

**FOR  
AGENDA**

EBS/08/89  
Correction 2

July 29, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Albania—Staff Report for the 2008 Article IV Consultation, Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, Financing Assurances Review, and Request for Modification of Performance Criteria**

The attached correction to EBS/08/89, Cor. 1 (7/23/08) has been provided by the staff.

**Typographical Error**

**Page 10, third text chart, series label:** for “Other CHECK THIS” read “Other”

Questions may be referred to Mr. Oestreicher, EUR (ext. 37493).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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Other Distribution:  
Department Heads



### Box 1. Implementation of Past Fund Policy Recommendations

The authorities' responsiveness to Fund advice in earlier Article IV consultations has been good, as reflected in strong program performance and the completion of four reviews under the current arrangement. Macroeconomic policies have been prudent and delivered a strong growth performance.

On structural reform, the vulnerabilities that were previously identified in revenue administration, debt management, and banking supervision are being tackled, with progress on tax administration being particularly advanced. However, some key areas for structural reform have lagged behind. The persistently weak financial performance of the electricity sector is a serious macroeconomic concern, and limiting the resulting quasi fiscal costs is subject to program conditionality. Implementation of the reforms to strengthen title registration and enforce contracts has also been slow.

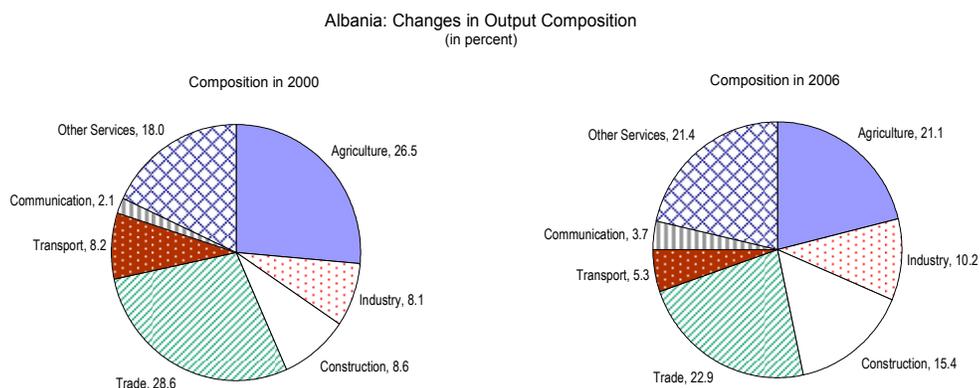
4. **Supported by the authorities' continued commitment, performance under the PRGF/EFF-supported program remains strong.** For the fifth review, all March quantitative performance criteria were met (MEFP Table 1) and structural conditionality appears on track (Table 3) with, however, some stress in the energy sector (see below).

## II. BACKGROUND

### A. Recent Economic Performance

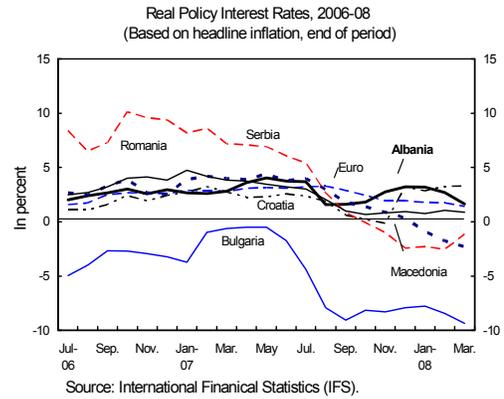
5. **Since the last Article IV consultation, macroeconomic performance has remained strong even in trying times.**

- **Notwithstanding a drought, growth remained at potential and became broader based.** Real GDP grew by 6 percent in 2007 and the same rate is projected for the current year. A regional drought in 2007 affected Albania particularly hard because of dependence on hydro-electric power generation and rain-fed farming. But the recovery was rapid as the economy diversified with buoyant construction and trade and the opening of new markets and export activities—e.g., in textiles, footwear and mining (Chart).

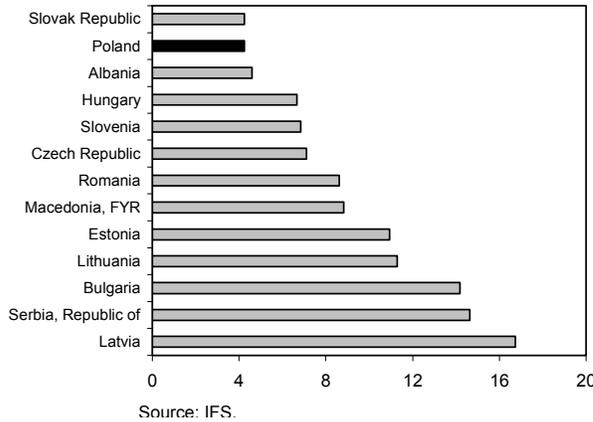


Source: Albanian authorities.

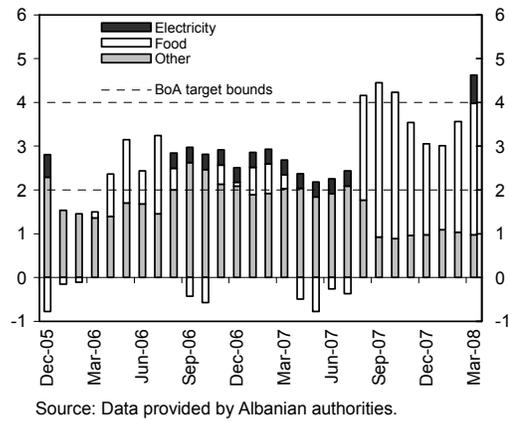
- Inflation, while episodically above the target range, is among the lowest in the region.** In spite of global food- and commodity price shocks, there were only temporary deviations from the  $3 \pm 1$  percent inflation target, and expectations appear firmly anchored. A cumulative 125 basis points increase in the policy rate since July 2006, has maintained positive real interest rates, buttressed by timely regulatory tightening (Box 2).



Annual Year-on-Year Inflation, March 2008



Albania: Percentage Contribution to Year-on-Year Total Inflation, December 2005-March 2008



- In addition, risks to external and domestic stability have receded somewhat.** Domestic credit growth, though still elevated, has decelerated from past highs. The share of exports of goods and services in GDP has risen in each of the past five years. Albania continues to attract investment in its traditional exports, textiles and footwear. In addition, non-traditional export sectors such as chromium have expanded rapidly and, in the services sector, tourism is registering buoyant growth. As a result, the past heavy concentration of exports to the key Italian and Greek markets has begun to diminish.

6. **These favorable trends are a continuation of more than a decade's rising investment and productivity** (Box 3). Business improvements, labor shedding and inter-industry resource reallocation following the collapse of communism were key, supported by the successful macroeconomic stabilization and market-oriented reforms.