Supply & Demand

Read Topic 3

Demand
- willingness and ability to purchase something

Law of Demand
- the lower the price, the higher the demand
- the higher the price, the lower the demand

substitution effect
- as prices rise, consumers will switch to lower priced alternatives

Demand Schedule
- a chart comparing price of items with number sold

Demand Curve
- graphic representation of demand schedule

Changes in demand curve
- Changes in income
- Changes in consumer expectations
- Population shifts
- New products
- Substitute & complement items
  - All the above forces demand curve to shift

Supply
- ability and willingness of sellers to make things available for sale
  - both increasing existing supply or starting new business

Law of Supply
- as price rises the quantity supplied will rise
- as price falls the quantity supplied will fall

Supply Schedule
- a chart that compares price with quantity supplied

Supply Curve
- graphic representation of supply curve

Changes in Supply
- Fixed vs. variable costs
- unusual changes in market conditions
  - competition
  - change in expectations
  - natural disasters
- technological improvements
- any other change in cost
- government role
  - subsidies
  - taxes
  - regulation

Markets are caused by interaction between consumers(demand) & sellers(supply)

Equilibrium Price

- optimal price is where demand and supply curves meet
- prices higher than equilibrium cause surplus
- prices lower than equilibrium cause shortage

when demand and supply curves shift, equilibrium prices change

Government interference affects supply and demand

- price ceilings
  - artificially keeps prices down
  - causes shortages in supply
- price floors
  - artificially keeps prices up
  - causes surplus in supply

Elasticity (Elastic vs. Inelastic)

- how responsive prices are to market changes
- Factors affecting change
  - Availability of substitutes
  - Percentage of current spending
    - Necessity or Luxury?
  - Change over time
- elasticity of demand
  - how much demand changes based on change in price
    - impact on revenue
      - impact on price
- elasticity of supply
  - how much supply changes in response to change in price

Interaction of markets

- Ripple effect
  - AKA “second order conditions”
  - changes in markets have many levels of consequences
- Cycle of economic activity
  - consumers buy goods & services
  - businesses must produce goods & services
  - businesses purchase capital goods from consumers
  - consumers have income
  - cycle repeats