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Demand, Supply and Price Determination

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DEMAND

➤ Demand and its Determinants:

➤ A General Definition:

Demand is the quantity of a good or resource that buyers (or demanders) are willing and able to buy under a given set of *conditions* over a given period of time.

➤ **Conditions:** price, income, taste, prices of related goods, expected prices, number of buyers, etc.



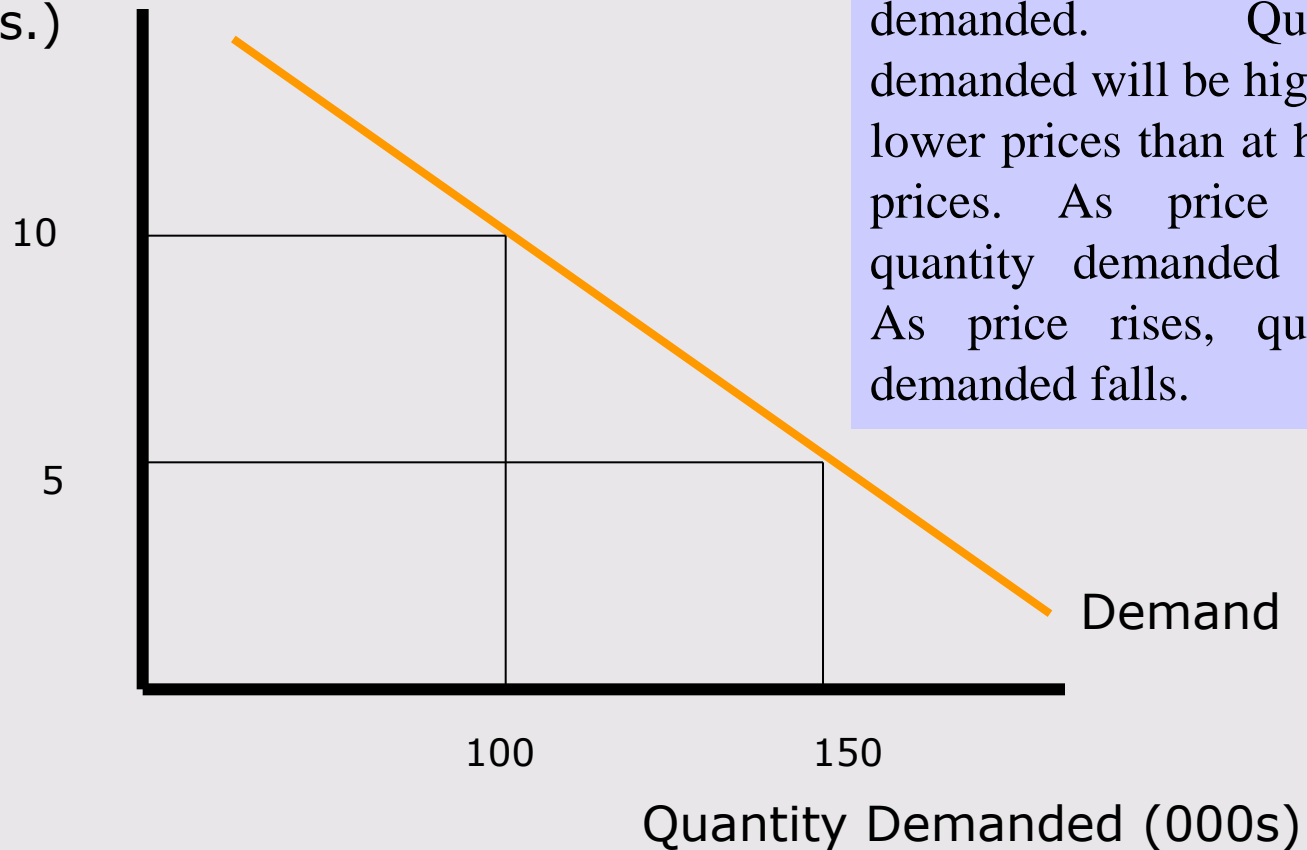
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The Demand Curve

The demand curve slopes downwards from left to right (a negative slope) indicating an inverse relationship between price and the quantity demanded. Quantity demanded will be higher at lower prices than at higher prices. As price falls, quantity demanded rises. As price rises, quantity demanded falls.

Price (Rs.)





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Factors Influencing demand

$$D = f (P_n, P_{n-1}, \dots, P_{n-1}, Y, T, P, A, E)$$

Where: P_n = Price

- P_{n-1}, \dots, P_{n-1} = Prices of other goods – substitutes
- and complements
- Y = Incomes
- T = Tastes and fashions
- P = The level and structure of the population
- A = Advertising
- E = Expectations of consumers



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The Demand Curve

- Changes in any of the factors **other than price** causes the demand curve to shift either:
 - **Left** (Less demanded at each price) or
 - **Right** (More demanded at each price)



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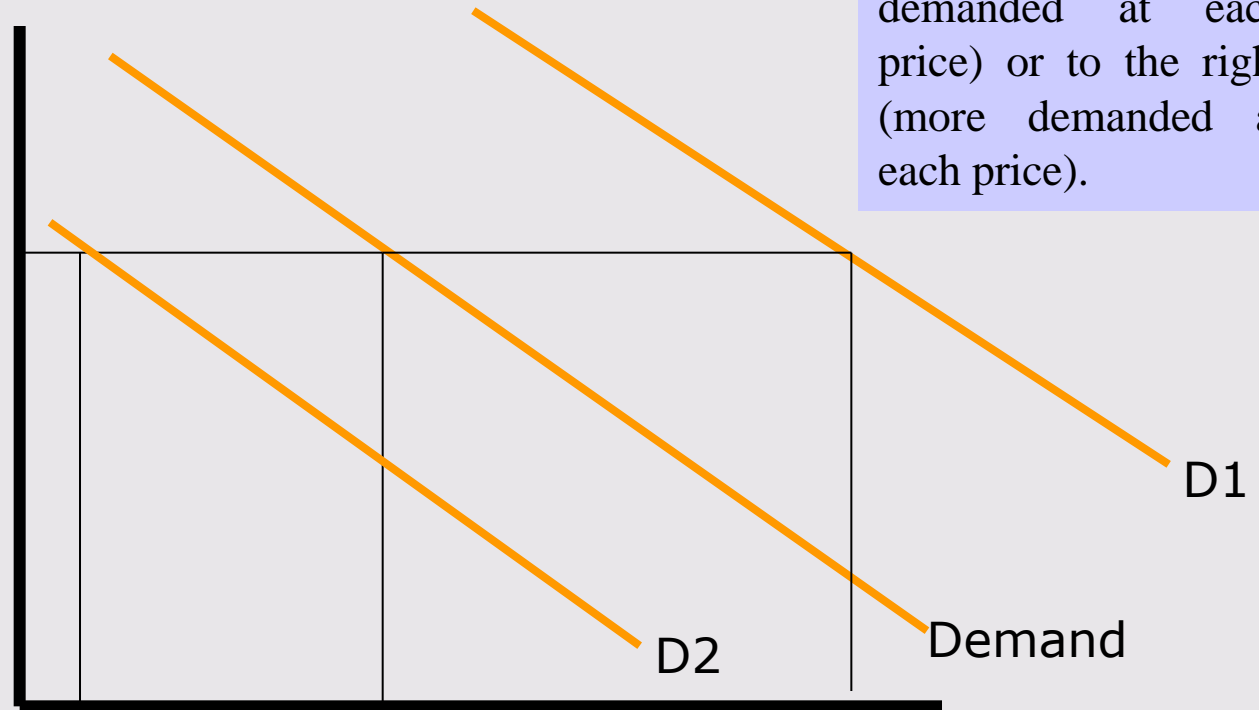
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Shifts in Demand Curve

Changes in any of the factors affecting demand *other than price* cause the entire demand curve to shift to the left (less demanded at each price) or to the right (more demanded at each price).

Price (Rs)

10



10

100

200

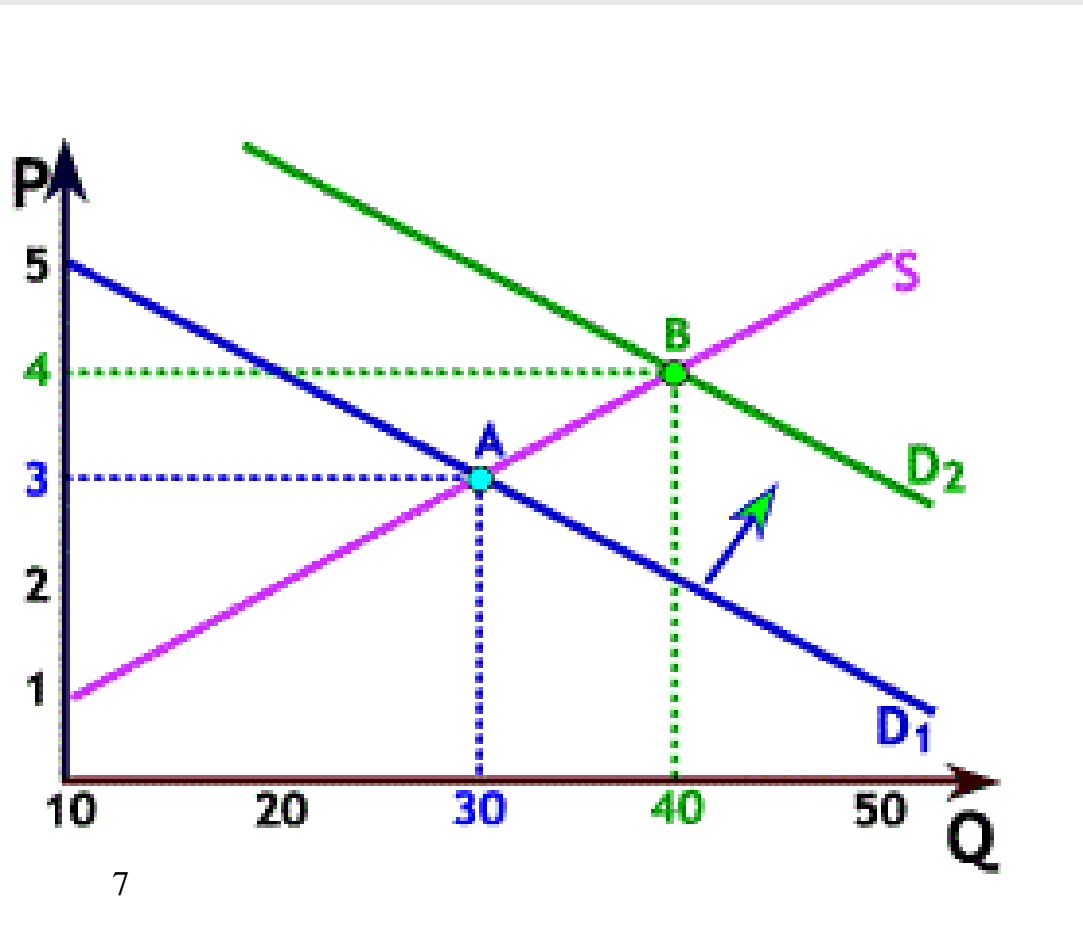
Quantity Demanded (000s)



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A Shift in the demand curve changes the equilibrium position





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Supply

Supply is the quantity of a good or resource that sellers (or suppliers) are willing and able to offer to the market for sale under a given set of conditions over a specific period of time.



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Determinants of Supply

- Price
- Prices of inputs, technology
- Prices of related goods
- Taxes
- Expectations
- Number of firms, etc.



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Supply Curve

- A supply curve shows the relationship between price and quantity supplied only
- All (other) factors affecting supply are assumed to remain unchanged along a supply curve.

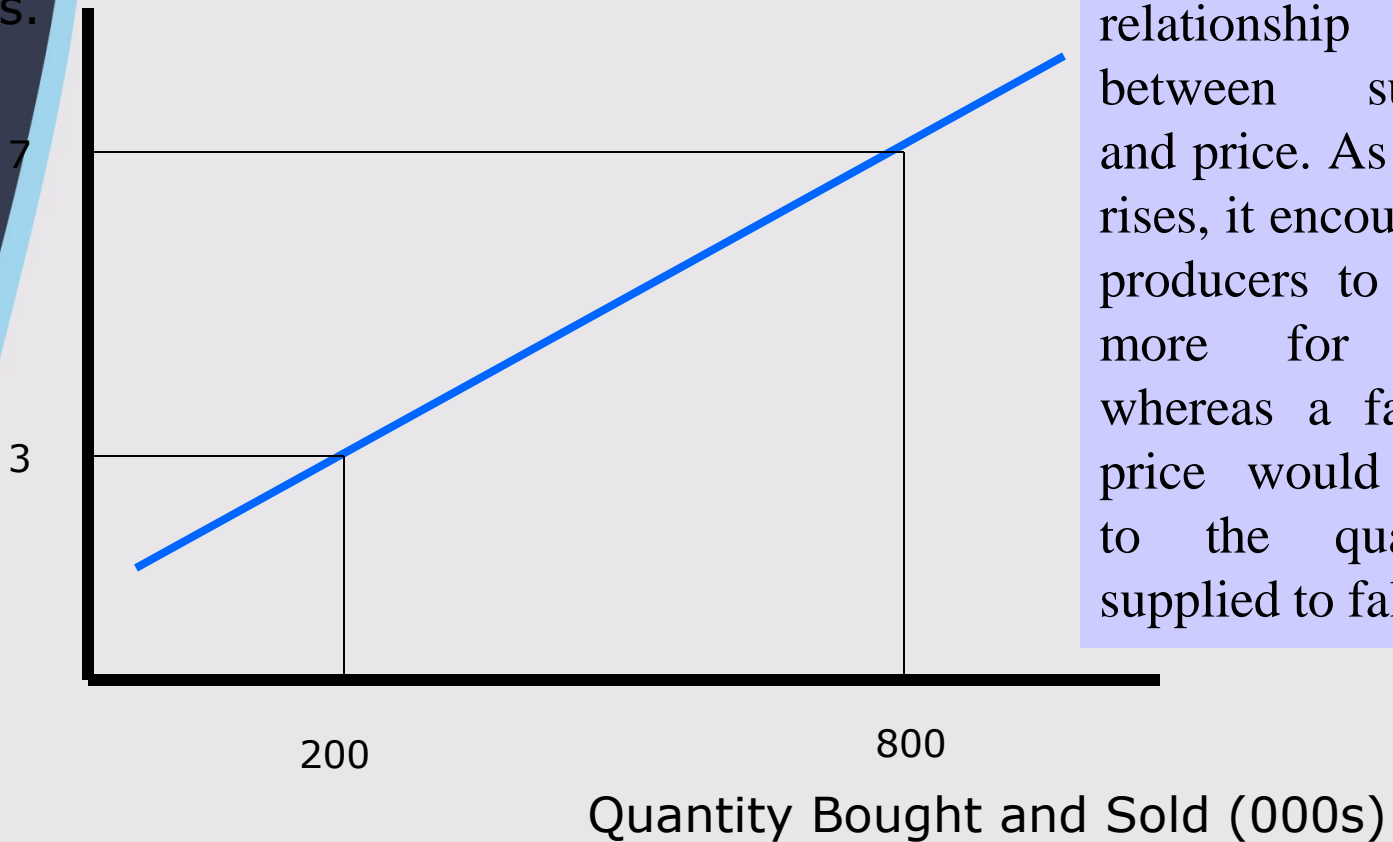


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The Supply Curve

The supply curve slopes upwards from left to right indicating a positive relationship between supply and price. As price rises, it encourages producers to offer more for sale whereas a fall in price would lead to the quantity supplied to fall.





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Factors Influencing Supply

Factors influencing supply:

$$S = f (P_n, P_{n..}P_{n-1}, H, F_1..F_m, E, Sp)$$

Where:

P_n = Price

$P_{n..}P_{n-1}$ = Profitability/attractiveness of other goods
in production

H = Technology

$F_1..F_m$ = Costs of production

I = Industrial disputes

S = Seasons

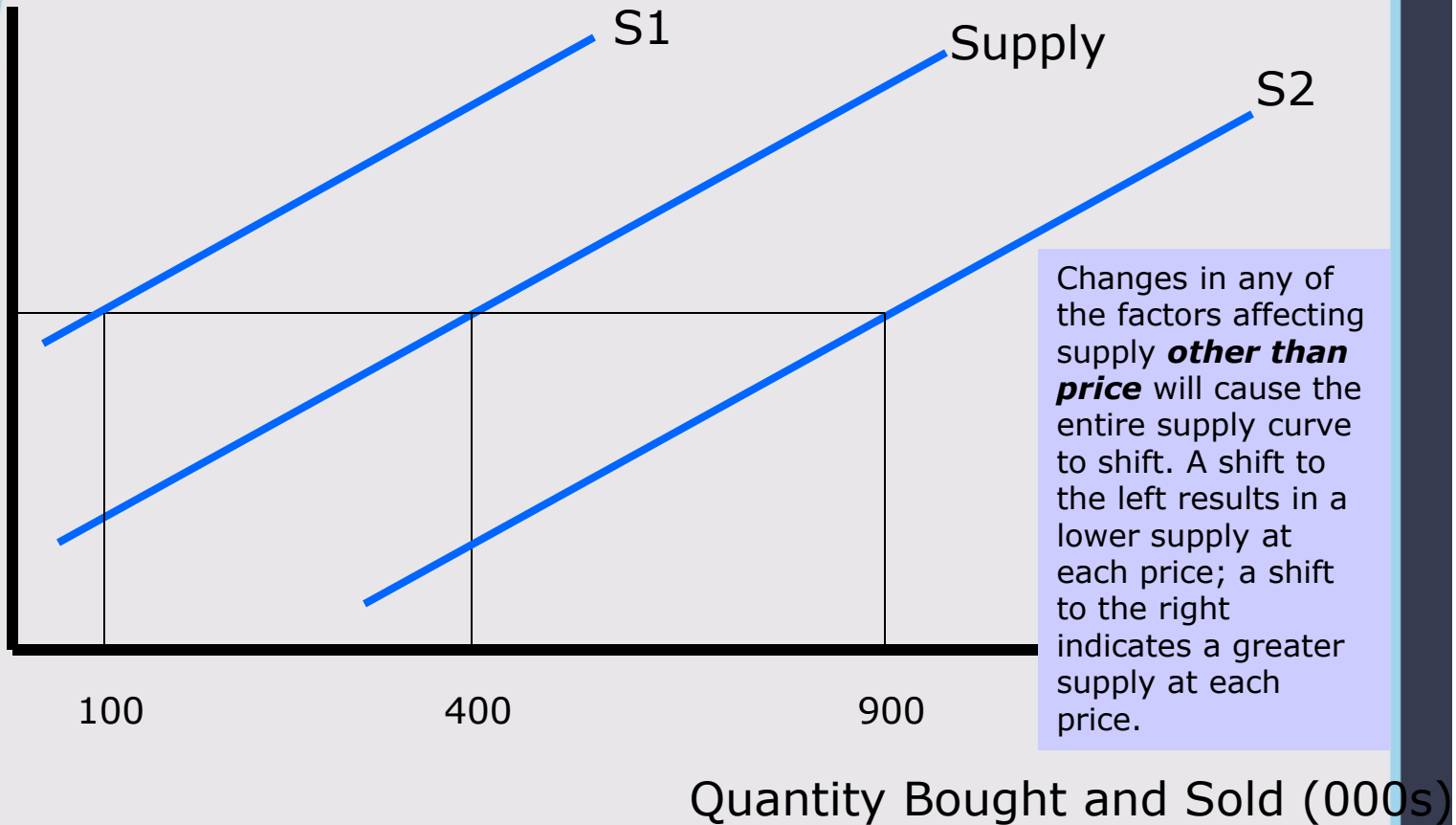


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Price Rs.

Shifts in Supply Curve.





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The Market

- Market equilibrium is determined by the intersection of demand curve and supply curve
- What may be shortage in relation to demand and supply in an equilibrium market.
- **Show it graphically**
- What may be 'surplus' in relation to demand and supply in an equilibrium market.
- **Show it graphically**



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Equilibrium

In economics, an *equilibrium* is a situation in which:

- ✓ there is no tendency to change,
- ✓ quantity demanded equals quantity supplied, and
- ✓ the market just clears.

TABLE 1

Music Album Equilibrium

Price	Quantity Demanded	Quantity Supplied
500	10	50
400	20	40
300	30	30
200	40	20
100	50	10



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Continued

TABLE 1
Music Album Equilibrium

Price	Quantity Demanded	Quantity Supplied
500	10	50
400	20	40
300	30	30
200	40	20
100	50	10



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A Shift versus a Movement Along a Demand Curve

TABLE 2
Change in Demand for
Albums after Incomes Rise

Price	Initial Quantity Demanded	New Quantity Demanded	Quantity Supplied
500	10	30	50
400	20	40	40
300	30	50	30
200	40	60	20
100	50	70	10

Suppose that incomes in a community rise because a factory is able to give employees overtime pay.



A Shift versus a Movement Along a Demand Curve

TABLE 3
Change in Demand for Albums after Incomes Rise

Price	Initial Quantity Demanded	New Quantity Demanded	Quantity Supplied
500	10	30	50
400	20	40	40
300	30	50	30
200	40	60	20
100	50	70	10

Suppose that incomes in a community rise because a factory is able to give employees overtime pay.

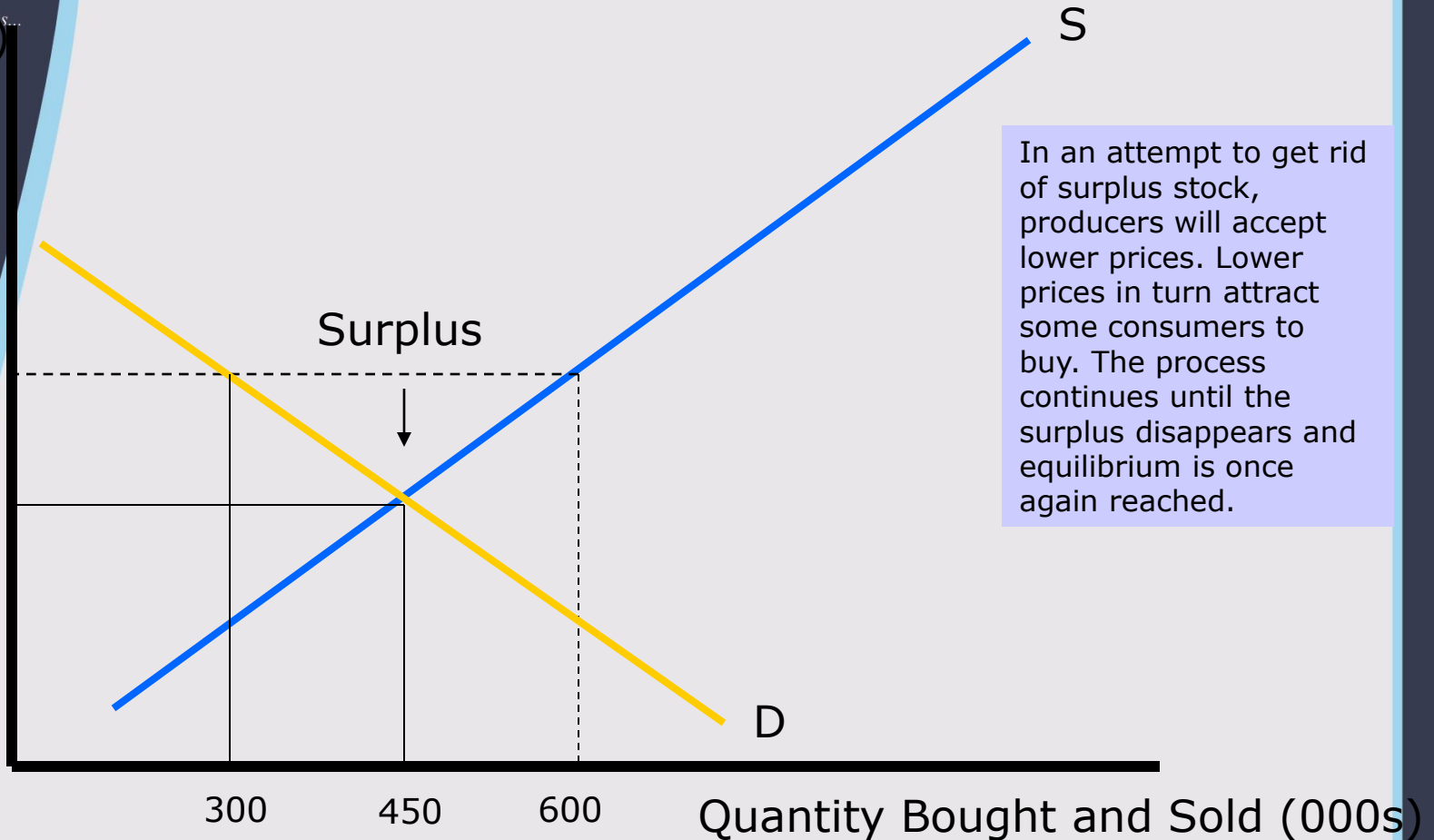


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Price (Rs)

The Market

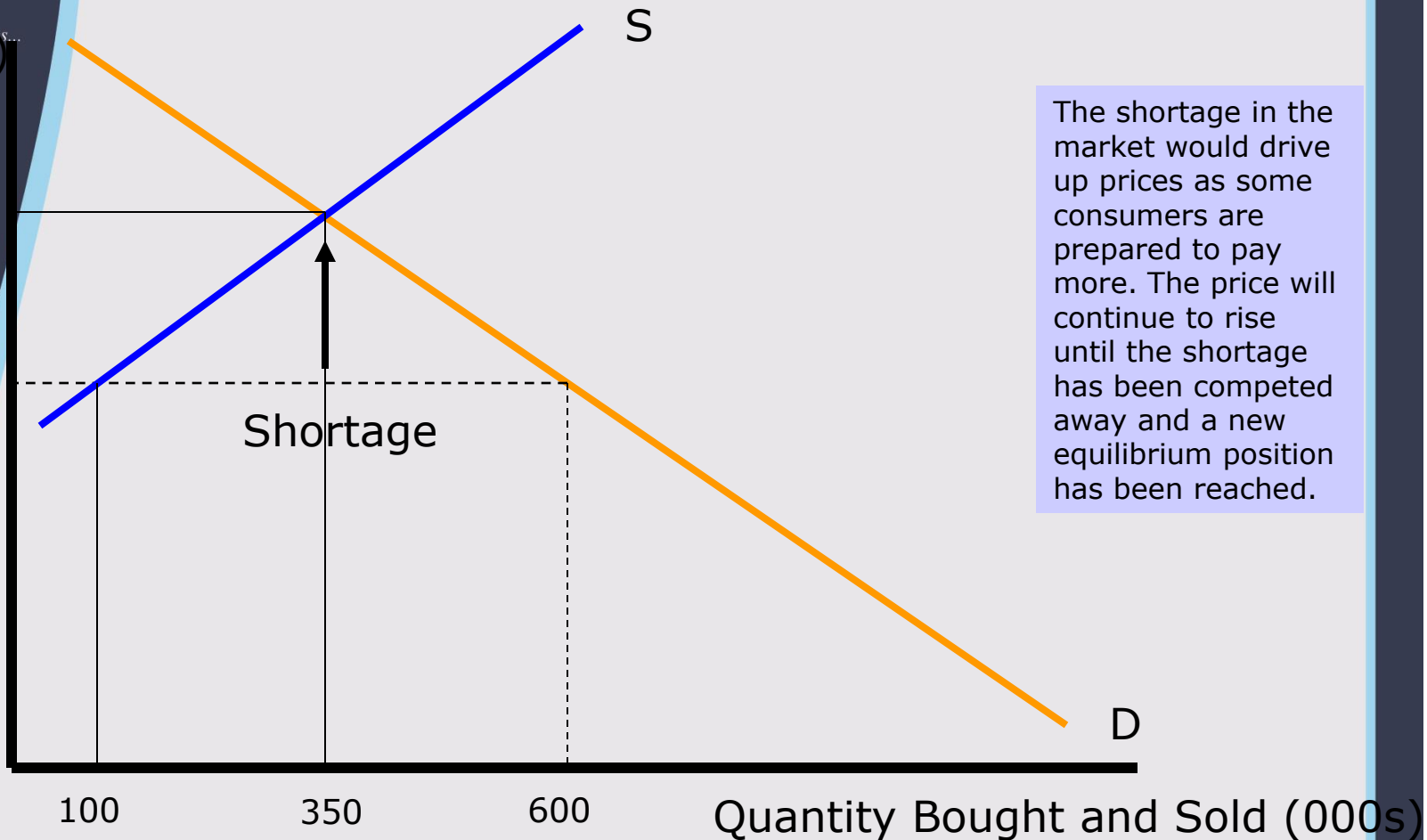




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The Market



The shortage in the market would drive up prices as some consumers are prepared to pay more. The price will continue to rise until the shortage has been competed away and a new equilibrium position has been reached.



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Rationing by Prices

- The marketplace through the interaction of supply and demand, does the rationing. This is *rationing by the purse*.
- *What* goods are produced? This is answered by the signals of market prices
- *For whom* are goods produced? The power of the purse dictates the distribution of income and consumption
- Even the *how* question is decided by supply and demand



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Happy Learning

