**Gross Domestic Product—GDP**

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**What Is GDP?**

Gross Domestic Product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of the country’s economic health.

Though GDP is usually calculated on an annual basis, it can be calculated on a [quarterly](https://www.investopedia.com/terms/q/quarter.asp) basis as well. In the United States, for example, the government releases an [annualized](https://www.investopedia.com/terms/a/annualize.asp) GDP estimate for each quarter and also for an entire year. Most of the individual data sets will also be given in real terms, meaning that the data is adjusted for price changes, and is, therefore, net of [inflation](https://www.investopedia.com/terms/i/inflation.asp).

**Key Takeaways**

* Gross Domestic Product (GDP) is the monetary value of all finished goods and services made within a country during a specific period.
* GDP provides an economic snapshot of a country, used to estimate the size of an economy and growth rate.
* GDP can be calculated in three ways, using expenditures, production, or incomes. It can be adjusted for inflation and population to provide deeper insights.
* Though it has limitations, GDP is a key tool to guide policymakers, investors, and businesses in strategic decision making.

**The Basics of GDP**

GDP includes all private and public consumption, government outlays, investments, additions to private inventories, paid-in construction costs, and the foreign [balance of trade](https://www.investopedia.com/terms/b/bot.asp) ([exports](https://www.investopedia.com/terms/e/export.asp) are added, [imports](https://www.investopedia.com/terms/i/import.asp) are subtracted).

There are several types of GDP measurements:

* **Nominal GDP** is the measurement of the raw data.
* **Real GDP** takes into account the impact of inflation and allows comparisons of economic output from one year to the next and other comparisons over periods of time.
* **GDP growth rate** is the increase in GDP from quarter to quarter.
* **GDP per capita** measures GDP per person in the national populace; it is a useful way to compare GDP data between various countries.

The balance of trade is one of the key components of a country's (GDP) formula. GDP increases when the total value of goods and services that domestic producers sell to foreigners exceeds the total value of foreign goods and services that domestic consumers buy, otherwise known as a [trade surplus](https://www.investopedia.com/terms/t/trade-surplus.asp). If domestic consumers spend more on foreign products than domestic producers sell to foreign consumers —[a trade deficit](https://www.investopedia.com/ask/answers/trade-deficit-effects-on-stock-market/)—then GDP decreases.

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**What Is GDP?**

**GDP's Significance**

**Calculating GDP**

GDP can be determined via three primary methods. All, when correctly calculated, should yield the same figure. These three approaches are often termed the expenditure approach, the output (or production) approach, and the income approach.

**GDP Formula Based on Spending**

The expenditure approach, also known as[s](https://www.investopedia.com/terms/n/netexports.asp)[pending approach,](https://www.investopedia.com/terms/e/expenditure-method.asp) calculates the spending by the different groups that participate in the economy. This approach can be calculated using the following formula: **GDP = C + G + I + NX**, or (consumption + government spending + investment + net exports). All these activities contribute to the GDP of a country. The U.S. GDP is primarily measured based on the expenditure approach.

The **C** is private consumption expenditures or [consumer spending](https://www.investopedia.com/terms/c/consumer-spending.asp). Consumers spend money to buy consumption goods and services, such as groceries and haircuts. Consumer spending is the biggest component of GDP, accounting for more than two-thirds of the U.S. GDP. Consumer confidence, therefore, has a very significant bearing on [economic growth](https://www.investopedia.com/ask/answers/032415/what-are-some-ways-economic-growth-can-be-achieved.asp). A high confidence level indicates that consumers are willing to spend, while a low confidence level reflects uncertainty about the future and an unwillingness to spend.

The **G** represents government consumption expenditure and gross investment. Governments spend money on equipment, infrastructure, and payroll. Government spending assumes particular importance as a component of GDP when consumer spending and business investment both decline sharply, as, for instance, after a recession.

The **I** is for private domestic investment or [capital expenditures](https://www.investopedia.com/terms/c/capitalexpenditure.asp). Businesses spend money to invest in their business activities (buying machinery, for instance). Business investment is a critical component of GDP since it increases productive capacity and boosts employment.

**NX** is net exports, calculated as total exports minus total imports (**NX = Exports - Imports**). Goods and services that an economy makes that are exported to other countries, less the imports that are brought in, are [net exports](https://www.investopedia.com/terms/n/netexports.asp). A [current account](https://www.investopedia.com/terms/c/currentaccount.asp) surplus boosts a nation’s GDP, while a chronic deficit is a drag on GDP. All expenditures by companies located in the country, even if they are foreign companies, are included in the calculation.

**GDP Based on Production**

The production approach is something like the reverse of the expenditure approach. Instead of measuring input costs that feed economic activity, the production approach estimates the total value of economic output and deducts costs of [intermediate goods](https://www.investopedia.com/terms/i/intermediate-good.asp) that are consumed in the process, like those of materials and services. The expenditure approach projects forward from costs; the production approach looks backward from the vantage of a state of completed economic activity.

**GDP Based on Income**

Considering that the other side of the spending coin is income, and since your expense is somebody else’s income, another approach to calculating GDP—something of an intermediary between the two other approaches—is the income approach. Income earned by all the [factors of production](https://www.investopedia.com/terms/f/factors-production.asp) in an economy includes the wages paid to labor, the rent earned by land, the return on capital in the form of interest, as well as corporate profits.

The income approach factors in some adjustments for some items that don’t show up in these payments made to factors of production. For one, there are some taxes—such as [sales taxes](https://www.investopedia.com/terms/s/salestax.asp) and [property taxes](https://www.investopedia.com/terms/p/propertytax.asp)—that are classified as indirect business taxes. In addition, [depreciation](https://www.investopedia.com/terms/d/depreciation.asp), which is a reserve that businesses set aside to account for the replacement of equipment that tends to wear down with use, is also added to the national income. All this constitutes national income, which is used both as an indicator of implied production and of implied expenditure.

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