Japanese financial system has limited direct exposure to U.S. subprime securities. On the upside, housing starts appear to have turned a corner and residential investment is expected to provide some support to growth in the first half of 2008. Reflecting these considerations, growth for Japan is projected to slip to 1.4 percent in 2008 before edging up to 1.5 percent in 2009.

The emerging Asian economies

Growth in emerging Asia held up well in the second half of 2007, although with some signs of softness. Growth was led by China and India. Robust domestic demand, led by consumption, supported activity in Indonesia, Malaysia, Hong Kong (China), the Philippines, and Singapore. Export growth remained strong in Korea and Thailand. However, the strength of domestic demand in the region, combined with rising food and energy prices, has contributed to a buildup of inflationary pressures in a number of countries. Growth prospects will depend on the resiliency of the region's economies and their financial systems to the financial market turbulence and the associated slowdown in the advanced economies. Ongoing robust domestic demand, a high degree of openness in the region, and a rising share of intra-Asia exports will help to offset some of the impacts of the weaker external environment.

China

2007 was the fifth straight year that growth has been posted in double-digit figures for the Chinese economy. Moreover, this growth has been accelerating on an annual basis over this period. In 2007, the Chinese economy expanded by 11.9 percent compared to 11.6 percent in 2006. Growth was led by the manufacturing and services sectors (which China formally calls the "secondary" and "tertiary" sectors), which grew by 13.4 percent and 12.6 percent, respectively.

The Chinese government is trying to rein in the economy somewhat, attempting to achieve "sound and fast" growth, with price stability as one of its top priorities. On the one hand, it wants to keep growth high to reduce poverty. On the other hand, it has been tightening monetary policy in an effort to rein in inflation without denting economic growth too much. Consumer prices rose 8.3 percent in March 2008 over the same month a year earlier, down only slightly from February's 8.7 percent rate, the highest rate in nearly 12 years. Most of the gains came from a 21 percent jump in food costs in the first quarter, including pork and vegetables. Government authorities worry about a backlash if prices keep rising rapidly. Bouts of high inflation in the 1980's and 1990's have previously sparked protests. Moreover, the government is trying to cool an investment boom in real estate and some other industries that it worries could ignite a financial crisis.

China posted large income and current account surpluses in 2007. China maintains a growing stock of foreign exchange reserves and has become an important international investor, for which it earns income from its rising overseas investments. The current account surplus is estimated to have widened to US$381.3 billion in 2007, driven by the trade surplus which was boosted by surging export growth and relatively weaker import demand. The trade surplus will remain large in 2008. Tourism-related inflows linked to the Olympic Games will likely push the services account briefly into surplus for 2008, but rising services imports will push it back into deficit in 2009. Growth in goods exports will remain strong, although it is expected to be not quite as strong as in 2007 due to rising domestic costs, currency appreciation against the U.S. dollar (by about 5 percent against that currency), and lower world demand.

China's currency — the renminbi — is, however, linked by a crawling peg to the U.S. dollar. In 2007, because of the recent weakness of the U.S. dollar, the renminbi actually depreciated against the euro. Side effects of these dual surpluses in the capital and current accounts include more rapid growth in money supply and investment[6]. It is thus expected that investment will continue to grow vigorously

6 Economist Intelligence Unit *China Monthly Report* for March 2008.