

Supply and demand

LECTURE: 2

Demand, Supply and Markets

- ✓ Buyers determine *demand* and Sellers determine *supply*.
- The terms supply and demand refer to the behavior of people ... as they interact with one another in markets;
- ✓ A market is a group of buyers and sellers of particular good or service.
- ✓ The market price of a good or service is determined by both the supply and demand for it.

What is Market?

An actual or nominal place where forces of demand and supply operate, and where buyers and sellers interact (directly or through intermediaries) to trade goods, services, or contracts or instruments, for money or barter.

Markets include mechanisms or means for determining price of the traded item, communicating the price information, facilitating deals and transactions, and effecting distribution. The market for a particular item is made up of existing and potential customers who need it and have the ability and willingness to pay for it.

What is Demand?

The power to purchase a good along with willingness to purchase it; If a consumer holds one of them Demand does not exist

The quantity of a good that potential purchasers would buy or attempt to buy, at a certain price

Demand refers to the consumption behavior of buyers in the market.

Demand also means the willingness to pay of consumers at various prices and quantities.

“Demand is the representation of the various amounts of a product that consumers are willing and able to purchase at each of a series of possible prices during a specific period of time”

Demand Schedule and Demand Curve

DEMAND SCHEDULE

A list showing the quantity of a good that consumers would choose to purchase at different prices, with all other variables held constant

DEMAND CURVE

Graphically shows the relationship between the price of a good and the quantity demanded, holding constant all other variables that influence demand

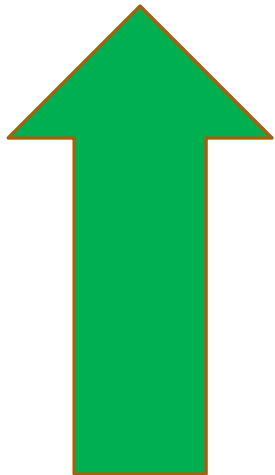
The Law of Demand

Quantity demanded rises as price falls, other things held constant (such as income or the prices of competitive products).

Quantity demanded falls as prices rise, other things constant.

Therefore, there is an inverse or negative relationship between price and quantity demanded.

When price
goes up...



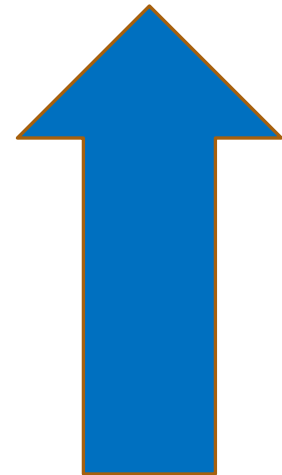
Demand
goes down...



When price
goes down...



Demand
goes up...



The Demand Curve

The slope tells us that quantity demanded varies indirectly—in the opposite direction—with price.

The slope of the demand curve is negative because the relationship between price and quantity is inverse.

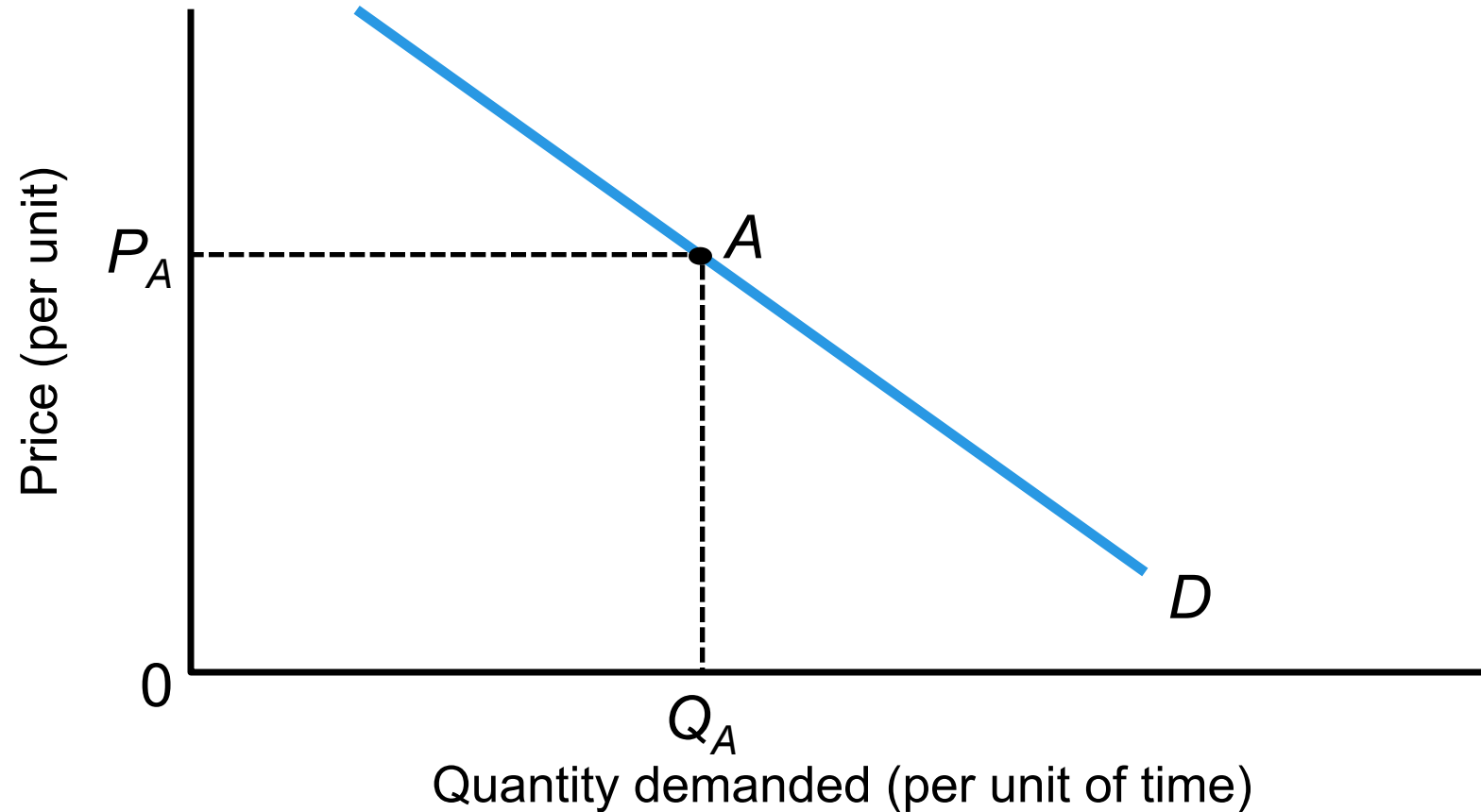
A simple equation of demand in slope-intercept form is

$$Q_d = a - mP$$

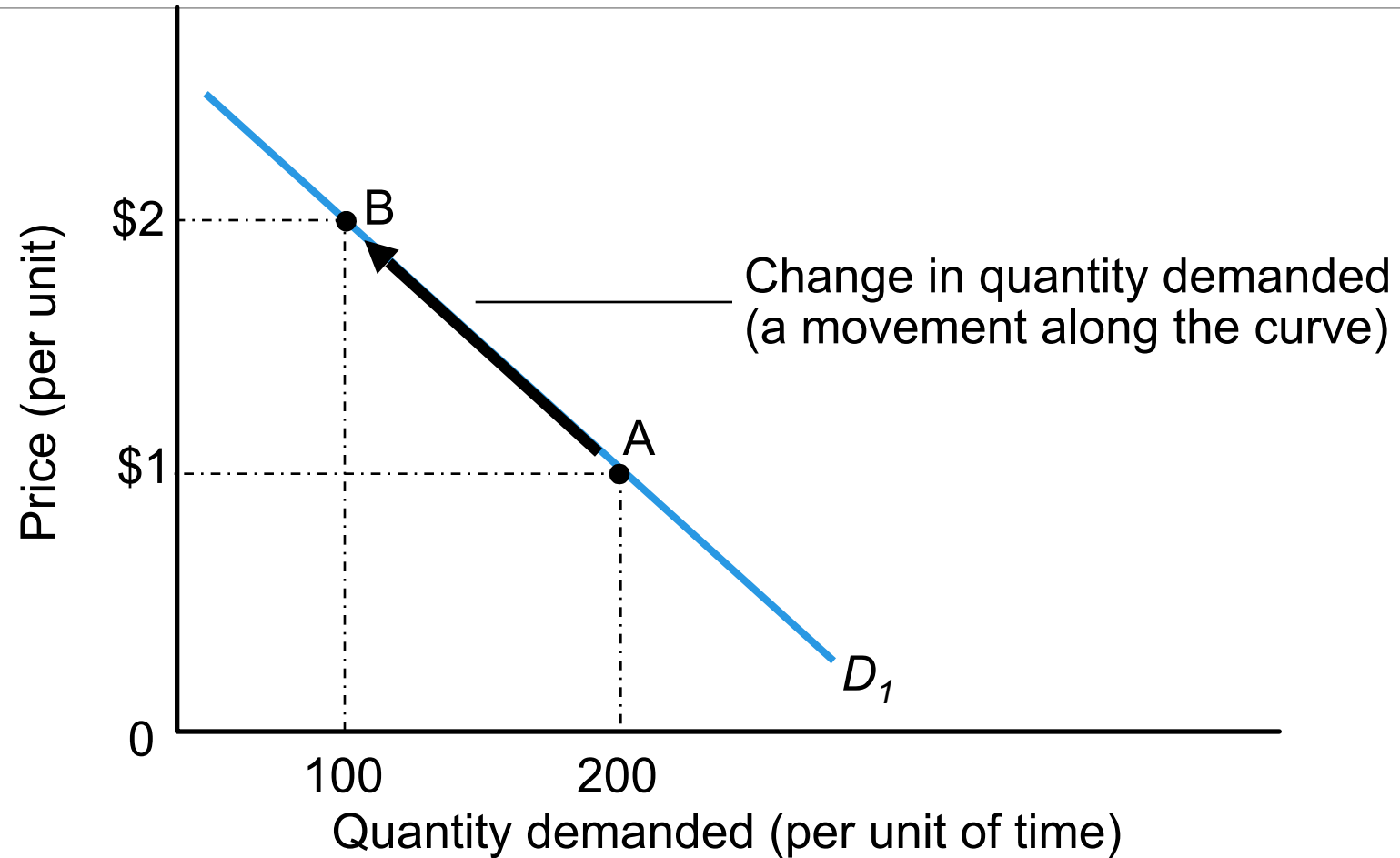


Slope is negative

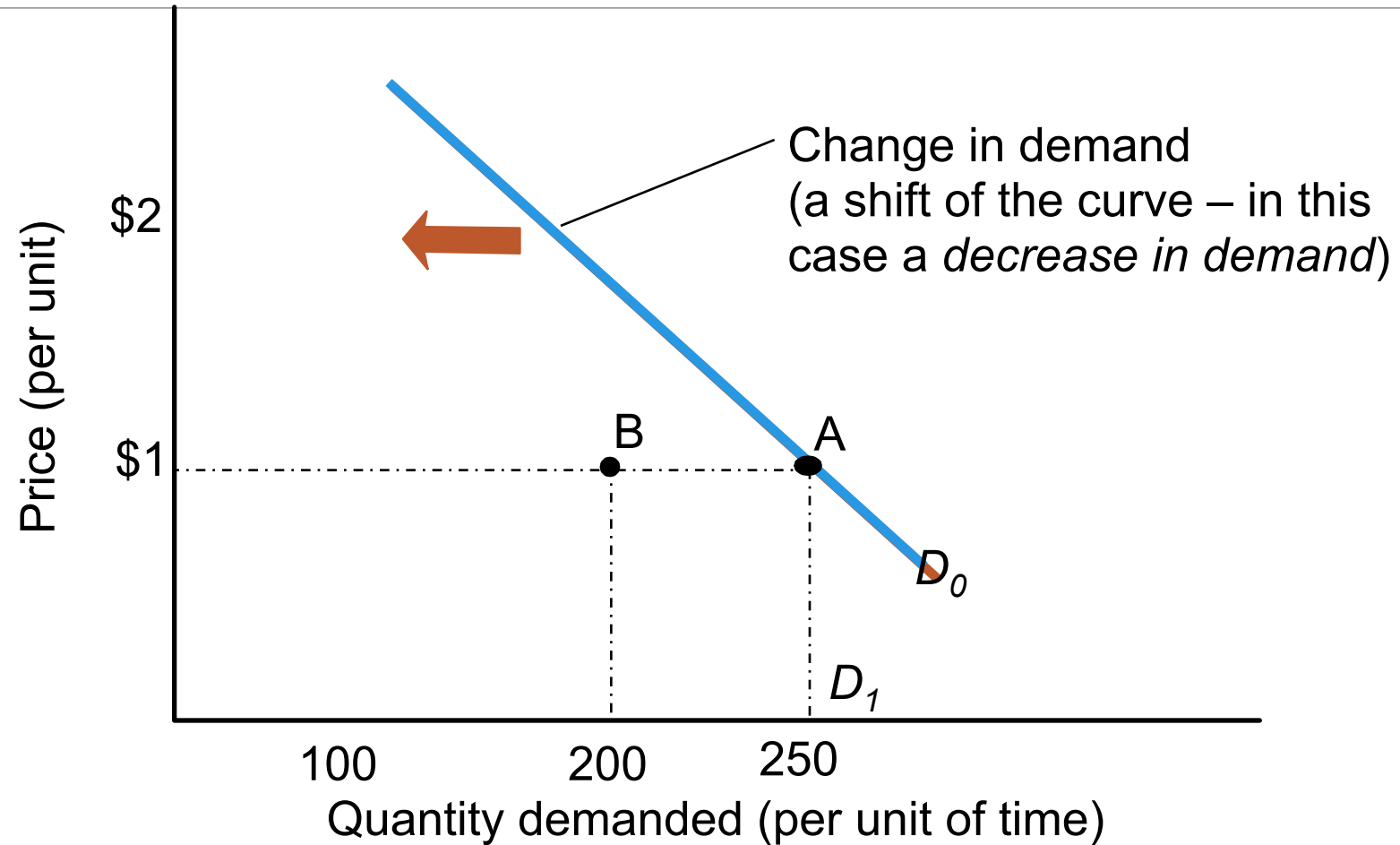
A Sample Demand Curve



Change in Quantity Demanded



Shift in Demand



The demand table

The demand table assumes all the following:

As price rises, quantity demanded declines.

Quantity demanded has a specific time dimension to it.

All the products involved are identical in shape, size, quality, etc.

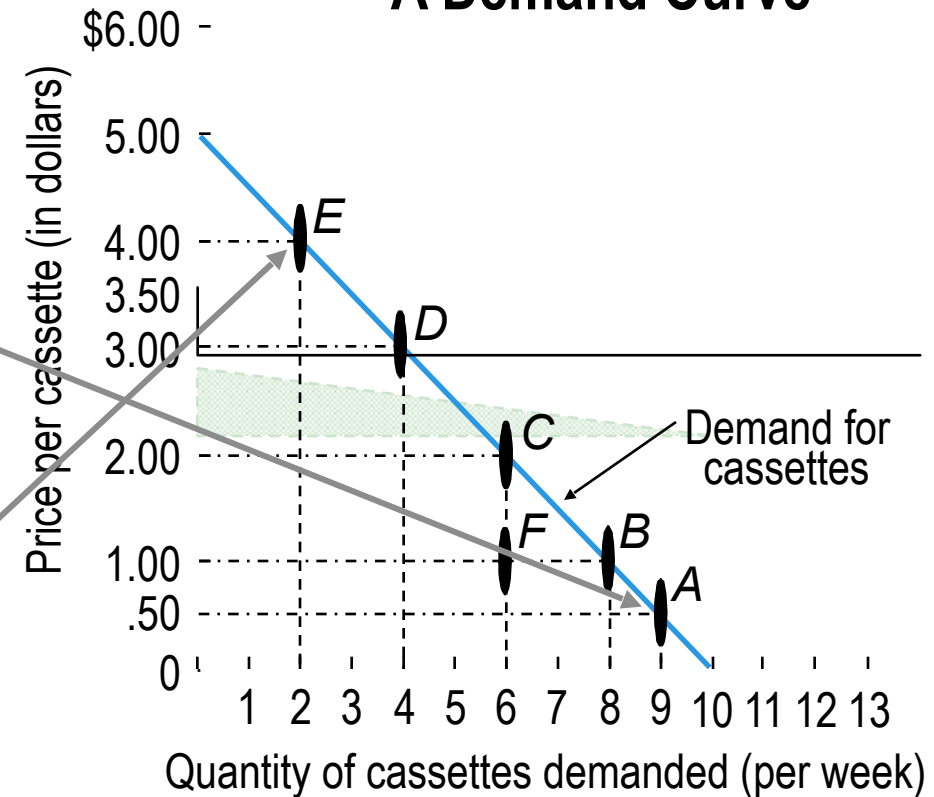
The schedule assumes that everything else is held constant.

From a Demand Table to a Demand Curve

A Demand Table

	Price per cassette	Cassette rentals demanded per week
A	\$0.50	9
B	1.00	8
C	2.00	6
D	3.00	4
E	4.00	2

A Demand Curve



Demand determinantes

Price of the good

Price of related goods [substitutes and complements]

The size of household income

Taste and fashion

Expectation

The distribution of income among households

Number of Buyers

What is Supply?

Quantity of output brought for sale in the market at a certain price

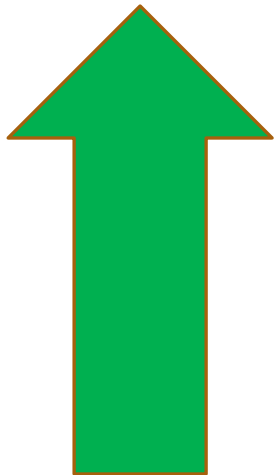
The amount of a good producers would want to produce and sell at a specific price

The Law of Supply

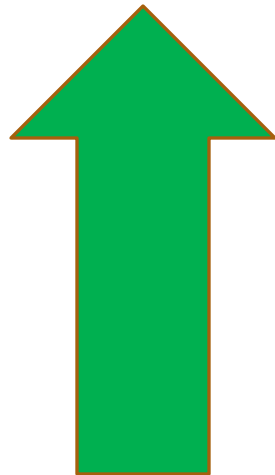
Explains the fundamental characteristic of supply “All else equal, as price rises, the quantity supplied rises, as price fall the quantity supplied falls”

Positive or direct relationship between the quantity supplied and the price

When price
goes up...



Supply
goes up...



When price
goes down...



Supply
goes down...



The Supply Curve

The supply curve is the graphic representation of the law of supply.

The supply curve slopes upward to the right.

The slope tells us that the quantity supplied varies directly—in the same direction—with the price.

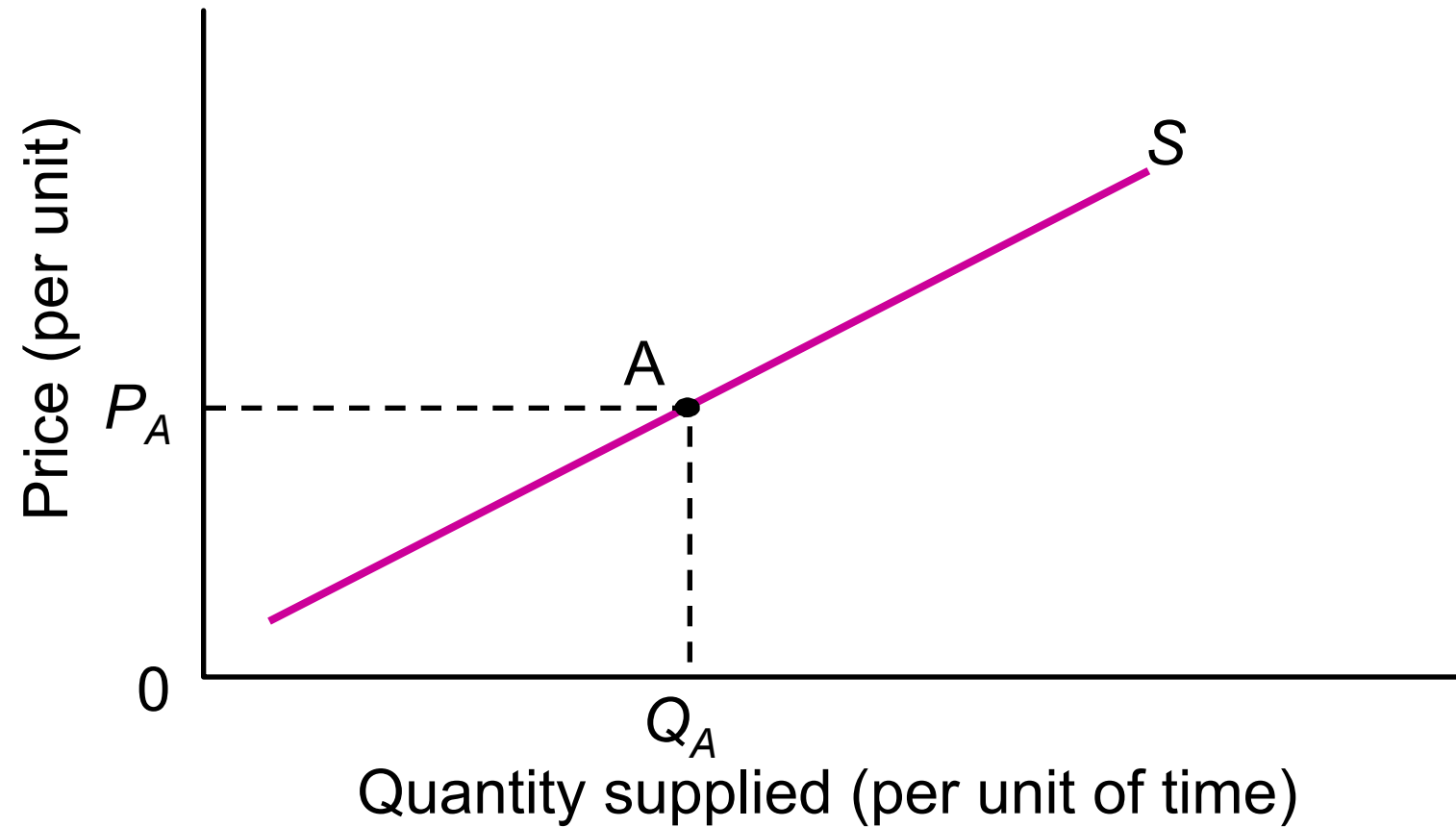
A simple equation of supply is

$$Q_s = a + mP$$

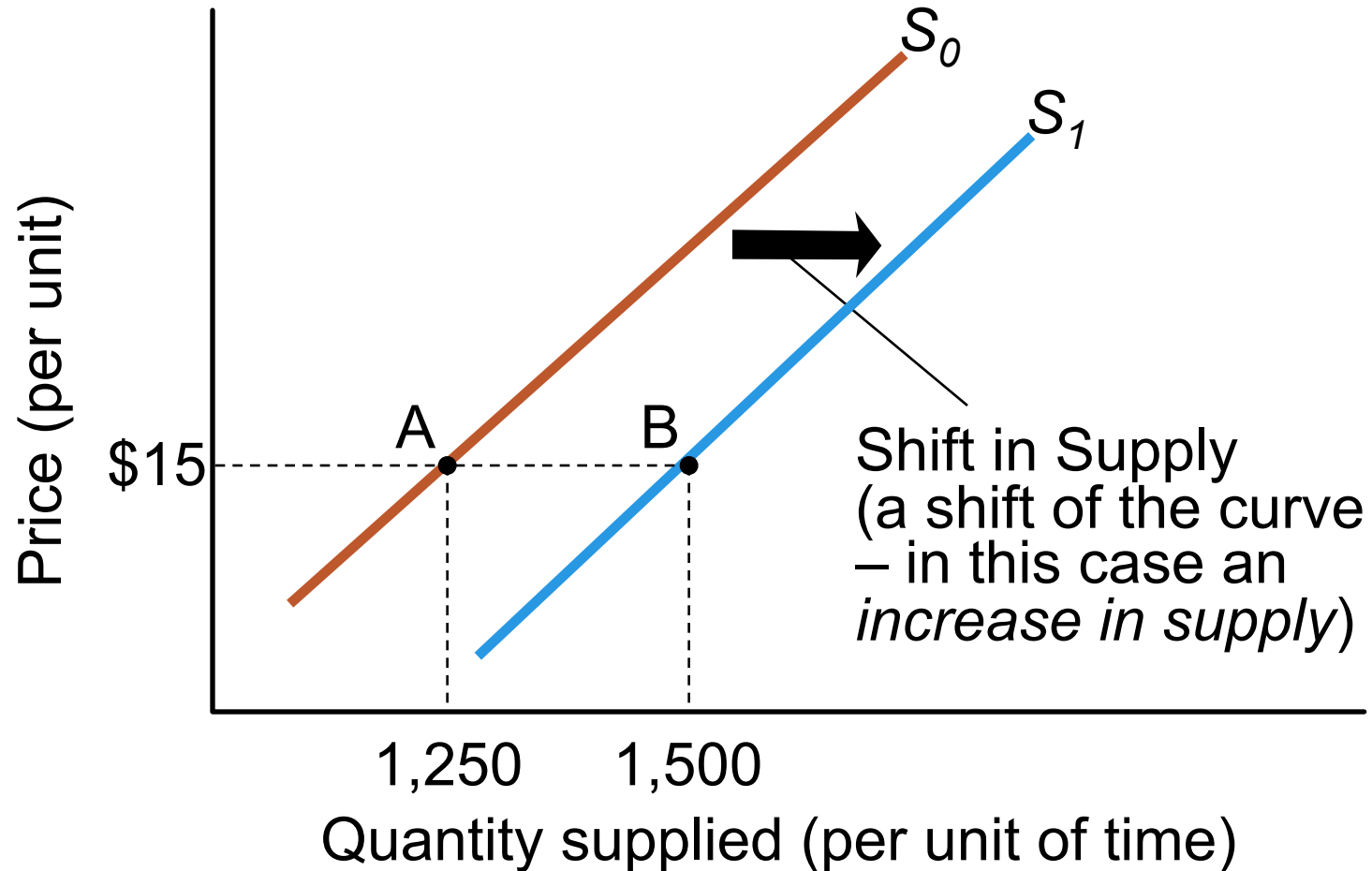


Slope is positive

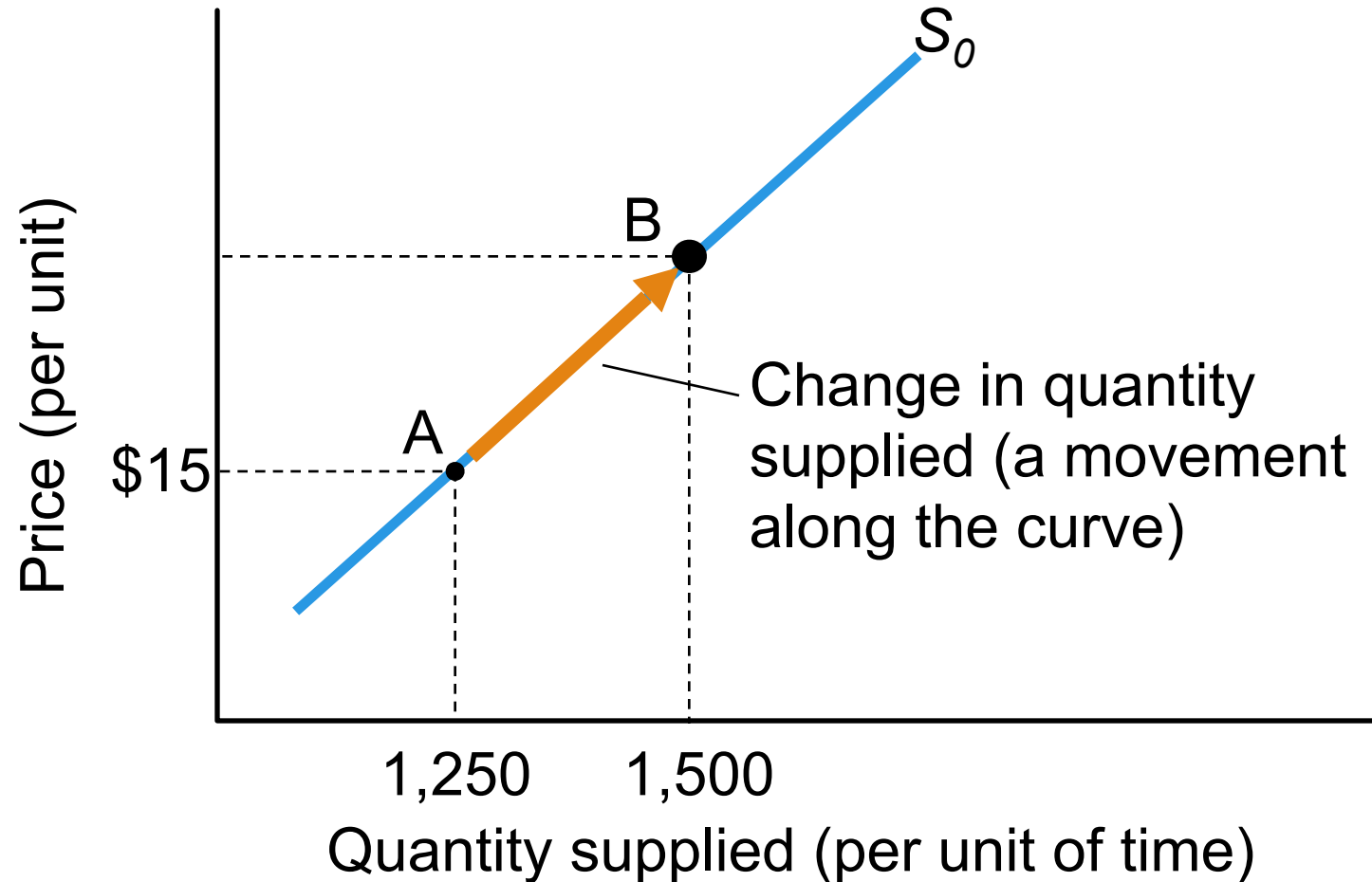
A Sample Supply Curve



Shift in Supply



Change in Quantity Supplied



Supply determinantes

Price of the good

Resource Prices

Technology

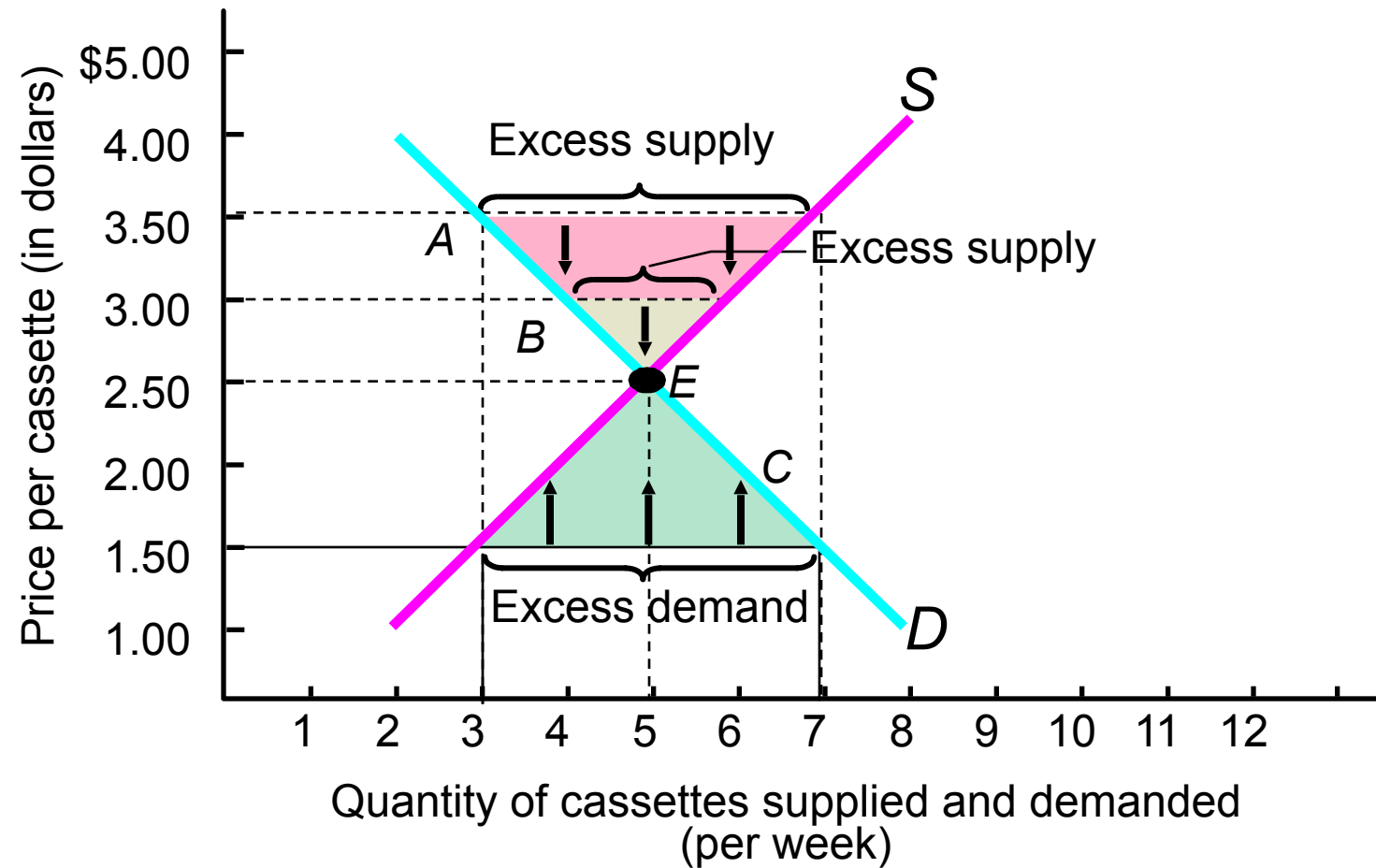
Taxes and subsidies

Price of Other Goods

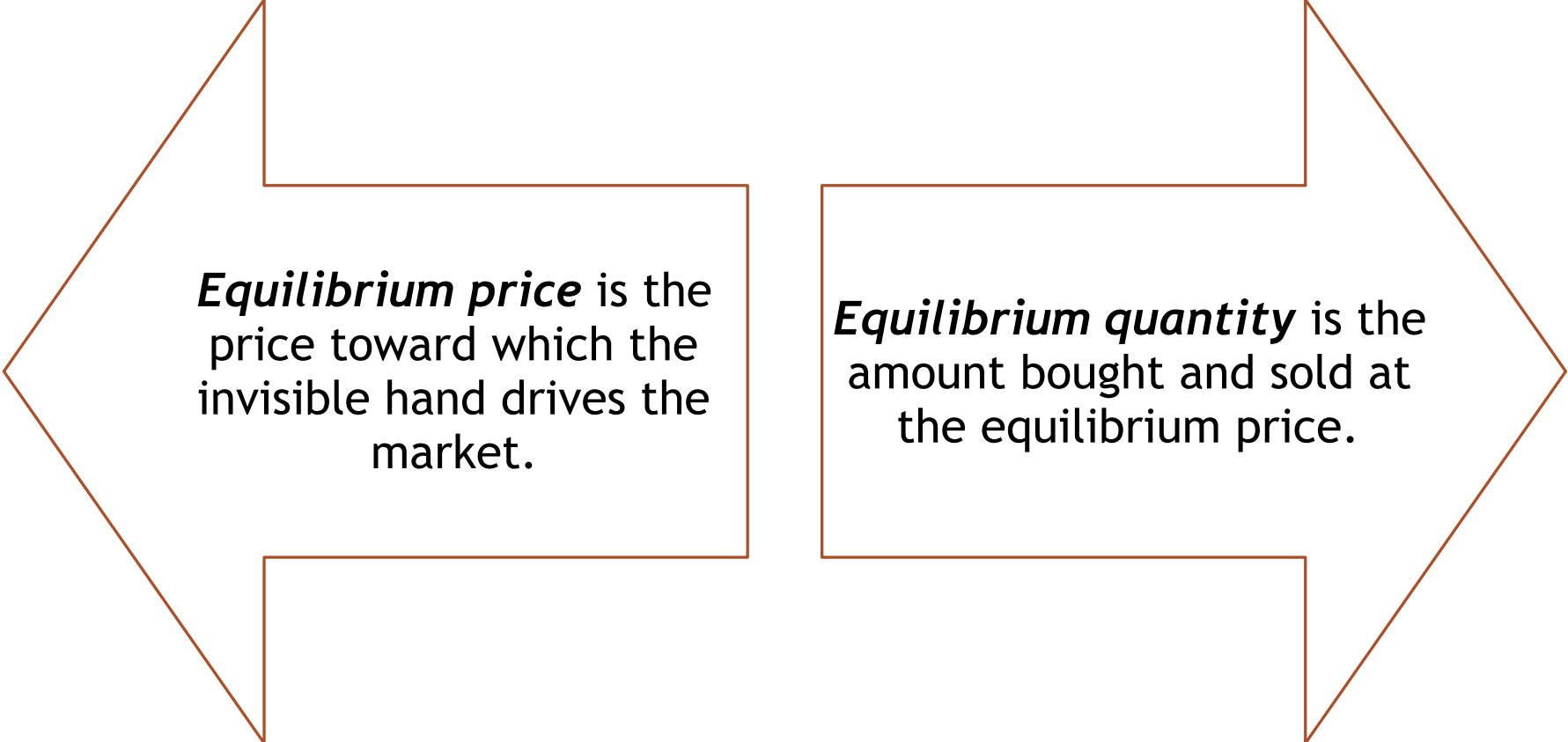
Expectations

Number of Sellers

“The Marriage of Supply and Demand” Equilibrium



Equilibrium



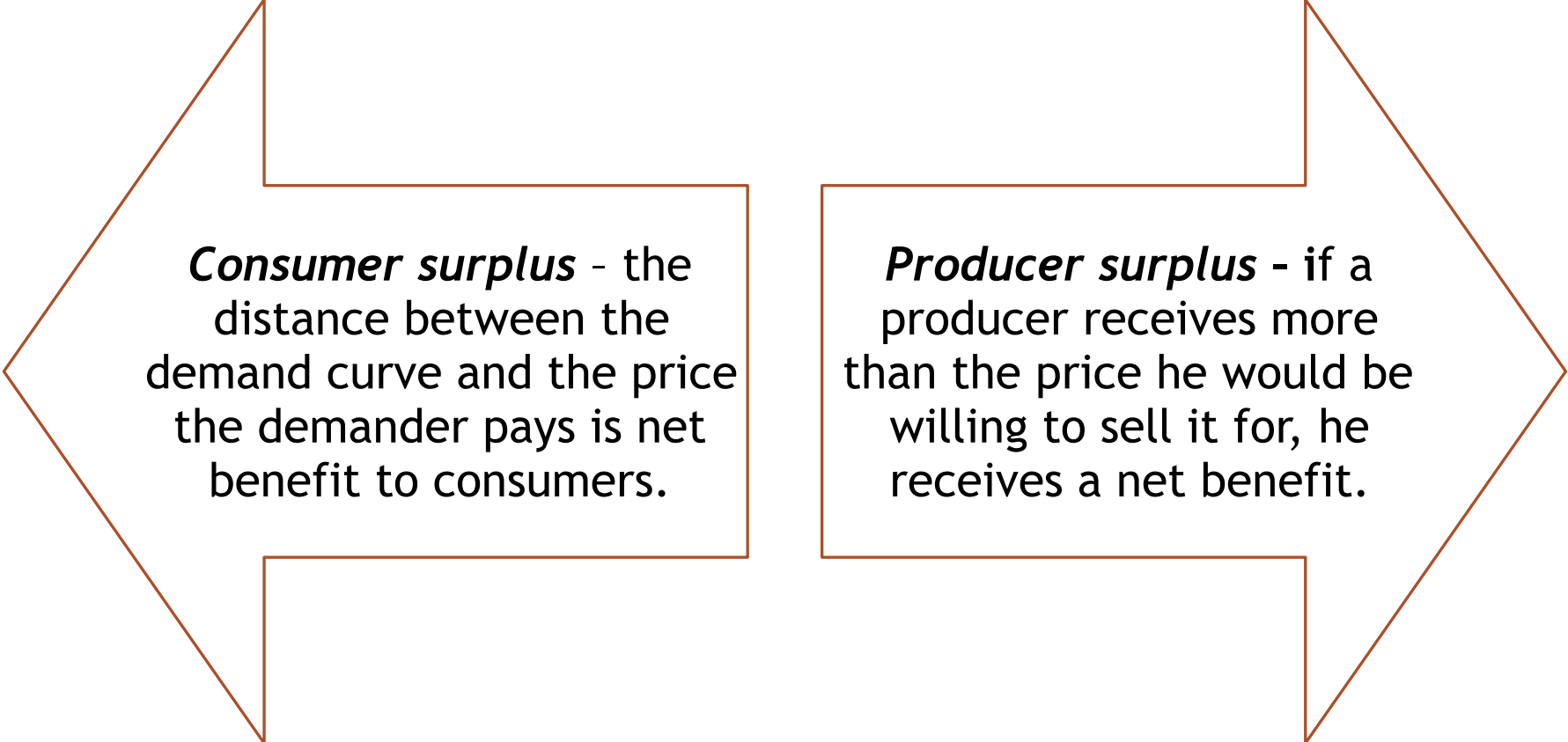
Equilibrium price is the price toward which the invisible hand drives the market.

Equilibrium quantity is the amount bought and sold at the equilibrium price.

Equilibrium is not...

- A state of the world—it is a characteristic of the *static model* we use to examine the world.
- Neither good or bad—but simply a *state* in which dynamic pressures offset each other.
- Equilibrium exists at a particular moment in time.

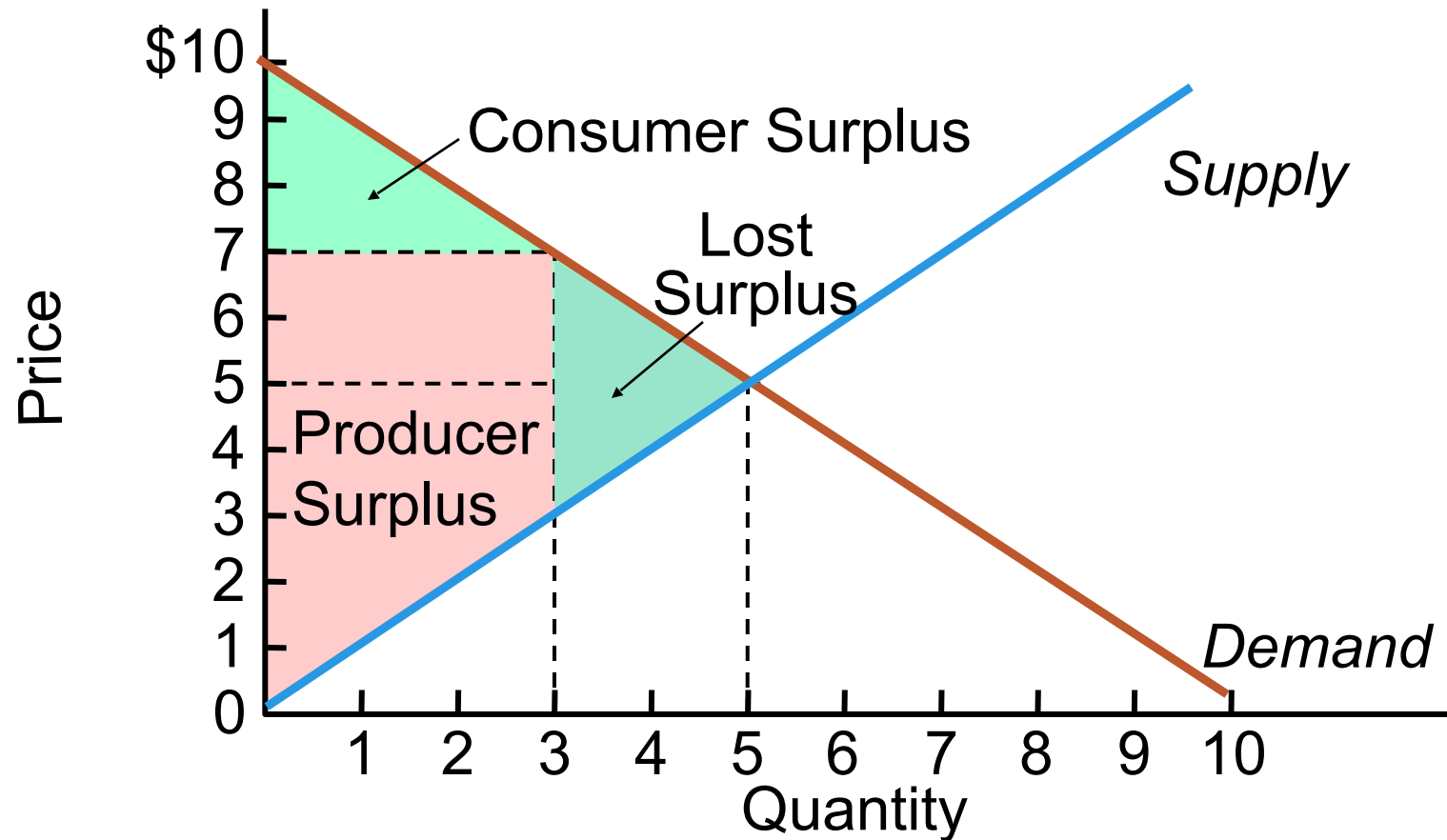
Desirable Characteristics of Supply/ Demand Equilibrium



Consumer surplus - the distance between the demand curve and the price the demander pays is net benefit to consumers.

Producer surplus - if a producer receives more than the price he would be willing to sell it for, he receives a net benefit.

Consumer and Producer Surplus



According to an old quip, even a parrot can become an economist simply by learning to say “supply and demand.” These last two chapters should have convinced you that there is much truth in this statement. The tools of supply and demand allow you to analyze many of the most important events and policies that shape the economy. You are now well on your way to becoming an economist (or at least a well-educated parrot).

THANKS FOR YOUR ATTENTION!