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- 10 The Circular-Flow Diagram and the National Accounts
- 11 Gross Domestic Product (GDP)



12 Interpreting Real Gross Domestic Product

What GDP Tells Us

- To measure the economy's growth with accuracy, we need a measure of **aggregate output**.
- Aggregate output is the total quantity of final goods and services the economy produces.
- The value of aggregate output for an economy is called GDP.

Real versus Nominal GDP

- **Real GDP** is the total value of the final goods and services produced in the economy during a given year, calculated using the prices of a selected base year.
- **Nominal GDP** is the value of all final goods and services produced in the economy during a given year, calculated using the prices current in the year in which the output is produced.

Calculating Real GDP

TABLE 12-1

Calculating GDP and Real GDP in a Simple Economy

	Year 1	Year 2
Quantity of apples (billions)	2,000	2,200
Price of an apple	\$0.25	\$0.30
Quantity of oranges (billions)	1,000	1,200
Price of an orange	\$0.50	\$0.70
GDP (billions of dollars)	\$1,000	\$1,500
Real GDP (billions of year 1 dollars)	\$1,000	\$1,150

Calculating Real GDP

- Except in the base year, real GDP and nominal GDP are different because they use different prices
- **Chained dollars** is the method of calculating changes in real GDP using the average between the growth rate calculated using an early base year and the growth rate calculated using a late base year

Calculating Real GDP

TABLE 12-2

Nominal versus Real GDP in 2001, 2005, and 2012

	Nominal GDP (billions of current dollars)	Real GDP (billions of 2005 dollars)
2001	\$10,286	\$11,347
2005	12,683	12,638
2012	15,829	13,648

Source: Bureau of Economic Analysis.

What Real GDP Doesn't Measure

- A country can have a higher GDP simply by having a higher population.
- **GDP per capita** is a measure of average GDP per person, but is not by itself an appropriate policy goal.
- Real GDP does not include many of the things that contribute to happiness.

GDP and the Meaning of Life

Percent that say their life is “thriving”

