from the more flexible exchange rate regime in a number of ways. In the face of structural changes in the regional and global environment, the two-way flexibility accorded by the exchange rate regime allows for greater policy flexibility to deal with potential external shocks. Early evidence suggests that the gradual appreciation of the real exchange rate has been another factor that has encouraged those in the tradable sector to undertake further adjustments to improve their efficiency and productivity. Such structural adjustments have moved Malaysia up the production value chain and thus improved the overall competitive position of the economy. Finally, the stronger currency had contributed to alleviate some of the price pressures emanating from imported inflation.

Nevertheless, as with any small open economy with liberal exchange control policies, global developments and capital flows can be a challenge for the management of the exchange rate. In Malaysia's case, the healthy two-way flow of capital enabled orderly foreign exchange market conditions throughout 2006. The upward pressure on the ringgit arising from inflows due to international trade, FDI and portfolio investment was counterbalanced by outflows arising from external debt repayments and prepayments, the large repatriation of profit and dividends by non-resident corporations, as well as overseas investments by residents. On the latter factor, there were increased investments overseas, as resident companies took advantage of their improved financial strength to venture into strategic investments abroad. The sum of outflows accounted for by the repatriation of profits and dividends and overseas investments amounted to RM29 billion or 5.3% of GDP in 2006.

With countries attaining a higher degree of economic and financial openness amid the growing sophistication of financial instruments and markets, developments in the global markets are having an increasingly more significant effect on domestic monetary and financial conditions. As the economy and the financial system become more integrated with the global system, the magnitude, channels and speed of risk transmission across countries are also becoming more challenging. This has prompted closer regional cooperation between central banks to pool their resources to enhance the surveillance networks and promote regional monetary and financial stability. The following box article highlights several ongoing initiatives that are being earnestly pursued by regional central banks, including Bank Negara Malaysia.

Selected Ongoing Central Bank Initiatives for Promoting Regional Cooperation

The EMEAP Task Force Initiative

- During the year, a significant development in regional cooperation was the establishment of the Task Force on Regional Financial Cooperation in Asia in February 2006. It represented the intensification of efforts to foster deeper financial cooperation among the regional central banks with the overriding objective of promoting macroeconomic and financial stability in the region and thus achieving mutually reinforcing regional growth and stability. The initiative focuses on the six mandates of cooperation: regional macro-monitoring and risk management; crisis management and resolution; financial market and infrastructure development and integration; capacity building; sharing of information, expertise and experience; and in communications.

Chiang Mai Initiative

- Significant effort has been devoted into regional crisis management and resolution, in particular the development and further enhancement of the regional self-help and support arrangement. The Chiang Mai Initiative (CMI) marks a particularly important step towards promoting such a regional self-help and support arrangement among the ASEAN+3 countries[1] with the objective of ensuring regional monetary and financial stability.

- The CMI was launched on 6 May 2000 by the ASEAN+3 Finance Ministers to supplement existing international financial facilities, and hence, make available, in a timely manner, financial resources to member countries facing temporary balance of payments and short-term liquidity needs. The CMI has two components, namely the ASEAN Swap Arrangement (ASA) and a network of bilateral swap arrangements (BSAs).

- To further strengthen the regional self-help financial support, the ASEAN+3 countries have agreed to work towards an advanced framework of regional liquidity support arrangement and as such achieve the long-term goal of multilateralising the CMI. In this regard, a task force was set up to study the possible options and progressive steps in multilateralising the CMI. The proposed framework is aimed at promoting a more effective and efficient pooling and utilisation of liquidity support among member countries.

- Under the CMI, Malaysia has entered into three BSA agreements, namely with Japan, Korea and PR China. The total amount of Malaysia's BSAs stands at USD4 billion. Collectively, as at end-2006, the BSA network, which comprised 16 agreements among eight ASEAN+3 countries, totalled USD77 billion, compared to USD58.5 billion at end-2005.

- Recent developments have also highlighted the need to enhance collaboration in the areas of macroeconomic and financial surveillance to provide early detection of risks within the region. As such, the region has embarked on a series of efforts to promote greater surveillance, particularly in complementing the BSAs under the CMI. In May 2006, the ASEAN+3 Finance Ministers agreed on measures to further strengthen regional surveillance capacity to assist the policy dialogue under the ASEAN+3 Economic Review and Policy Dialogue (ERPD) process. The ASEAN+3 Finance Ministers agreed to establish the Group of Experts (GoE). The GoE, which is made up of several regional professional experts, would serve as an independent economic assessment vehicle for this region. The experts are expected to identify and undertake in-depth studies on economic and financial vulnerabilities and concerns within the region, especially in the areas of macroeconomic policy, fiscal policy, external sector (trade and international finance), and monetary policy.

- In addition, the ASEAN+3 Finance Ministers also agreed to establish the Technical Working Group on Economic and Financial Monitoring (ETWG) to assist in further strengthening the surveillance process in the region. The ETWG would play an important role in developing the Early Warning System to facilitate early detection of emerging risks in the system. The ETWG is also expected to assist in enhancing and strengthening member countries' capacity building and surveillance capability.

[1] ASEAN countries comprise Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Cambodia, Lao PDR, Myanmar and Vietnam. '+3' countries comprise Japan, Korea and PR China.