capacity of the economy, which in turn will promote higher levels of economic activity over the near term.

Going forward, potential output of the economy is expected to grow above 6% in 2007 with the output gap remaining negligible during the year. The potential output growth would be driven by the continuous expansion of both the capital stock and labour force. This balanced expansion is expected to prevail going into the future, supported by further recovery of investment activity and the improvement in economic resilience and productivity.

output gap remaining negligible during the year. With continued investment by the private and public sector, the productive capacity of the economy would be further expanded. This implies that while demand will continue to grow, it is not expected to cause undue pressures on prices. Apart from these domestic factors, the global environment is also expected to remain relatively favourable given the lower oil and commodity prices. Importantly, inflation expectations are expected to remain well anchored.

Nevertheless, there are risks and uncertainties going forward that could have a material impact on the policy environment. The direction and volatility of oil prices in the global markets could become a source of concern. Although the current forecast is for the world economy to grow at a slightly slower pace, it is also possible that economic growth will turn out to be better than currently estimated, in which case demand pressures could emerge. Alternatively, there remain some downside risks emanating from the correction in the US housing market which could affect consumption in the US, with possible repercussions on world trade and growth of the world economy.

Capital flows could potentially pose a challenge to the management of monetary policy for most of the regional economies in 2007. As with any small open economy with liberal exchange control policies, capital flows need to be closely monitored. Such flows could result in excessive volatility in the financial markets and the economy. There would thus be continued intensive surveillance. The country is better positioned to absorb the volatility and the strategy of a gradual and sequential liberalisation of its capital account remains on course.

The conduct of monetary policy in 2007 will continue to balance between the need to ensure that interest rates remain at a level that would enable the central bank to respond to any risks of rising inflation, while remaining conducive to sustaining growth in domestic demand. At current interest rate levels, monetary policy remains accommodative. Bank Negara Malaysia will continue to assess developments in the domestic and international economies and will adjust its monetary policy stance as circumstances require.

**Liberalisation of the Foreign Exchange Administration Policies**

Malaysia has always undertaken a structured approach in reviewing the foreign exchange administration policies based on the readiness of the economy. Over the years, the foreign exchange administration policies have been progressively liberalised, aimed at enhancing Malaysia's competitiveness through reducing cost of doing business, increasing efficiency of the regulatory delivery system, providing a greater degree of risk management to businesses while safeguarding economic and financial stability.

In line with the country's strategic objectives and supported by progress achieved from previous liberalisations, Bank Negara Malaysia announces further liberalisation to the foreign exchange administration rules with effect from 1 April 2007 as follows:

(a) To provide greater flexibility to licensed onshore banks to undertake foreign currency business, the following foreign exchange administration rules are liberalised:

(i) Abolish net open position limit of licensed onshore banks which was previously capped at 20% of the banks' capital base.

(ii) Abolish the limit imposed on licensed onshore banks for foreign currency accounts maintained by residents.

(iii) Allow investment banks in Malaysia to undertake foreign currency business subject to a comprehensive supervisory review on the capacity and capability of the investment banks.

(b) To widen the investor base for ringgit assets and financial products, the following foreign exchange administration rules are liberalised:

(i) Grant further flexibility for non-resident stockbroking companies and custodian banks to obtain ringgit overdraft facility from licensed onshore banks to avoid settlement failure due to inadvertent delays by:

- Removing the previous overdraft limit of RM200 million; and
- Expanding the scope on utilisation of the overdraft facility to also include ringgit instruments settled through the Real Time Electronic Transfer of Funds and Securities (RENTAS) System and Bursa Malaysia. Previously, utilisation of the facility was confined only to shares traded on Bursa Malaysia.

(ii) Abolish the limit on the number of residential or commercial property loans obtained by non-residents. Under the previous policy, non-residents were allowed to obtain a maximum limit of three property loans from residents to finance the purchase or construction of residential or commercial properties in Malaysia.

(iii) Allow licensed onshore banks to appoint overseas branches of their banking group as a vehicle to facilitate the settlement of any ringgit assets of their non-resident clients.

(iv) Allow non-resident corporations to utilise proceeds arising from the listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia, abroad.

(v) Remove the restriction on Labuan offshore banks to transact in ringgit financial products on behalf of non-resident clients.

(c) To reduce cost of doing business, enhance business efficiency as well as promote Malaysia as a centre of origination, the following foreign exchange administration rules are liberalised:

(i) Increase the limit of foreign currency borrowing that can be obtained by resident corporations from licensed onshore banks and non-residents as well as through issuance of onshore foreign currency bonds, to RM100 million equivalent in aggregate and on corporate group basis from the previous RM50 million equivalent. The proceeds may be used for domestic purposes or offshore investment.

(ii) Allow residents to hedge foreign currency loan repayment up to the full amount of underlying commitment.

(iii) Enhance flexibilities for resident individuals and corporations to invest in foreign currency assets as follows:
- Increase the limit for resident individuals with domestic ringgit borrowing to invest in foreign currency assets up to RM1 million per calendar year, from the previous limit of RM100,000;
- Increase the limit for resident corporations with domestic ringgit borrowing to invest in foreign currency assets up to RM50 million per calendar year, from the previous limit of RM10 million; and
- Allow resident corporations to utilise proceeds arising from listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia for offshore investment purposes.

(iv) Increase the limit for resident institutional investors to invest in foreign currency assets as follows:
- Unit trust companies: up to 50% of net asset value (NAV) attributable to residents from the previous 30% of NAV;
- Fund management companies: up to 50% of funds of resident clients with domestic credit facilities from the previous 30% level; and
- Insurance companies and takaful operators: up to 50% of NAV of investment-linked funds marketed from the previous 30% of NAV.

(v) Allow resident corporations to lend in foreign currency, the proceeds arising from listing of shares on foreign stock exchanges to other resident corporations within the same corporate group in Malaysia.

(vi) Abolish restrictions on payments in foreign currency between residents for settlement of foreign currency financial products offered onshore.

(vii) Allow resident individuals to open and maintain joint foreign currency accounts for any purpose. Previously, resident individuals were allowed to maintain joint foreign currency accounts only for purposes of education and employment overseas.

Details of the liberalisation can be obtained from the Annex.

**FISCAL POLICY IN 2007**

The 2007 Budget is aimed at enhancing the macroeconomic fundamentals and promoting a more broadly balanced economic structure by placing emphasis on new areas of domestic economic activity. Fiscal policy in 2007 is therefore focused on facilitating the private sector in taking a greater role in economic development as well as in generating new sources of growth in the technology and knowledge-intensive sectors.

Expected higher revenue collection has allowed the Federal Government to plan increased expenditures, while reducing the budget deficit to