plant. Assuming that the power shortages and the nuclear crisis are resolved within a few months, the IMF projects growth in Japan to slow to 1.4 percent in 2011 before recovering to 2.1 percent in 2012.

Euro zone

In Europe, the recovery is proceeding modestly. Overall, real activity in the region remains below its potential level and unemployment remains high, with substantial variation across economies. According to the IMF, concerns about banking sector losses and fiscal sustainability led to widening sovereign spreads in euro zone countries, in some cases reaching highs not seen since the launch of the Economic and Monetary Union.

After posting a 4.1-percent decline in real GDP in 2009, growth in euro zone real output was up 1.8 percent last year. Gains were modest across most sub-components of GDP with the exception of trade, which posted vigorous rates of expansion.

Real exports were up 11.6 percent in 2010 while real imports advanced 10.7 percent as net exports contributed 0.8 percentage point to overall GDP growth.

The remaining 1.0 percent of growth came from domestic demand. Private consumption and inventory replenishment both contributed 0.5 percentage point to real growth, as real consumption was up 0.8 percent. Government consumption was also up, advancing 0.7 percent to contribute a further 0.2 percentage point to growth; however, a 0.8-percent decline in euro zone gross fixed capital formation (GFCF) removed 0.2 percentage point from growth. For GFCF, it was the third consecutive annual decline.

The euro zone is not without its problems and the outlook is for a continued gradual and uneven expansion. In 2011, the largest economies in the region (e.g., France, Germany and Spain) will implement measures to reduce their deficits, while other countries that have come under market pressure (e.g., Greece, Ireland and Portugal) will continue with sizable front-loaded consolidation. Additionally, financial systems in Europe remain vulnerable and several key issues need to be addressed. In particular, questions about asset quality remain largely unresolved while some euro zone banks face significant capital shortfalls.

Euro zone real GDP is projected to grow at 1.6 percent in 2011 and 1.8 percent in 2012. However, prospects across the region are divergent, largely reflecting differences in the state of public and private sector balance sheets and the stance of macroeconomic policies.

In particular, growth in Germany is expected to moderate from 3.5 percent last year to 2.5 percent this year and 2.1 percent next year, mainly due to the withdrawal of fiscal support and the slowdown in external demand growth. In France, growth is projected to fall in line with the euro zone average, rising to 1.6 percent this year and 1.8 percent in 2012, as consumption growth is subdued by the retrenchment of fiscal stimulus and export growth is weakened by slowing external demand. In Italy, the recovery is expected to remain weak, as longstanding competitiveness problems constrain export growth and the planned fiscal consolidation weighs on private demand. Growth in Italy is forecast to fall below the euro zone average over the next few years, at 1.1 percent for 2011 and 1.3 percent for the following year. The austerity measures taken in response to the sovereign debt crisis will particularly impact those economies most closely associated with the crisis: Greece is projected to contract by 3.0 percent in 2011; Portugal is also projected to post a decline of 1.5 percent this year; and Ireland and Spain are expected to post modest gains of 0.5 percent and 0.8 percent, respectively.