1. The Economy and Financial Markets

1.1. Macroeconomic Context

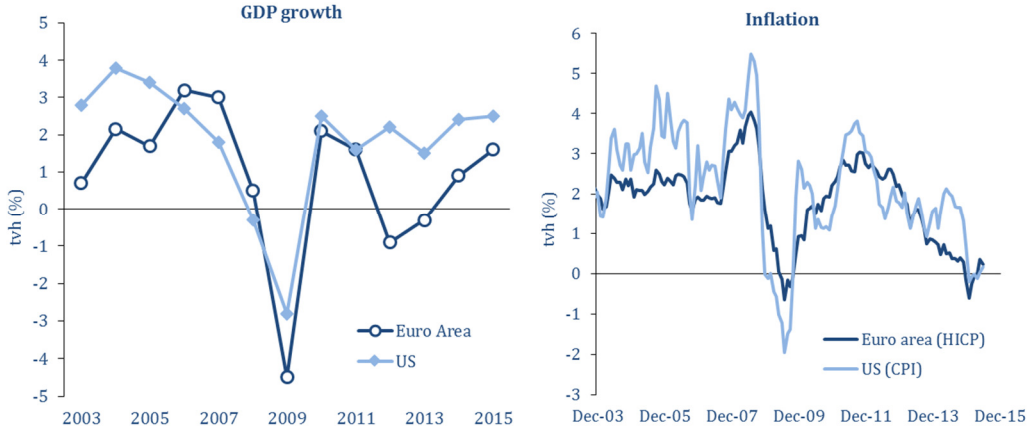
In 2015, economic activity remained relatively contained. Growth in emerging and developing economies slowed for the fifth consecutive year, while in advanced economies the recovery continued modest. The latest IMF estimates point to a global economic growth of 3.1% in 2015, representing a decrease of 0.3pp compared to the previous year.

In the US, average GDP growth stood at 2.5% (0.1pp above 2014), with the economy maintaining a steady growth rate over the year, despite the onset of a weaker year (mainly due to one-off factors).

Economic recovery in the euro area continued at a moderate pace, supported by monetary stimulus, a neutral fiscal policy and low oil prices. Growth was in the order of 1.6% in 2015 (0.9% in 2014), reflecting a relatively strong recovery of the Spanish economy (3.2%) and also of the French economy (1.1%), albeit less markedly. Nevertheless, the high debt level of the private sector continued to limit a stronger recovery of investment and private consumption in many euro-area countries.

Emerging and developing countries once again had an unfavourable influence on overall economic activity, with the slowdown of China being the most relevant factor.

Graph 1 – Real GDP growth and general price developments



Source: EC and Eurostat

Source: Eurostat and Bureau of Labor Statistics

Inflation remained low in advanced economies and well below the objective of central banks. After a slight recovery in the first half of the year, inflation in the euro area fell back to close to zero in the context of further declines in energy prices and a slight appreciation of the euro. Average inflation thus stood at 0.1% during 2015, a decrease of 0.3pp compared to 2014. In the US, average annual inflation also remained at low levels, reflecting the low prices of energy and imported goods, settling at 0.1% in 2015, 1.5pp lower than 2014.

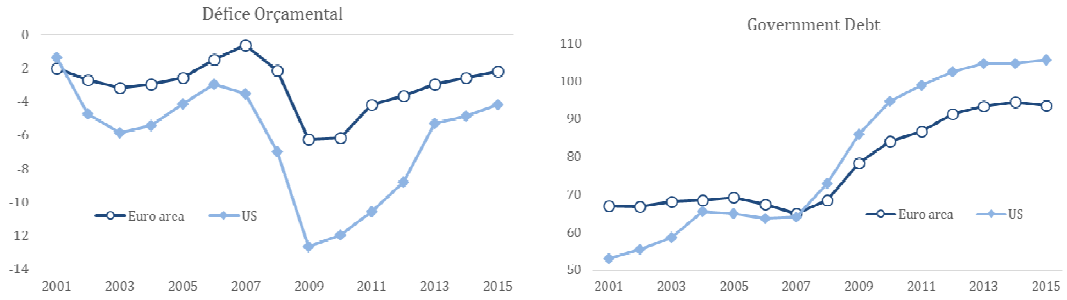
The recovery of activity, albeit moderate, has been accompanied by an improvement in the labour market. In the US, the most recent forecasts point to a reduction from 5.3% in the unemployment rate of the active population in 2014 to 4.8% in 2015, with the economy proving to be buoyant in creating new jobs. In the euro area, the evolution observed in the unemployment rate continues to signal a gradual improvement of conditions in the labour market. It is expected to decrease from 11.6% in 2014 to 11.0% in 2015.

Public finances in the euro area and the EU have kept the upward trend that started in 2010 in a context of the recovery of economic activity and interest rates at historically low levels. In 2015, the general government deficit decreased to 2.2% of GDP in the euro area, compared with 2.6% in

2014. In the US, the deficit also evolved favourably, decreasing from 4.9% of GDP in 2014 to 4.2% in 2015.

With regard to the debt-to-GDP ratio, 2015 was the year in which it was possible to reverse the upward trend of the debt stock in the euro area, with a slight reduction in the peak in 2014 from 94.5% to 93.5% in 2015. This was not the case in the US, where debt rose again, albeit marginally, from 104.8% in 2014 to 105.6% in 2015.

Graph 2 – Government debt and budget deficit in advanced economies
(As a percentage of GDP)

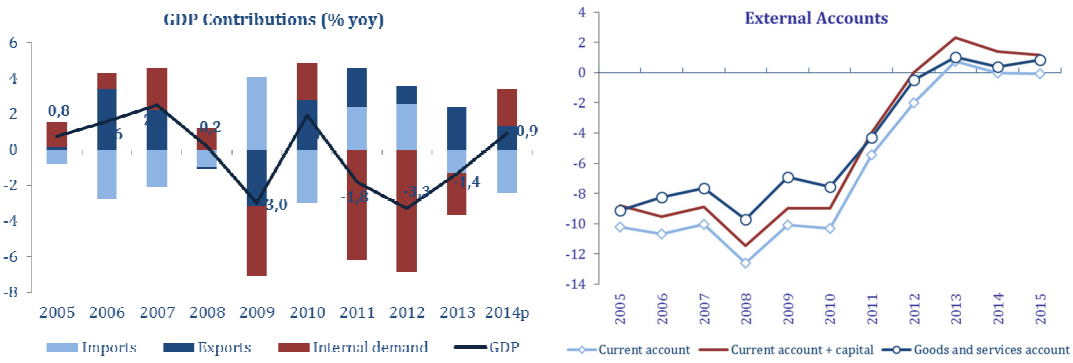


Source: European Commission

In 2015, the Portuguese economy confirmed the gradual recovery scenario of economic activity initiated in the previous year, with the economy showing a similar growth rate to the euro area for the second consecutive year. In annual average terms, GDP grew by 1.5% over the year, accelerating 0.6pp compared to the previous year and 0.1pp below the euro area. The recovery of activity was supported by buoyant domestic demand, with particular emphasis on private consumption.

The contribution of net exports was negative, reflecting an increase in imports stronger than exports. Nevertheless, the balance of goods and services remained in surplus for the third consecutive year (0.8% of GDP), reflecting a sustained improvement in the terms of trade in recent years. Similarly, the economy's financing capacity has remained relatively stable in positive values, ending the year 2015 at 1.1% of GDP.

Graph 3 – Economic growth and External accounts in Portugal



Source: INE

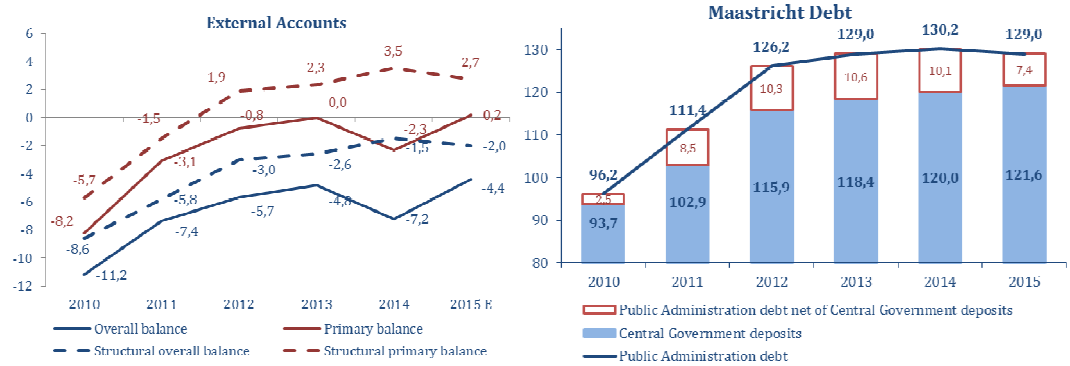
Conditions in the labour market continued the upward trend started in 2013, with the unemployment rate declining from 13.9% of the active population in 2014 to 12.3% in 2015.

With regard to price developments, the context of reduced inflationary internal and external pressures dictated a low-inflation scenario also in Portugal. After decreasing by 0.2% in 2014, the annual average rate of change of the HICP recovered slightly to 0.6% in 2015, a development that reflects the non-energy component, since energy prices fell during 2015.

In sectorial terms, there was a decrease in the financing capacity of households (from 2.7% to 0.8% of GDP), financial corporations (from 5.1% to 4.2%) and non-financial corporations (from 0.7% to 0.6%). This was largely offset by the improvement of the situation of the government as the deficit was reduced from 7.2% to 4.4% of GDP (3.0 %, excluding the impact of the resolution applied to Banif).

The positive trend of public accounts reflected an improvement in the primary balance from -2.2% to 0.2% of GDP (1.5% excluding Banif), with the first primary surplus since 1997. This evolution, along with the nominal GDP growth of 3.4% and the reduction in deposit balances, permitted the start of a downward trend of public debt, which stood at 129.0% of GDP at the end of 2015 (minus 1.2pp than at the end of the previous year).

Graph 4 – Public finances in Portugal
(As a percentage of GDP)



Source: INE

1.2. MONETARY POLICY AND FINANCIAL MARKETS

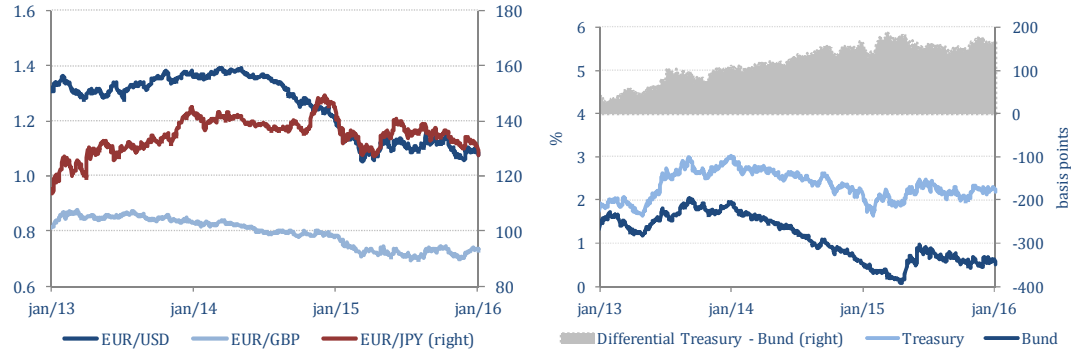
While remaining globally accommodative, monetary policy showed different trends throughout 2015, becoming successively more expansionary in the euro area, while in the US the Fed began to hike rates.

Given the general improvement of economic prospects and the labour market, the Federal Reserve decided at the last meeting in 2015 to start the rate hike cycle, even though inflation continued far from the 2% goal.

On the other hand, given the fall in inflation to negative values, the ECB decided to announce a Public Sector Purchase Programme (PSPP), which began in March. Initially, it was envisaged that the programme would last until September 2016 but it has since been extended until March 2017, given the limited impact of the programme on inflation until the end of the year.

Given the different policy stance adopted by the ECB and the Fed, the euro maintained a downward trend against the dollar, especially in the first quarter of the year, recording an annual depreciation of more than 11.4%. With regard to the British currency, the euro depreciated by 5.5% and 10.9% against the yen. The European currency depreciated by about 6.2% against the SDR basket of currencies in which the IMF loans are denominated, which contributed to increase the debt stock, valued in euro before currency hedges, in about EUR 1.9 billion throughout 2015 (see section 2.3).

Graph 5 – Foreign-exchange rates and 10-year interest rates



Source: Bloomberg

The European and US money markets reflected the monetary policies of the ECB and the Fed, respectively. On the one hand, the 3-month Euribor continued its downward trend, ending the year at historic lows of -0.013%, while Libor displayed the opposite behaviour, ending the year at 0.62%, the highest since 2009.

In the first quarter of 2015, there was a generalised downward trend in the yields of benchmark bonds in the euro area, in line with the implementation of the PSPP by the ECB, with the 10-year Bund reaching historical lows of 0.074% in April. In April and May, there was a significant correction of the rate level in a period of less liquidity of the secondary market, followed by a period of relative stability, with the 10-year Bund finishing the year above the values of end-2014 (0.63% vs. 0.54%).

The behaviour of the 10-year Treasury was similar to the Bund throughout 2015, with a decline – although less pronounced – at the beginning of the year, reaching a minimum of 1.64% in January. Taking into account the subsequent correction, the Treasury ended the year at 2.27% (compared with 2.17% at the end of 2014). The Treasury-Bund differential thus stood at 164pb at the end of the year, identical to the 163pb recorded at the end of 2014.

Simultaneously, the spreads of peripheral countries of the euro area continued to narrow. Despite the correction of this trend in the second half of 2015, spreads ended the year at values below the end of 2014.

Graph 6 – *OT* yields and euro-area sovereign spreads vs the Bund

Source: Bloomberg

In 2015, the Portuguese government debt market was marked by a significant reduction in interest rates and a narrowing of the spread against the Bund in the first quarter of the year. This trend was largely corrected in April and May, with the *OT*-Bund spread stabilising somewhat in the second half of the year. The 10-year *OT*-Bund differential therefore ended the year close to the levels seen in late 2014.

Benefiting from the low interest rates, *IGCP* prepaid part of the IMF loan, amortising SDR 5.1 billion in March and SDR 1.5 billion in June and lengthening the average maturity of the portfolio. It even issued a new 30-year benchmark (*OT* 4.1% in February 2045).