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Panama's sovereign lead

Opportunity for growth in Central America

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Global Public Investors are here to stay, they are major financial players, and they are becoming a major source of national wealth. A sovereign fund could bring several benefits for Central American and Caribbean countries if properly structured.

The growth of the Global Public Investor – central banks, pension funds and sovereign funds – over the past decade has been remarkable. Sovereign funds, which can be loosely defined as state investment vehicles with long-term horizons, have experienced asset base compounded growth of 15% per year over the last ten years, reaching $7tn.

Relative to the global economy, sovereign funds' ratio of assets under management to GDP leapt to 9% from 4% during that period. Adding pension funds' assets results in an AUM to GDP ratio of 60-70%, underscoring public investors' importance to the financial health and stability of their home country.

Public investors in commodity-based economies have performed strongly. They have captured the benefits of the so-called commodity super-cycle for economies levered to crude oil and mining. This has been coupled with impressive rates of return, particularly following the 2008-09 global recession.

In the current environment of low or negative interest rates and 'stretched' public equity markets valuations, the potential for continued asset growth and accompanying returns remains constrained. This is particularly the case for central banks, which are more limited – for legal reasons (mandates) – in their choice of investable asset classes, typically limited to very short duration fixed income investments.

Notwithstanding these growth challenges, three main conclusions are possible in respect of public investors. First, they are here to stay. Second, they are major global financial players. Third, they are becoming a major source of national wealth as they invest abroad, in diverse asset classes, and seek to provide benefits for their home countries for future generations.

The view that commodity-based economies are more inclined to establish a sovereign fund is changing, as it should. There are a number of examples of non-commodity-producing countries championing the creation of a national investor: Singapore, with two sovereign funds, comes to mind.

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The Central America and Caribbean region is fraught with development challenges

Countries in Central America and the Caribbean – Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua and Panama – should embrace the development of a national investor, because the region lacks appreciable levels of natural resources deposits or commodities for export.

The Central America and Caribbean region is fraught with development challenges. The $280bn in GDP the region produces (around 22% and 2% of the GDP of Mexico and the US respectively) may not be enough to whet the appetite of external investors. The region would be better positioned for growth by championing a state-led investor class, preferably in the form of a sovereign fund, which would seek to catalyse and outline the path towards economic growth.

A public investor such as a sovereign fund could bring several benefits for Central American and Caribbean countries if properly structured. These include de-risking long-term cash flows if investing outside the country (think foreign exchange risks); potentially earning higher risk-adjusted returns than those available locally; developing asset management networks, skillsets, and expertise; stimulating the execution of infrastructure projects, a major factor in generating growth and employment; developing local capital and financial markets; and utilising earnings for targeted development, for example in education – a cornerstone of a nation's long-term economic growth.

Panama has been taking the lead in this endeavour, to diversify its economy and solidify its position on the global stage. The country's economy has been growing at 7-9% annually over the last 10 years, and is expected to grow by 5-6% in 2016. Growth in productive and well-diversified foreign direct investment has been in lock-step with growth in the economy, amounting to around $26bn since 2003.

Panama's economy is dollar-based and supported by an expanding Panama Canal (accounting for less than 10% of GDP), a robust real estate market, a growing maritime and air logistical hub, a long-standing pan-regional financial services industry, cemented energy (including renewables) and mining segments, a budding infrastructure sector, a sprawling communications industry, and growing pharmaceuticals and consumer services sectors. In addition, partly as a result of its political and monetary stability, Panama

Panama's model provides a reasonable starting point for regional countries to evaluate the merits and challenges of establishing a sovereign fund.

has become a strategic option for major consumer companies seeking regional headquarters.

Panama has taken an additional step towards diversifying and protecting its economy with the creation of the Fondo de Ahorro de Panama, its sovereign fund. The fund's mandate is to serve as a long-term savings vehicle for the Panamanian state in the event of national emergency (natural disasters) or economic deceleration – a combination of a 'rainy day' fund and a stabilisation vehicle. The fund provides the government with annual returns to be used for public investments.

Panama's sovereign fund model provides a starting point for Central American and Caribbean countries

Initial funding came from a series of public investments in telecommunications, energy and land that were monetised over 15 years. New funding is due to come from a variety of sources, primarily the earnings (over and above 3.5% of GDP) of the Panama Canal – whose expansion is expected to be completed this year – and the sale of partly government-owned enterprises (there are 10 such companies currently).

The fund's investment strategy is generally conservative and rooted in investment beliefs that seek to preserve capital, tolerate a reasonable amount of risk (maximum drawdown) and have a long-term horizon (minimum of five years), given the fund's low liquidity needs. From a geographic standpoint, it seeks to invest outside the country. Certain provisions allow the fund to invest in Panamanian debt (up to 10% of assets), though its current asset allocation does not incorporate such investments.

Panama's sovereign fund model provides a starting point for Central American and Caribbean countries to evaluate the merits and challenges of establishing a sovereign fund. It also confirms that being a commodity-exporter is not a prerequisite for the responsible task of saving and investing for the future. Moreover, it lays the foundation for an open dialogue about how an investor mindset, through a sovereign fund, can be a sensible prescription for long-term economic growth in these emerging economies. ■

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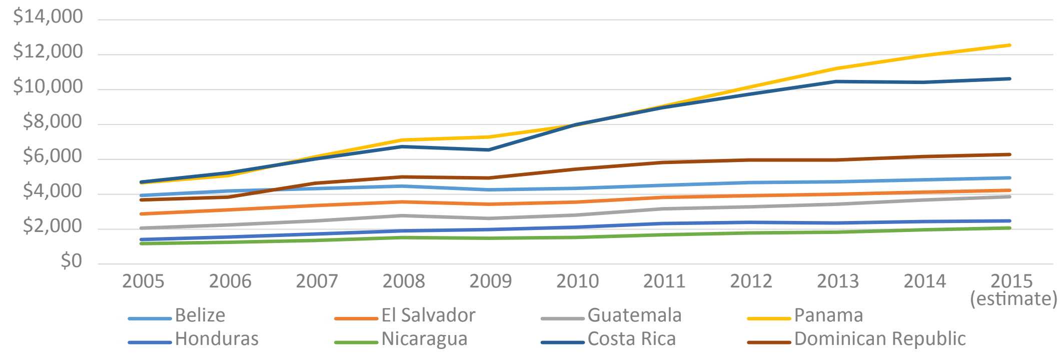
Chart 1: Panama is fastest growing economy in Central America

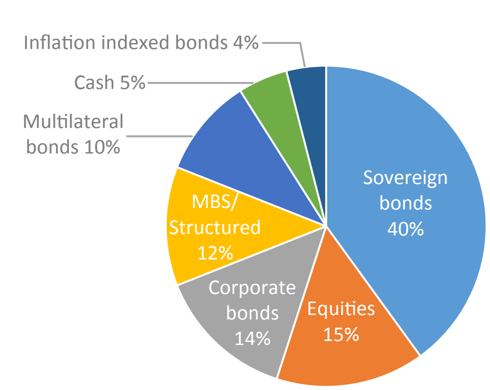
GDP per capita, 2005-2015



Source: The World Bank, Fondo de Ahorro de Panama

Chart 2: Fondo de Ahorro de Panamá expected strategic asset allocation

Fund AUM: $1.4bn



Source: Fondo de Ahorro de Panama