in 2008 after having contributed 0.9 percentage points to growth the year before. Residential investment fell again in 2008, down by 6.9 percent after having fallen 9.3 percent in 2007, which subtracted 0.2 percentage points from real GDP growth for the year. Net exports contributed only 0.1 percentage points to real GDP growth in 2008 after contributing 1.1 percentage points in 2007. Exports of both goods and services decelerated in 2008, adding only 0.3 percentage points from real GDP growth. Imports of goods remained fairly stable, rising by 1.1 percent in 2008. Government spending was up by a modest 0.9 percent compared to an increase of 2.0 percent in 2007.

On a quarterly basis, Japan posted declines over the last three quarters of 2008, capped by the fastest rate of contraction posted by Japan in 35 years in the final quarter. GDP fell at an annualized real rate of 12.1 percent in that quarter, the steepest decline since Japan felt the full force of the 1974 oil crisis. The contraction was led by a 44.9 percent (annualized) decline in exports of goods and services in the fourth quarter. Non-residential fixed investment also contracted noticeably—falling by 19.8 percent (annualized)—the fourth consecutive quarterly decline. Household incomes fell as employment stalled and wages declined, resulting in a contraction of household consumption. Growth in personal consumption expenditures turned negative in the fourth quarter.

Three successive fiscal packages introduced since August 2008—which together total about 2 percent of GDP—coupled with the impact of the automatic stabilizers, will mitigate the depth and length of the recession.[4] However, the current downturn is projected to be the most severe in Japan's post-war history. The yen's strength and tighter credit conditions more generally have added to the problems of the export sector. Output is projected to decline by 6.2 percent in 2009, raising unemployment and pushing Japan back into deflation. A recovery in domestic demand from mid-2010 is expected to lift output growth into positive territory, although well below potential.

Euro Area

Economic activity in many of the advanced European economies had begun to contract well before the September 2008 financial meltdown, owing mainly to rising oil prices. Growth in the euro area slowed to 0.9 percent in 2008, down two thirds from the 2.7 percent rate posted in 2007.

The initial perception was that advanced European economies would escape a full-blown recession. Healthier household balance sheets in most major economies and different housing and financial market structures than for the U.S. were considered protective factors. However, financial systems suffered a much larger and more sustained shock than expected. Because of the close linkages between Europe's major financial institutions and their high leverage, the financial crisis rapidly transformed into a crisis for the real economy.

As a result, most advanced European economies have suffered sharp contractions since mid-2008. Real GDP fell at an annual rate of about 6.0 percent during the fourth quarter in the euro area. Real GDP is forecast to drop by 4.2 percent in the euro area in 2009 and continuing to fall for several more quarters, making this the worst recession since World War II. Growth is expected to contract by about 0.4 percent on an annual average basis in 2010. The recession is projected to be particularly painful in Ireland, as its construction boom has sharply reversed. As a result of the broad-based fall in output, unemployment rates in the advanced economies are projected to exceed 10.0 percent in late 2009 and climb further through 2011.

The downside risks around the projections for both advanced and emerging European economies are large, particularly for the latter, where external financial constraints could worsen further. The

4 *OECD Economic Outlook*, March 2009.