Difference Between GDP Nominal and GDP PPP

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Key Difference – GDP Nominal vs GDP PPP

Macroeconomic factors are important economic indicators, and GDP nominal and GDP PPP are two key indicators. Out of the two, GDP nominal is the widely used measure, and GDP PPP can be used for selected decision making. The key difference between GDP nominal and GDP PPP is that GDP nominal is the **GDP unadjusted for the effects of inflation and is at current market prices** whereas **GDP PPP is the GDP converted to US dollars using purchasing power parity rates and divided by total population.**

What is GDP Nominal?

GDP nominal is the GDP unadjusted for the effects of inflation; thus it is at current market prices. 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 nominal is greater than the real GDP since the real GDP is arrived at after considering the effects of inflation. Inflation diminishes the time value of money and reduces the amount of goods and services that can be purchased in the future.

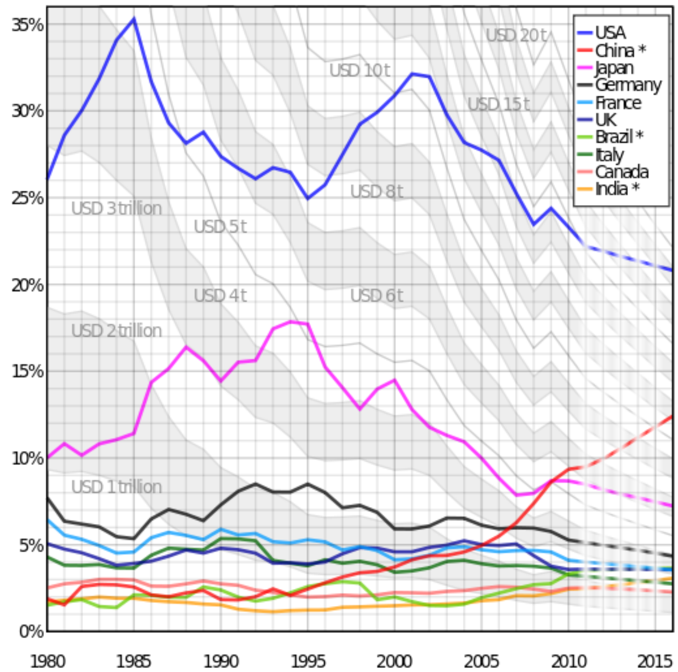

Figure 01: Historical top ten nominal GDP

GDP nominal can be derived using the following methods.

Output Method

Output 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

This adds up 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 aggregates all spending in the economy by households and firms to purchase goods and services.

In a broader economic sense, the values obtained by the above three methods are equal to each other. Therefore, any one of these three methods can be used to measure GDP.

What is GDP PPP?

GDP PPP refers to the GDP converted to US dollars using purchasing power parity rates and divided by total population. Purchasing power parity (PPP) is used to adjust the exchange rate differences among countries. This economic theory states that the exchange rate between two currencies is equal to the ratio of the currencies' respective purchasing power. PPP provides an opportunity to compare countries that have different standards of living by recalculating the value of a country's goods and services as if they were being sold at U.S. prices.

E.g. China and UK has a GDP of $200m and $175m respectively, where the GDP of China is more by $25m. Assuming a basket of goods cost $200 in China and $175 in the UK, 1 million baskets of goods can be purchased in China whereas 1.75 million baskets of goods can be purchased in the UK.

According to the above, a higher GDP does not necessarily make a country richer, the relative purchasing power is important. In order to make price comparisons across countries, a wide range of goods and services must be considered. This is a very exhausting exercise; however, this has been made convenient by the International Comparisons Program (ICP) founded by the United Nations and University of Pennsylvania. ICP generates purchasing power parity rates based on a worldwide price survey that compares the prices of hundreds of various goods. This information can be used to compare countries to arrive at GDP PPP.

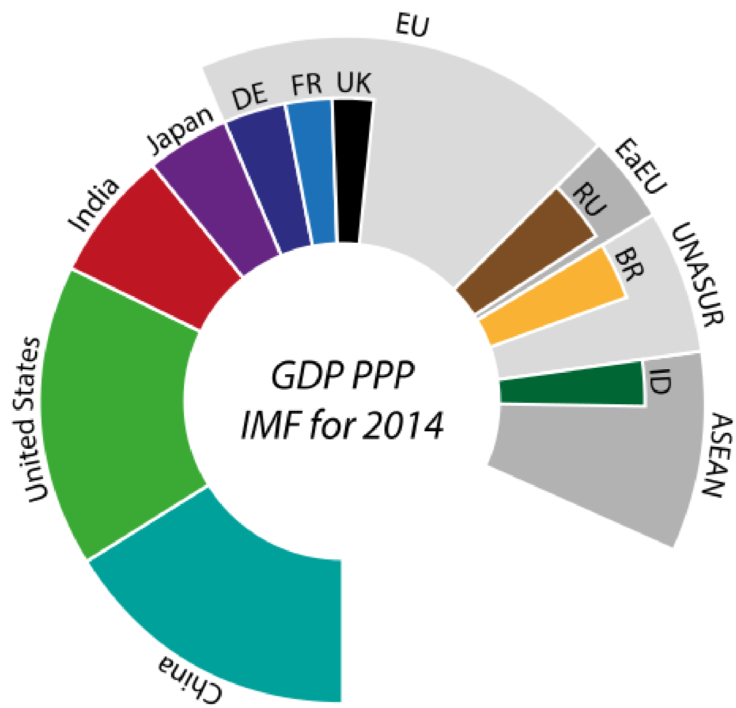

Figure 02: GDP PPP of top ten countries and trade blocks

What is the difference between GDP Nominal and GDP PPP?

GDP Nominal vs GDP PPP	
GDP nominal is the GDP unadjusted for the effects of inflation thus is at current market prices	GDP PPP is the GDP converted to US dollars using purchasing power parity rates and divided by total population
Underlying Concept	
GDP nominal is derived based on the concept of interest rates.	Underlying concept for GDP PPP is differences in exchange rates.
Exchange Rate Variations	
GDP nominal is not adjusted to reflect exchange rate variations among countries	GDP PPP is adjusted to reflect exchange rate variations.

Summary – GDP nominal vs GDP PPP

The difference between GDP nominal and GDP PPP is that GDP nominal reflects the current market prices while GDP PPP is calculated using the concept of purchasing power parity theory. Both these measures assist effective decision making regarding economic growth and other economic conditions that affect countries.

Reference:

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