

## **Answer on Question #44675 – Economics – Macroeconomics**

### **Task:**

Hi, in lecture my professor said that when there is inflation, nominal GDP is greater than real GDP, why is that?

### **Answer:**

The cause of Real GDP being less than Nominal GDP is inflation. Let us say Real GDP was 200 last year and Nominal GDP was also 200. This Year Real GDP is 300 but nominal GDP is 400. So Nominal GDP increases by 100% but Real GDP has increased by 50% only. So how could nominal GDP increase by 100%? The extra 50% increase in Nominal GDP is due to increase in prices of goods and services (inflation).

$$\text{Real GDP} = \text{Nominal GDP} / \text{GDP Price Deflator}$$

So, If prices remain the same, GDP Price Deflator = 1, which means Real GDP and Nominal GDP are equal.

If prices have risen, GDP Price Deflator is greater than 1 and hence Real GDP is less than Nominal GDP.

If prices have fallen, GDP Price Deflator is less than 1 and hence Real GDP is higher than Nominal GDP.