, growth surprised on the upside in 2010 at 7.5% and Fitch projects a robust 7% expansion in 2011 and 2012. Panama expanded 8.1% on average between 2004 and 2009 despite decelerating to 3.2% in 2009 amid the global crisis. High economic growth has also resulted in the improvement in per capita income, which has converged to the 'BBB' median on a Purchasing Power Parity basis. Fiscal performance has been boosted by the economy's vigorous growth and the implementation of two tax reforms over the past year. This combined with a sharp reduction in government indebtedness in recent years has increased the flexibility of the government to finance an ambitious USD 13.5 billion public investment program. Fitch expects the government to comply with its fiscal deficit target of 2% of GDP this year. Fitch's debt dynamics analysis demonstrates that Panama's general government debt (%GDP) will continue to decrease, although the pace of reduction has slowed somewhat due to the government's use of waivers (resulting in higher fiscal spending) allowed by the Fiscal Responsibility Law. Fitch notes that the sovereign debt service profile is highly manageable. Debt maturities are expected to remain below 2% during the forecast period. In contrast, 'BBB' rated peers median debt maturities stood at 6% in 2010. Moreover, authorities are also in the process of developing local capital markets, which could enhance medium-term financing flexibility. Importantly, the Panama Canal expansion continues to remain on track and costs are so far within budget. Fitch believes that the Canal expansion will provide Panama with an increasing stream of fiscal resources potentially starting in 2015 that can be employed to address the country's key lingering structural issues: 1) Fiscal flexibility 2) Social Security deficit and 3) Social disparities. 'Panama's near-term challenges include managing domestic demand pressures in order to mitigate potential risks associated with overheating, especially as investment expansion goes into high gear,' said Shetty. Also, a successful selection, management and execution of public investment will be important to permanently enhance growth prospects and maintain fiscal stability. In the context of dollarization and a narrow tax base, maintaining a modest government debt burden is imperative in order to respond to external shocks. Going forward, significant improvement in fiscal flexibility underpinned by a good track record of adhering to fiscal targets, a sizable reduction in government indebtedness and a build up in fiscal buffers through the implementation of an institutional framework to efficiently manage the Canal's enhanced revenues would be positive for Panama's creditworthiness. Panama's ascent to a wealthier country through robust growth would be viewed positively. In contrast, unexpected fiscal deterioration beyond the scope of the Fiscal Responsibility Law or the realization of contingent liabilities leading to a sustained weakening of the government debt dynamics would be viewed negatively. Contact: Primary Analyst Lucila Broide Director +1-212-908-0898

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