Purchasing Power Parity Formula

Purchasing power parity or PPP is an economic indicator that refers to the purchasing power of the currencies of various nations of the world against each other.

In other words, the ideology behind the purchasing power parity is that the exchange rate of the countries should be on par with each other, so that it allows a consumer to buy the same amount of goods and services for the same price across the globe.

For example a smartphone costing around ₹ 3000 in India would be costing around $40 in USA if exchange rate is considered as ₹75 for $1.

Purchasing power parity is one of the most important macroeconomic metrics that are used by economists in determining the economic productivity and living standards of a country.

PPP is based on the law of one price, which states that identical goods will be having the same price.

The purchasing power parity formula can be expressed as

$S = P1 / P2$

Where,

S = Exchange rate of one currency 1 to currency 2

$P1$ = Cost of a good in currency 1

$P2$ = Cost of the same good in currency 2