

PRINCIPLES OF ECONOMICS

Lecture 37: GDP- REAL VS NOMINAL
October, 2015



TOPICS TO BE DISCUSSED

- 1. GDP**
- 2. Real Vs Nominal GDP**
- 3. Rules for Computing GDP**

GDP

Valuation of total quantity of goods and services produced in an economy during one accounting year

$$\text{GDP} = \text{Total Output} \times \text{Market Price}$$

NOMINAL GDP

- Valuation of total production of goods and services produced in an economy during one accounting year at current prices
- Nominal GDP values the production of goods and services at current prices
- Nominal GDP changes if price changes or quantity changes

$$\text{Nominal GDP} = \text{Total Output} \times \text{Current Market Price}$$

REAL GDP

- Valuation of total goods and services produced in an economy during one accounting year at constant prices
- Real GDP values the production of goods and services at the prices of base year
- Real GDP will change only if output changes

$$\text{GDP} = \text{Total Output} \times \text{Market Price of Base Year}$$

REAL Vs NOMINAL GDP

- Nominal GDP is not a true indicator of economic growth- increase in nominal income does not always mean economic growth
- Increase in nominal GDP may be because of inflation (increase in current prices)
- Real income is a better measure of economic growth/wellbeing
- Increase in real GDP means economic growth

CONVERSION OF NOMINAL GDP INTO REAL GDP

Real GDP is calculated as follows:

$$\bullet \text{ Real GDP} = \frac{\text{Nominal GDP}}{\text{GDP Deflator}}$$

GDP Deflator- indicator of overall prices in the economy

GDP deflator measures the price of output relative to its price in the base year

RULES FOR COMPUTING GDP

- GDP includes all goods and services produced in the economy and sold legally in markets
- It does not include illegal production of goods and services, such as illegal drugs and black money
- GDP excludes production that never enter the marketplace
- It excludes services of the housewives
- It excludes windfall gains and second hand goods sale
- It includes imputed value of self owned house

THANK YOU 😊