What does it mean by GDP?

Many professions commonly use abbreviations and acronyms. To engineers, lawyers, and photographers, abbreviations such as NASA (National Aeronautics and Space Administration), ADR (Alternative Dispute Resolution), and FF (Full Frame), respectively, need no explanation. However, to someone unfamiliar with these fields these initials are meaningless without an explanation.

Like other professions, economics is full of such abbreviations and acronyms. One of the common terms used abbreviation in economics is GDP which stands for Gross Domestic Product. The word is widely used in the media, business community and government publications in relation to measuring the health of the economy.

In simple terms, GDP is a measure of the net value of all final goods and services in monetary terms produced within the borders of a country in a given period of time. It is a measure of the new economic value created in a country in a specific period (mostly a quarter or a year). Compilation of GDP is usually done through three different perspectives: by adding up the output of goods and services *less* intermediate consumption (production approach), accounting for the income to factors of production (income approach) and tracking final spending by households a, government and non-profit institutions serving households, investment and the net exports (exports-imports). Estimates compiled using the various approaches are confronted with each to ascertain the differences in order to establish the veracity of the estimates.

Approaches to GDP

The **production approach** calculates GDP by summing the value of all goods and services produced in the economy. It focuses on the output generated by various sectors such as agriculture, manufacturing, and services. This approach is one of the main approaches used in the compilation of GDP in Kenya. The approach is used to compile quarterly GDP as presented in KNBS's Quarterly GDP Reports as part of the Bureau's Statistical Releases. The approach is also used to compile annual GDP at the end of the calendar year, as presented in Chapter 2 of the *Economic Survey* series in the Bureau's Publications.

There is need to introduce the formula/identity

$$
\begin{aligned}
GDP(P) = \; & \text{Output at basic prices} \\
& - \text{Intermediate consumption} \\
& + \text{Taxes on products} \\
& - \text{Subsidies on products}
\end{aligned}
$$

The **expenditure approach** tracks total spending on the nation's final goods and services. It includes consumption by households (HHs) and non-profit institutions serving households (NPISH), investment, government spending, and net exports (exports minus imports). This is the second approach used in compiling the annual GDP in Kenya for the calendar year, also presented in Chapter 2 of the *Economic Survey* series in the Bureau's Publications.

GDP(E) = Final Consumption Expenditures (HHs, NPISH, Government)
+ Gross Fixed Capital Formation
+ Changes in Inventories
+ Exports of goods & services - Imports of goods & services

The **income approach** measures GDP by adding up all incomes earned by individuals and businesses, including wages, profits, rents, and taxes minus subsidies. It provides insight into how income is distributed among different groups within the economy. GDP by income approach is usually derived from the other two approaches, as presented in Chapter 2, Tables 2.13 and 2.14 of the *Economic Survey* series in the Bureau's Publications.

GDP(I) = Compensation of employees
+ Gross Operating surplus/Gross Mixed Income
+ Taxes less subsidies on production and imports

Real GDP, what does it mean?

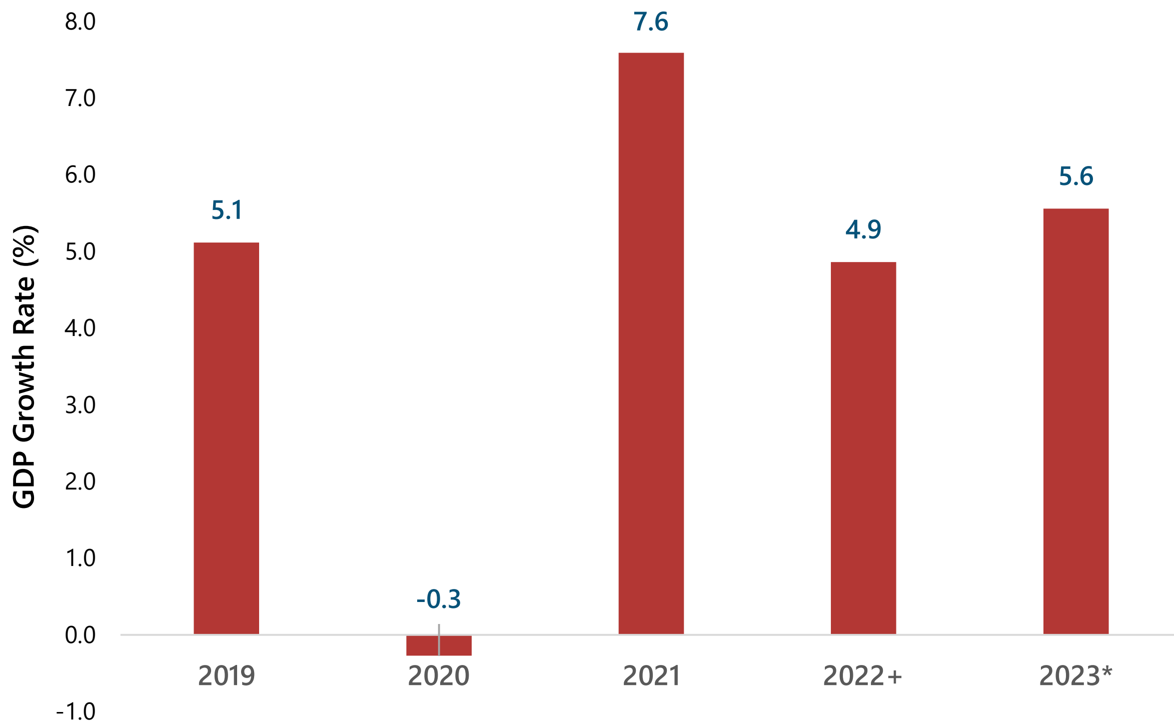

Figure showing the annual real GDP growth rates in Kenya in the last 5 years, Economic Survey 2024

GDP is always used when people want to know whether the economy is growing or contracting by comparing two periods. Since GDP is usually collected at current prices, a comparison between two periods at this point may not give a true picture of the economy. The true picture can only be achieved after making adjustments for inflation (rate of price increase over a given period of time). An adjusted GDP to account for price changes is what is referred to as "real GDP". A statistical tool known as a price deflator is used to adjust GDP at current prices to the real GDP.

Generally, an increase in real GDP is interpreted to mean that the economy is doing well. When real GDP is growing, it points to a bigger cake in real terms and in the long term can translate to improvement in the wellbeing of the populace if measures to mitigate rise in inequality are implemented.

Real GDP growth rate, what does it mean?

Real GDP growth rate, usually expressed in percentages, shows the changes in real GDP from one year to the next. A positive growth rate will, therefore, imply that the volume of goods and services produced valued using prices of a fixed year (base year) has risen quantitatively compared to the preceding period. A negative growth rate (often referred to as contraction), on the other hand, implies that real GDP has declined in the current period compared to the immediate previous period.

The Bottom Line

A positive growth rate means that the economy is growing by the said percentage. The higher the growth rate, the faster the economic growth. However, a high growth rate does not necessarily mean that the size of the economy has become large but shows the quantitative changes between two periods. Large economies tend to report relatively low growth rates due to their size of their economies compared to those with smaller economies. For instance, in 2022, Kenya's real GDP growth rate was 4.9%, and the real GDP was about US$74,365 million. The USA's economy, on the other hand, grew by 1.9%, with a real GDP of about US$25.44 trillion in the same period.