SECOND SEMESTER (HONS.)

ECO-HC-2016: INTRODUCTORY MACROECONOMICS

Prepared By : Nilakshi Gogoi
Assistant Professor
Department of Economics
North Kamrup College, Baghmara

UNIT-1

Real versus Nominal GDP

When GDP is measured on the basis of current price, it is called GDP at current prices or nominal GDP. On the other hand, when GDP is calculated on the basis of fixed prices in some year, it is called GDP at constant prices or real GDP.

Nominal GDP is the value of goods and services produced in a year and measured in terms of rupees (money) at current (market) prices. In comparing one year with another, the problem that has arisen is that the rupees is not a stable measure of purchasing power. GDP may rise a great deal in a year, not because the economy has been growing rapidly but because of rise in prices (or inflation). On the contrary, GDP may increase as a result of fall in prices in a year but actually it may be less as compared to the last year. In both cases, GDP does not show the real state of the economy. To rectify the underestimation and overestimation of GDP, there is a need of a measure that adjusts for rising and falling prices. This can be done by measuring GDP at constant prices which is called real GDP. To find out the real GDP, a base year is chosen when the general price level is normal, i.e., it is neither too high nor too low. The prices are set to 100 (or 1) in the base year. Now the general price level of the year for which real GDP is to be calculated is related to the base year on the basis of the following formula which is called the **Deflator Index:**

$$\text{Real GDP} = \text{GDP for the Current Year} \times \frac{Base\ Year\ (=100)}{Current\ Year\ Index}$$

Suppose 1990-91 is the base year and GDP for 1999-2000 is Rs. 6,00,000 crores and the price index for this year is 300.

Thus, Real GDP for 1999-2000 = Rs. 6,00,000 x $\frac{100}{300}$ = Rs. 2,00,000 crores