We believe Panama's sovereign USD bond debt trades somewhat cheap relative to similarly rated peers; we think moderate spread compression is likely in the coming months (UBS).

Panama is added to our CIO coverage

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Panama's strategic role as a transportation and financial hub, coupled with robust growth in sectors such as construction, commerce, and transport, positions it as a key player in Central America.

Over the past two decades, Panama has in fact emerged as one of Latin America's strongest economies, boasting the highest per capita income among major Latin American countries, surpassing even Chile. It's no surprise that UBS is celebrating 55 years of uninterrupted presence in the country.

Panama's macro success is the result of remarkable dynamism in construction, commerce, transport, and communications. Our estimates suggest that approximately 60% of Panama's GDP growth since 2018 has been fueled by these sectors, with construction alone responsible for nearly one-third of the total GDP increase during this period. Key infrastructure projects such as the expansions of the Panama Canal and the Tocumen airport, the build-out of the Panama City metro lines, along with the surge in commercial and residential infrastructures, have been essential in fueling employment for the country's 4.5 million citizens.

However, Panama has been facing a series of economic and political challenges as of late. The country's fiscal metrics have deteriorated post-COVID-19, including bulkier deficits and a deterioration in debt ratios. More concerning to investors, Panama's Supreme Court declared the government's contract with Minera Panama as unconstitutional late last year, leading to the closure of the Cobre Panama copper mine, at the time estimated to account for about 4-5% of annual nominal GDP and close to one percentage point of GDP in fiscal revenues.

These developments have exerted negative ratings pressure and widened sovereign spreads. Fitch downgraded Panama's sovereign debt to speculative grade in early 2024, raising concerns that other major rating agencies currently rating the country investment grade might follow.

Yet we believe the negative expectations following the mining closure were somewhat exaggerated. Our estimates suggest Panama will surpass 4.0% real GDP growth this year, well above the Finance Ministry's latest 2.5% forecast. Moreover, Panama's authorities have been clear that although curbing expenditures will be difficult, there will be a concerted effort to bring about sustainability to the fiscal outlook, as is required by law. In this context, we find it unlikely that another major rating agency will downgrade Panama in the coming quarters.

Bottom line

Panama's US dollar sovereign bonds are trading 50-100 basis points wider than similarly rated peers. While this risk premium may persist owing to fiscal uncertainties, stronger-than-expected economic data, improved Panama Canal transit levels, and evidence of fiscal consolidation could lead to modest spread compression in the coming months.

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