Difference Between Current Price and Constant Price

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Key Difference – Current Price vs Constant Price

GDP based on current price and constant price are two key widely used macroeconomic indicators. Every country calculates both measures due to their differences; they are also widely known as nominal and real GDP, respectively. The relationship between current price and constant price is that GDP constant price is derived from the GDP current price. The key difference between current price and constant price is that **GDP at current price is the GDP unadjusted for the effects of inflation and is at current market prices** whereas **GDP at constant price is the GDP adjusted for the effects of inflation.**

What is Current Price?

GDP at current price is the GDP unadjusted for the effects of inflation; thus this is at current market prices. Another name given for GDP at current price is the **nominal GDP**. GDP (Gross domestic product) is the monetary value of all goods and services produced in a period (quarterly or yearly). In GDP, the output is measured as per geographical location of production. GDP at current price can be calculated using the following formula.

GDP= C + G + I + NX

Where,

C= consumer spending

G= government spending

I= investment

NX= net exports (Exports – Imports)

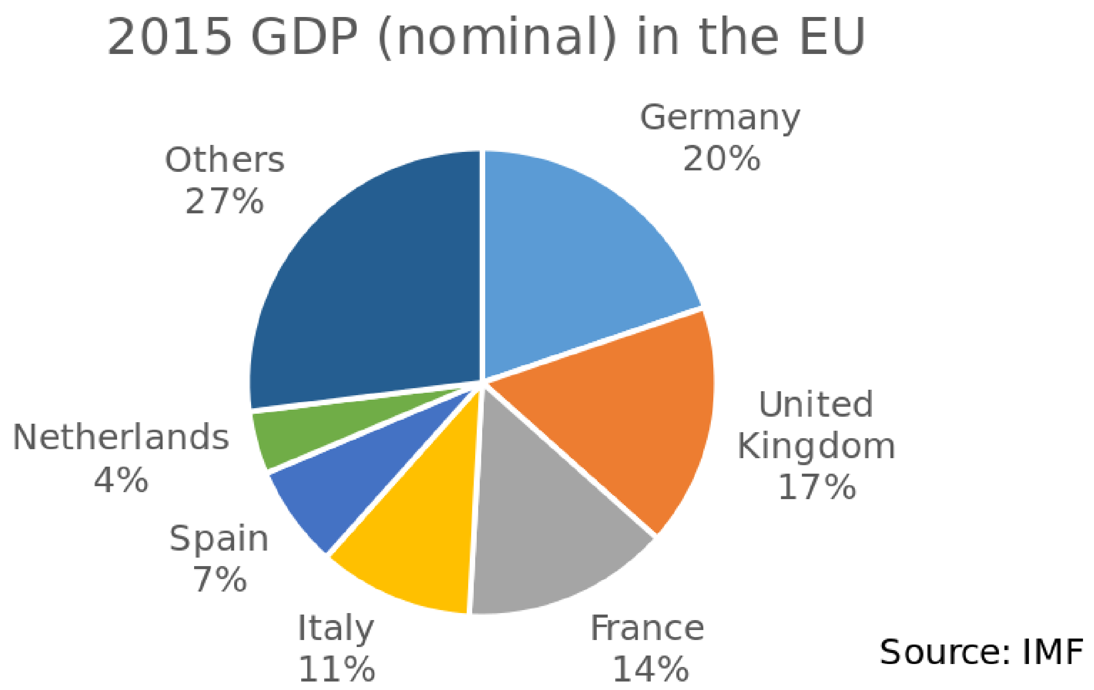

Figure 01: GDP at Current Prices

In a broader economic sense, output, income, and expenditure become equal as one person's expenditure becomes income to another when the goods and services (output) are being transferred. As a result, the below three methods can be used to arrive at GDP at the current price.

Output Method

This method combines the value of the total output produced in all sectors (primary, secondary and tertiary) of the economy, including agriculture, manufacturing and service industries.

Income Method

Income method aggregates all incomes received by the production of goods and services in the economy during a year. Wages and salaries from employment and self-employment, profits from companies, interest to lenders of capital and rents to landowners are included under this method.

Expenditure Method

Expenditure method adds all spending in the economy by households and firms to purchase goods and services.

What is Constant Price?

GDP at constant price is the GDP adjusted for the effects of inflation and known as the **real GDP**. Inflation diminishes the time value of money and reduces the amount of goods and services that can be purchased in the future. Therefore, GDP at constant price is lower than the GDP at the current price.

GDP at constant price is calculated as per below

Real GDP = Nominal GDP/Deflator

Deflator is the measurement of inflation since the base year (a selected previous year where GDP was calculated). The objective of using the deflator is to remove the effects of inflation.

E.g. the real GDP in 2016 is calculated using the prices of 2015 as the base year. The inflation rate is 4% and the nominal GDP of 2016 is $150,000. Thus, the real GDP is,

Real GDP = $ 150,000/1.04

= $ 144, 23.77

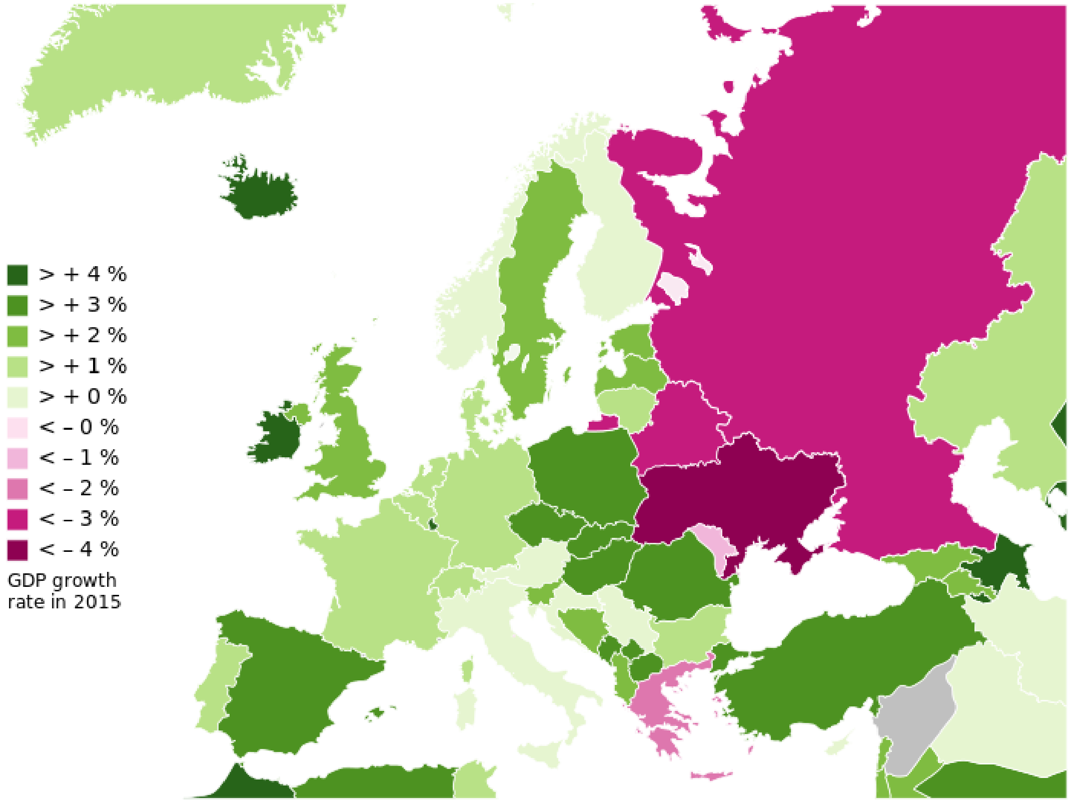

Figure 02: GDP at Constant Prices

GDP at constant price is a more accurate measure of the economic status of a country since inflation degrades the value of money. GDP growth rate and GDP per capita are vital economic indicators that affect a number of decisions taken at a national level, thus it is of utmost importance that these are measured at an accurate level.

What is the difference between Current Price and Constant Price?

Current Price vs Constant Price	
GDP at current price is the GDP unadjusted for the effects of inflation and is at current market prices.	GDP at constant price is the GDP adjusted for the effects of inflation.

Synonyms	
GDP at current price is also referred to as nominal GDP.	GDP at constant price is also referred to as real GDP.
Formula	
GDP at current price is calculated as (GDP= C + G + I + NX).	Formula (Nominal GDP/Deflator) is used to calculate GDP at constant price.
Use	
GDP at current price is not used much since it can be misleading due to the effects of inflation.	GDP at constant price is widely used as a reliable economic measure since it considers the actual increase in economic activity.

Summary – Current Price vs Constant Price

The difference between current price and constant price mainly depends on whether the GDP is calculated based on inflated amounts or whether the effects of inflation have been removed. Growth in GDP at current price does not necessarily mean an increase in economic activity due to rise in price based on inflation. Growth in GDP at constant price addresses this limitation and serves as a better indication of economic growth.

References:

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2. “Europe-real-GDP-growth-2015” By h – Own work (CC BY-SA 4.0) via Commons Wikimedia

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