

Chapter 4

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The Market Forces of Supply and Demand

Markets and Competition

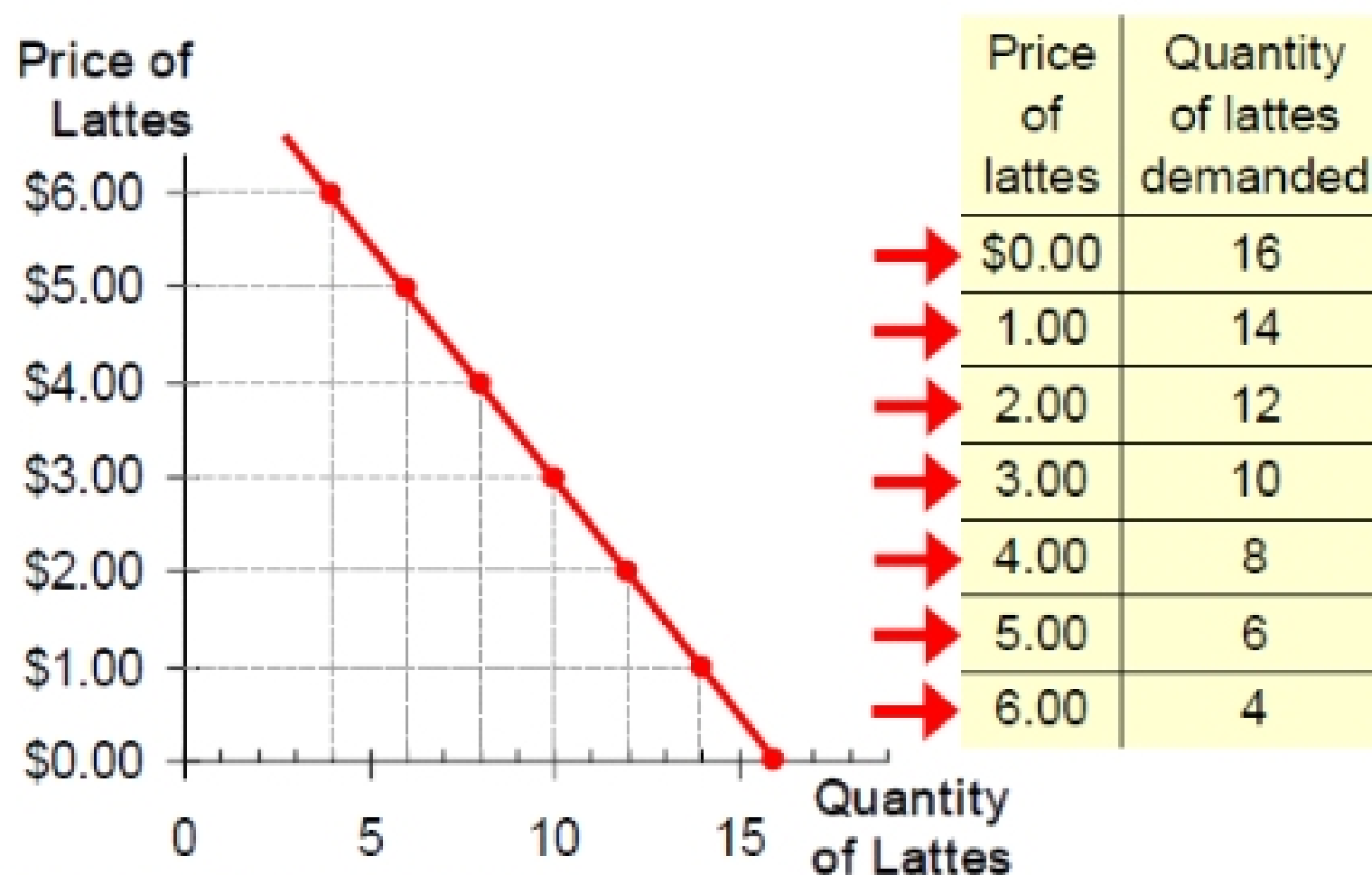
- A **market** is a group of buyers and sellers of a particular product
- A **competitive market** is one with many buyers and sellers, each has a negligible effect on price
- In a **perfectly competitive market**:
 - All goods are exactly the same
 - Buyers and sellers are so numerous that no one can affect market price - each is a "price taker"

Demand

- The **quantity demanded** of any good is the amount of the good that buyers are willing and able to purchase
- **Law of demand** states that the quantity demanded of a good falls when the price of the good rises, other things equal (Negatively correlated)

The Demand Schedule and Curve

- **Demand schedule**: a table that shows the relationship between the price of a good and the quantity demanded
 - Ex: Helen's demand for lattes



Market Demand vs Individual Demand

- The quantity demanded in the market is the sum of the quantities demanded by all buyers at each price.

Demand Curve Shifters

The demand curve shows how price affects quantity demanded, *other things being equal*

- "Other things" are non-price determinants of demand which shift the demand curve

The number of people

- An increase in the number of buyers increases quantity demanded at each price. The D curve shifts to the right.

- A decrease in the number of buyers decreases quantity demanded at each price. The D curve shifts to the left.

Income

- Demand for a **normal good** is positively related to income
 - An increase in income causes increase in the quantity demanded and shifts the D curve to the right
- Demand for an **inferior good** is negatively related to income
 - An increase in income shifts D curves for inferior goods to the left

Prices of related goods

- Two goods are **substitutes** if an increase in the price of one causes an increase in demand for the other
 - Ex: Pizza and Hamburgers
 - An increase in the price of pizza increases demand for hamburgers. This shifts the D curve to the right
- Two goods are **complements** if an increase in the price of one causes a fall in demand for the other
 - Ex: Computers and Software
 - If the price of computers rise, people buy fewer computers and, therefore, less software. The Software D curve shifts left

Tastes

- Anything that causes a shift in tastes *toward* a good will increase demand for that good and shift its D curve to the right
 - Ex: The Atkins diet became popular in the '90s. This caused an increase in the demand for eggs and shifted the egg demand curve to the right.

Expectations

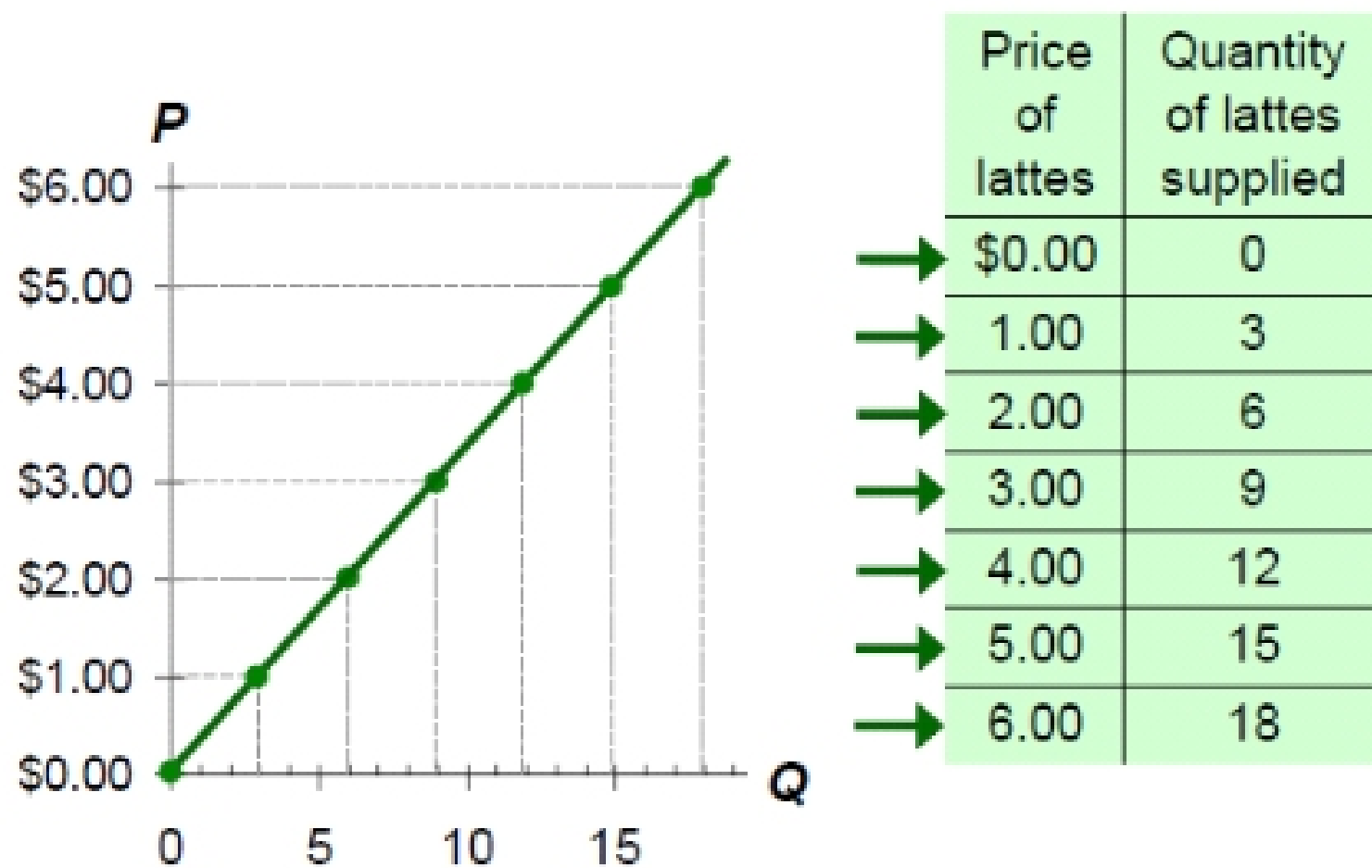
- Future earnings expectations can affect current spending decisions
 - Ex: If people expect their incomes to rise, their demand for meals at expensive restaurants may increase now. D curve shifts to the right.
 - Ex: If the economy is in a recession and worry about their job security, demand for a new car or home will drop now. D curve shifts to the left.

Supply

- The **quantity supplied** of any good is the amount that sellers are willing and able to sell
- **Law of supply** states that the quantity supplied of a good rises when the price of the good rises, other things equal (Positively correlated)

The Supply Schedule and Curve

- **Supply schedule:** a table that shows the relationship between the price of a good and the quantity supplied
 - Ex: Starbucks' supply of lattes



Market Supply vs Individual Supply

- The quantity supplied in the market is the sum of the quantities supplied by all sellers at each price

Supply Curve Shifters

The supply curve shows how price affects quantity supplied, *other things being equal*

- "Other things" are non-price determinants of supply which shift the supply curve

Input prices

- A fall in input prices makes production more profitable at each output price, so firms supply a larger quantity at each price and the S curve shifts to the right
 - Ex: The price of raw materials to make a desk (wood) goes down, the quantity supplied at each price level by the firm will go up.

Technology

- Technology determines how much inputs are required to produce a unit of output.
- A cost-saving technological improvement has the same effect as a fall in input prices, so the S curve shifts to the right.

The number of sellers

- An increase in the number of sellers increases the quantity supplied at each price and shifts the S curve to the right.

Expectations

- In general, sellers may adjust supply (if the good is not perishable) when their expectations of future prices change.
 - Ex: Events in the Middle East lead to expectations of higher oil prices. In response, owners of Texas oilfields reduce supply now and save some inventory to sell later at the higher price. The S curve shifts left now.

Supply and Demand Together

- **Equilibrium price:** the price that equates quantity supplied with quantity demanded
- **Equilibrium quantity:** the quantity supplied and quantity demanded at the equilibrium price