

Central Issues

By Derek Sambrook, FIBSA, TEP
Managing Director, Trust Services, S.A.,
Panama



I wonder how many readers expected 2008 to end the way it has for the world's economies. The year 2009 begins shrouded in economic uncertainty particularly for many parts of Latin America.

There are seven countries on the isthmus of Central America which lies in the tropics and runs from the southern border of Mexico to the northern border of Colombia. The countries (none of them large) are, from north to south, Belize, Guatemala, Honduras, El Salvador, Nicaragua, Costa Rica and Panama. They cover an area of 180,000 square miles which is about twice the size of the United Kingdom. English-speaking Belize, however, is the odd man out, never having fallen under Spanish colonial rule. British pirates, traders, runaway slaves and others of mixed blood made up the original population and because Latin America, by definition, consists of countries whose inhabitants speak a Romance language, Belize will be excluded from the rest of my comments.

Many players caused the eventual collapse of the financial house of cards in 2008 and the United States of America is, of course, an easy target, where graduates of the Harry Potter School of Banking and the wizards of Wall Street concocted their fatal brews. People took on mortgages they could not afford and institutions packaged the debt in attractive wrapping which was sold on to other institutions and hedge funds. But when the packages were unwrapped there was nothing inside. It is comforting, therefore, to see that Central America's banking structure bears little resemblance to that of its northern neighbour which, in large part, arose because bankers (not just in the USA) failed to stick to their knitting. Before Swiss Bank Corporation became UBS, one of its declared beliefs was: If you don't understand the business, you don't do it. Clearly, not just the name of the bank changed. By contrast, Panama's banking system, with its conservative lending policy, was never going to be a market for subprime mortgages backed by bonds and other assets which (falsely) were given legitimacy by having some instruments in the mix backed by high Credit Rating Agency investment grades.

Another factor is that Panama adopted the US dollar as its currency after independence and, therefore, has no central bank. The country must buy or obtain dollars by either producing or exporting real goods or services, so the money supply is market driven. The bankers have no fall back position and the distortions that government printing presses can create are absent. Importantly, the banks are financed by local deposits and doubtless they are mindful of the fact that liquidity is vital without the crutch of a lender of last resort in the form of a central bank. Article 114 of the country's 1904 constitution states: "There will be no forced fiat paper currency in the Republic. Thus, any individual can reject any note that he may deem untrustworthy".

Panama's aversion to paper currency stems from the fact that in the 19th century the country's currency was based on gold and silver, with a mixture of coins in circulation. The Silver Peso was the most popular although the US currency was also in circulation due mainly to the construction of a railway linking the Atlantic and Pacific oceans which was being built by an American company. Although originally independent from Spain in 1821, Panama later became part of Colombia and in 1866 the Colombian government made several decrees that forced the Panamanians to accept government fiat notes. But because the country's open economy, one based on transport and trade, could not really benefit from this move the result was dissatisfaction and discord.

It was Simón Bolívar who said that Panama could become "the emporium of the world" and the economy continues to this day to be driven by transport and trade

although its complexion has changed; Panama now has banking expertise and is emerging as a regional logistics and services hub. Projects presently under way include the development of an urban centre which will be the size of central London with an eventual value estimated at USD10 billion. The present canal expansion is behind plans for a USD7 billion oil refinery and a consortium's plans to make Balboa the largest port in Latin America.

Standard & Poor's raised Panama's long-term sovereign credit rating to BB+ in February reflecting the country's healthy economic growth and improved fiscal controls. Panama and also El Salvador are regarded as having particularly good banking systems because of their dollarised economies and sound institutions. According to International Monetary Fund figures, Panama is expected to see its gross domestic product grow in 2008 by some 7% (probably a little on the low side) with a 4% average for the remaining isthmus republics – although the country's current account deficit in 2009 is expected to reach USD2.5 billion (the highest in all six countries).

After years of successfully fighting inflation, prices in the region rose in the last 12 months up to June 2008, by 13.5% (over twice the 2006 figure). More worryingly, with so much of the population being very poor, food prices in the same 12-month period increased by almost 21%. The IMF, which may have to adjust its estimates, believes, at the time of writing, that in 2009 inflation will be highest in Honduras (8%) and lowest in El Salvador and Panama (around 4.5%).

As the harsh financial winds travel across the isthmus, the countries there have always been vulnerable over consumer costs because they neither produce oil nor are they self-sufficient in food. For the last decade the average GDP of the six countries has been USD19.6 billion and although some diversification has occurred, the main export market, and the dominant trading partner, remains the US which is now faltering financially. It is Panama's exceptional good fortune to have a revenue-producing and internationally-used canal with an expansion plan that could contribute 1% to future annual GDP growth.

The countries on the isthmus, in fact, rely on imports for three-quarters of their energy needs (some 100 million barrels of oil were imported in 2007). With the exception of El Salvador

and Panama, the remaining countries have joined Venezuela's Petrocaribe scheme which enables oil to be sold on concessionary terms; this allows for 60% of the purchase price from Venezuela to be deferred and paid over a 25-year period at a tempting 1% interest rate.

A few years ago, the question of Costa Rica being a signatory to such a Chávez-inspired arrangement would have been preposterous; since 1948, when a revolution released the forces of democracy, the country has been a democratic model for other countries in Central America. Neighbouring Nicaragua, on the other hand, has very close ties with Hugo Chávez and imports every drop of oil from Venezuela. With this exception, however, in the case of the remaining participants, it is fair to say that the motive for accepting the Venezuelan president's largesse is driven by economics rather than empathy for his politics. The US has seen for itself in Latin America how giving financial support does not guarantee political loyalty and doubtless Hugo Chávez will find this out for himself.

The strange thing is, even although the credit crunch in the US has not infected Latin America's banking system in a life-threatening way, it seems to have had a psychological effect because banks have become far more cautious with their lending. They are suffering, if you will, from monetary Munchausen's syndrome: making up symptoms that don't exist. Perhaps memories remain from what happened just a few years after America's 1929 stock market crash when 16 Latin American governments were swapped for either outright dictators or autocrats. Even so, the reality is that Central America's economies are better placed this time around to stave off global economic eruptions. In addition to Panama and El Salvador, both Nicaragua and Costa Rica have sturdy banking systems with central bank reserves having doubled in both countries since 2004.

But doubtless, in years to come, there will be more economic woes driven by the fact that, as Norman Douglas, the British writer, put it: "A man can believe a considerable deal of rubbish, and yet go about his daily work in a rational and cheerful manner". The financial manipulators of the present mess counted on this; their successors can again, I regret to say.

www.trustservices.net