

# **STUDY UNIT 5**

## **DEMAND & SUPPLY IN ACTION.**

# STUDY OBJECTIVES

- ▶ **You should be able to:**
  - **Graphically illustrate how a change in demand or supply affects the equilibrium price and quantity**
  - **Graphically illustrate the simultaneous changes in demand and supply and their effect on equilibrium price and quantity**
  - **Graphically illustrate the interaction between related markets**
  - **Explain the effects of government intervention**

# CHANGE IN DEMAND

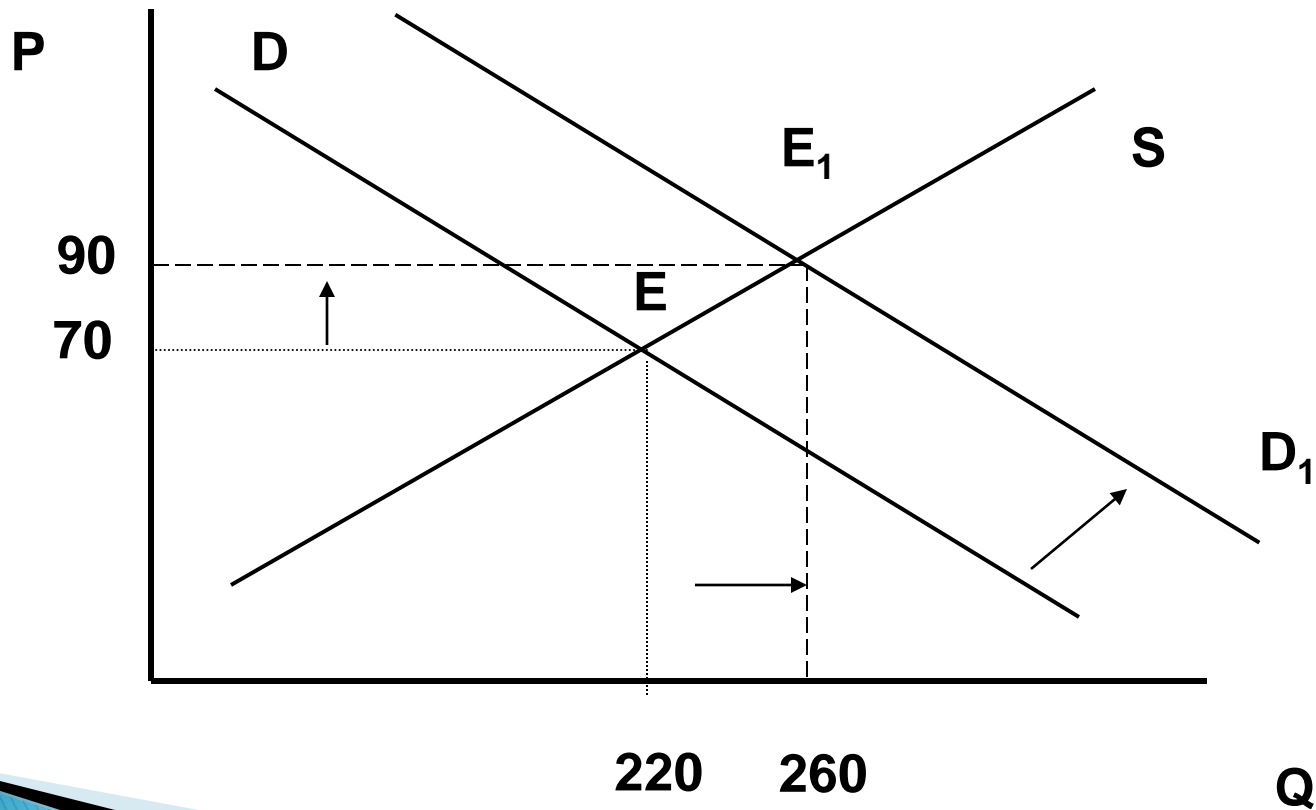
## □ INCREASE IN DEMAND

- Rightward shift of the demand curve.
- Caused by other determinants of demand, other than price of the good.
- Supply remains unchanged.

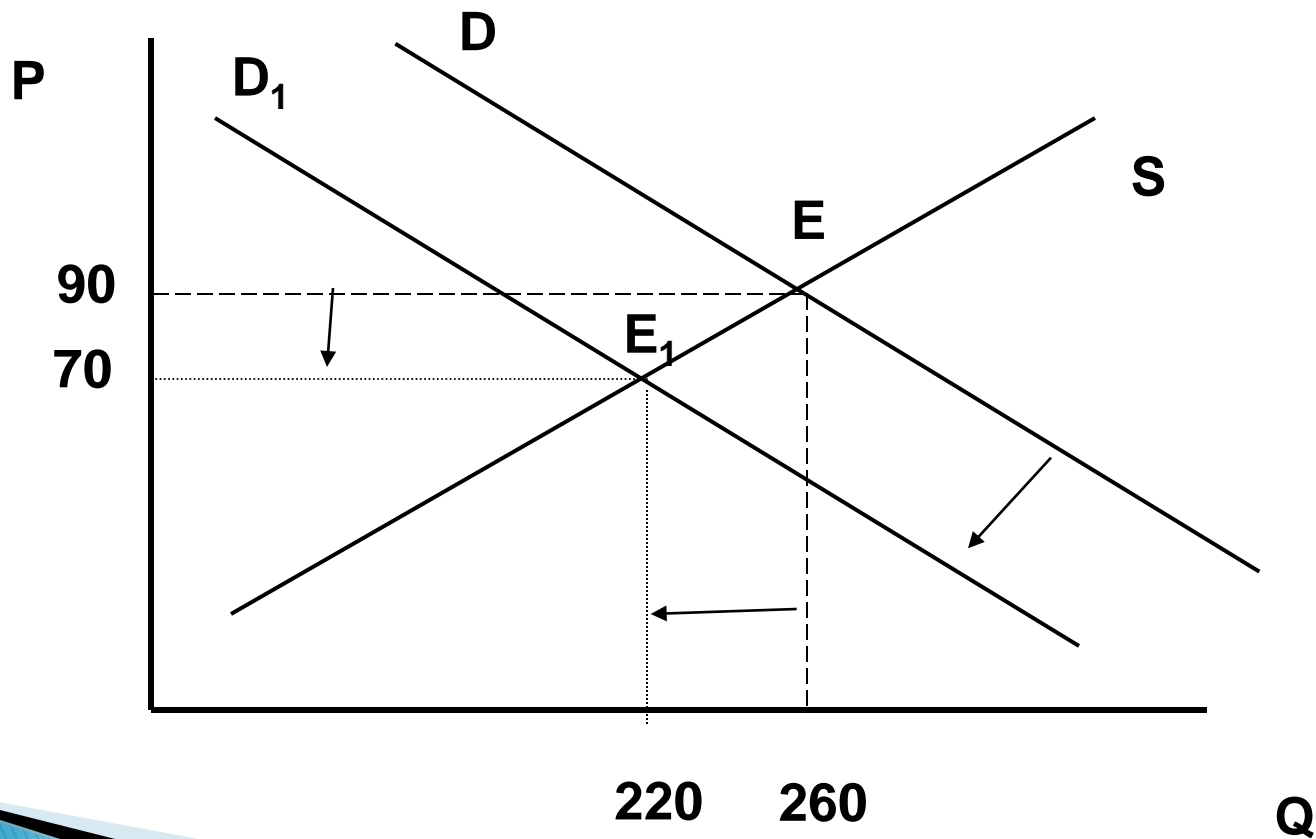
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# INCREASE IN DEMAND



# DECREASE IN DEMAND



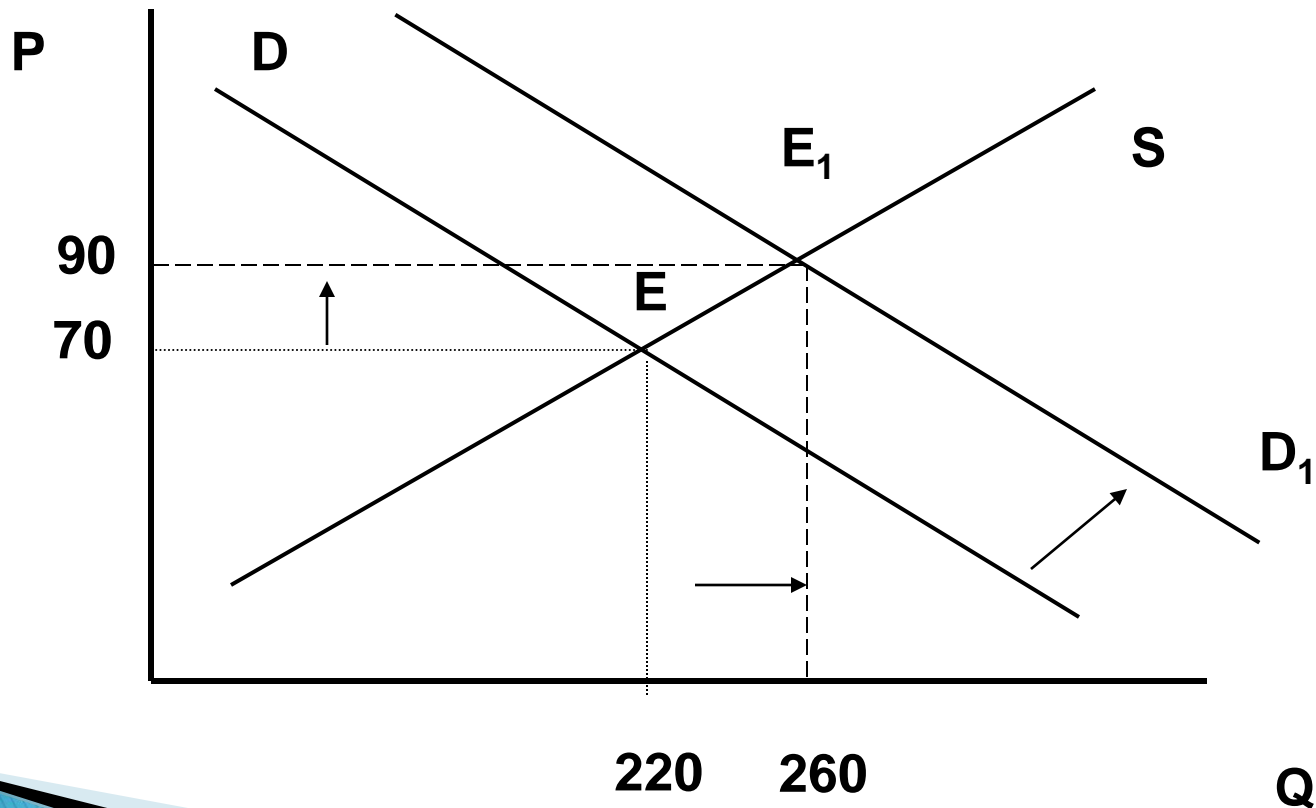
# Change in demand: summary

1. What is the effect of an increase in demand on:
  - equilibrium price and
  - equilibrium quantity?
  
2. What is the effect of a decrease in demand on:
  - equilibrium price and
  - equilibrium quantity?

# Examples of changes in demand

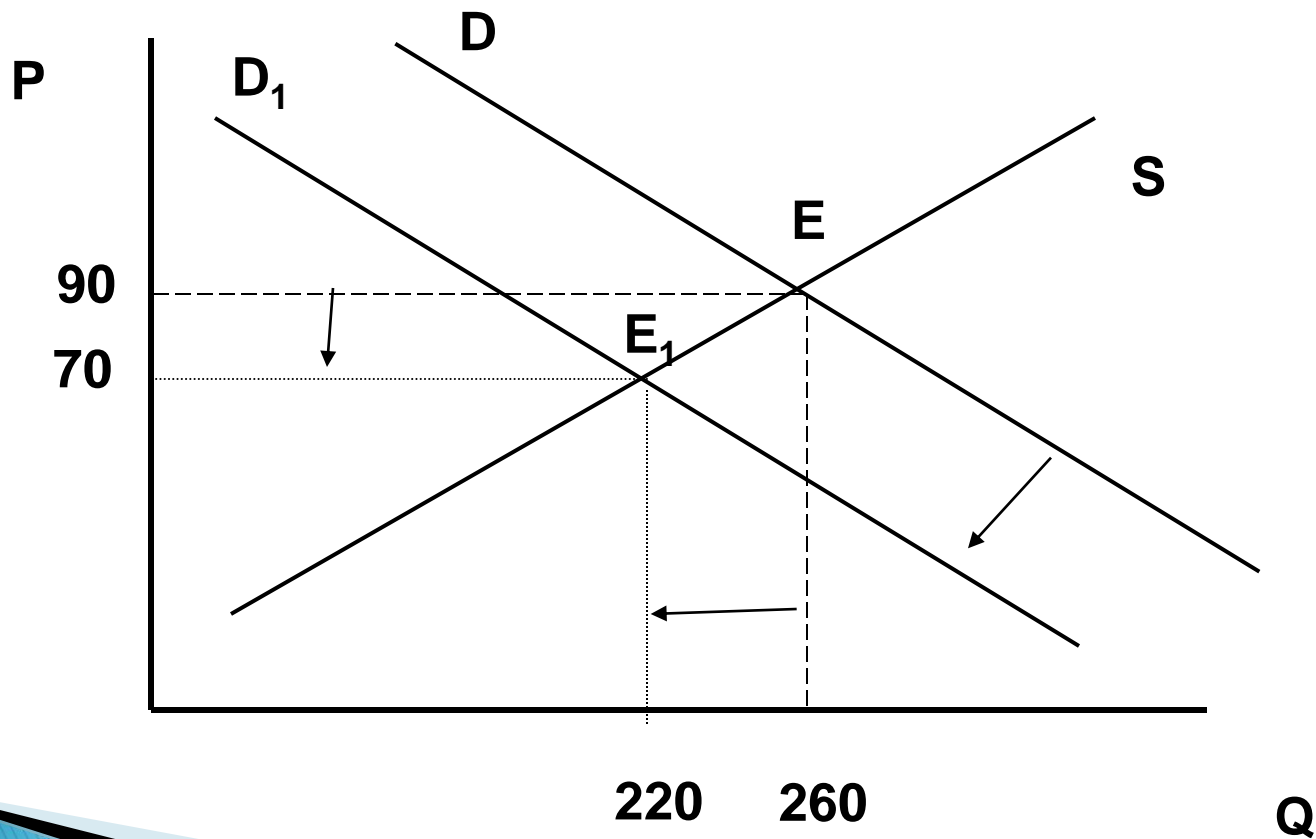
- ▶ Figure 8-2 of the text book:
  - **Increase in income:**
    - For normal goods – Demand increases (rightward shift of demand curve)
    - For inferior goods – Demand decreases (leftward shift of demand curve)
  - **Decrease in income:**
    - For normal goods – Demand decreases (leftward shift of demand curve)
    - For inferior goods - Demand increases (leftward shift of demand curve)
  - Increase of complements and substitute prices
  - Decrease in complements and substitute prices.

# INCREASE IN DEMAND – e.g. increase in income and a normal good

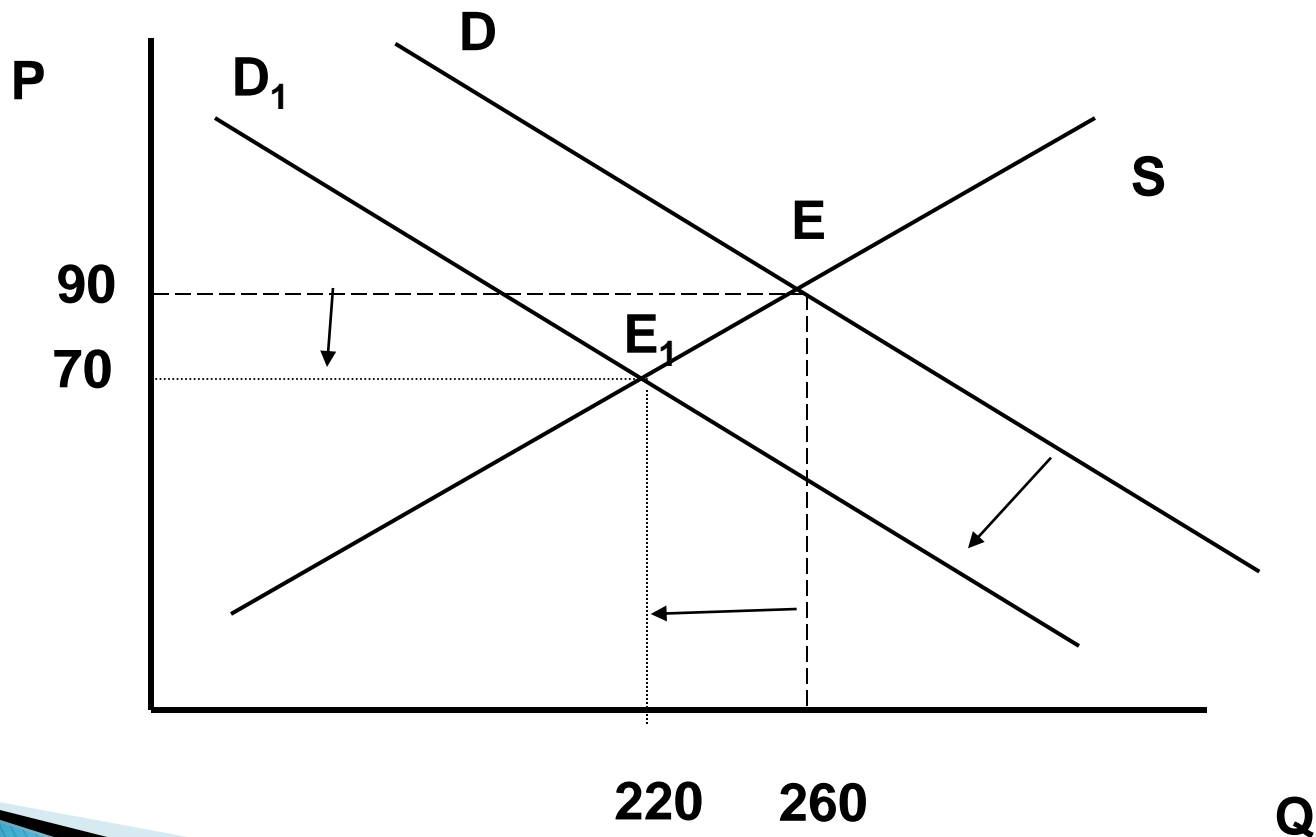




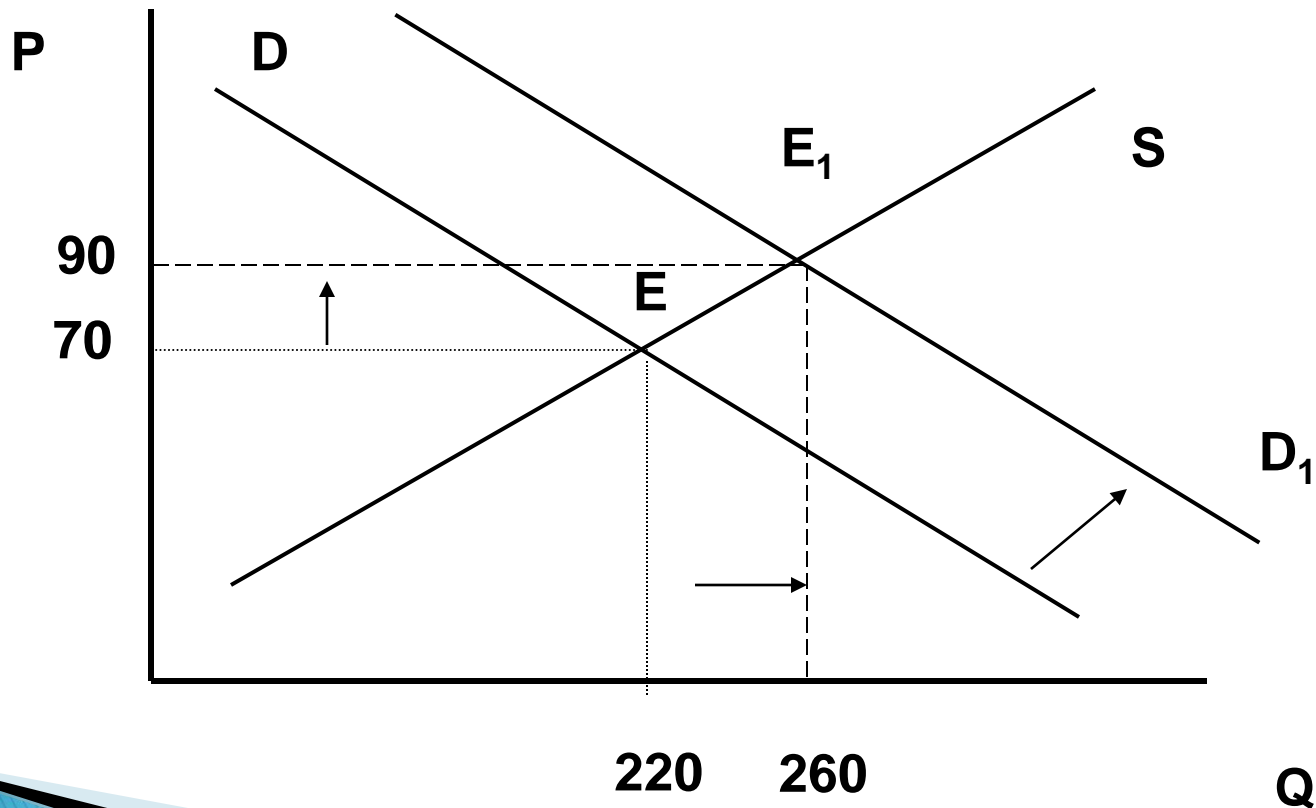
# DECREASE IN DEMAND – e.g. increase in income and an inferior good



# DECREASE IN DEMAND – e.g. decrease in income and a normal good



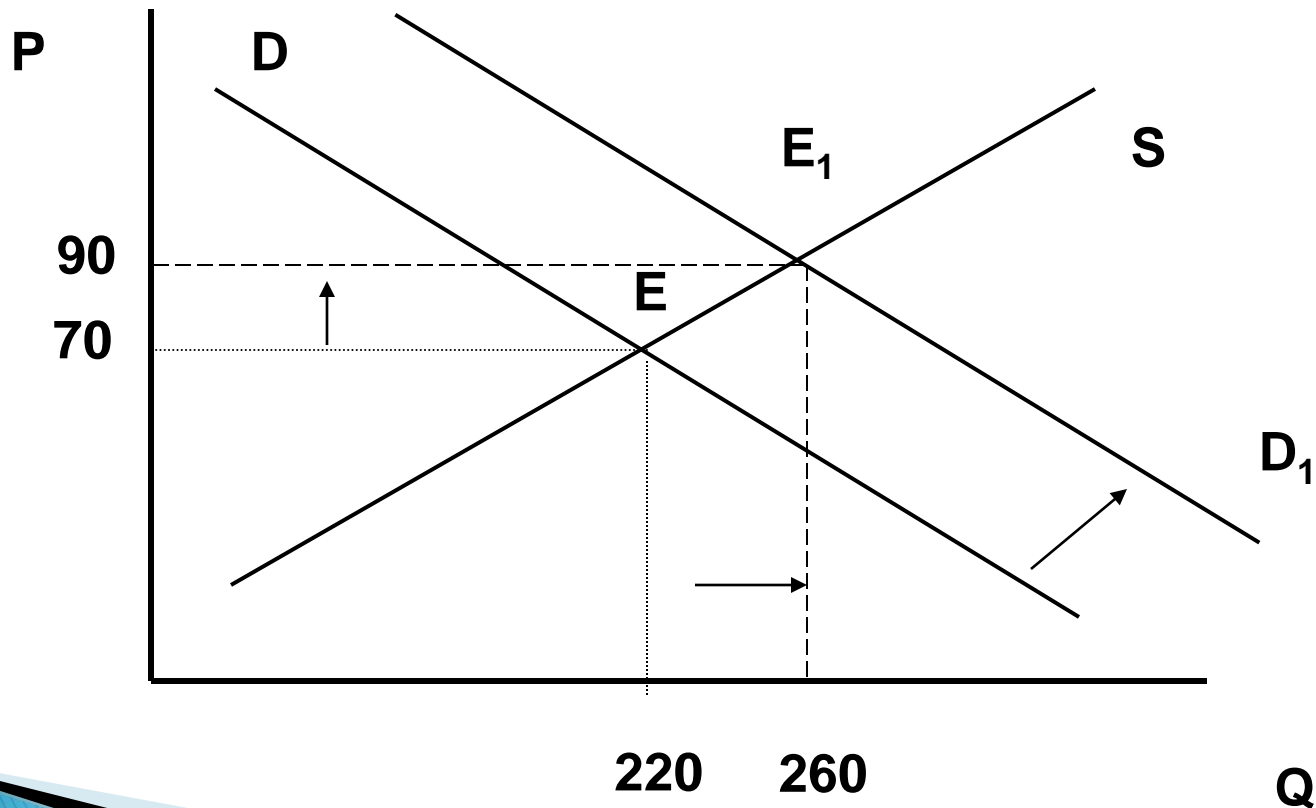
# INCREASE IN DEMAND – e.g. decrease in income and an inferior good



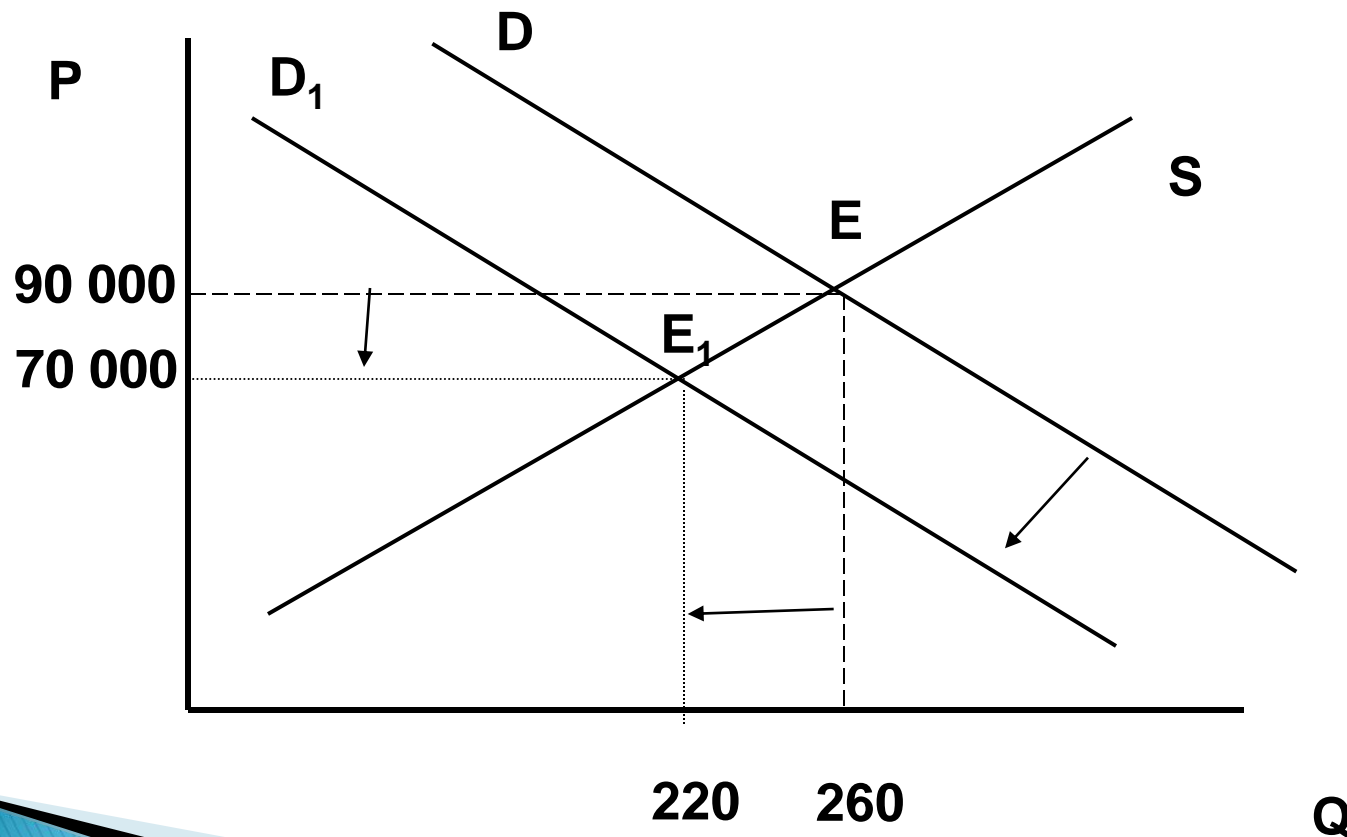
# EXAMPLES OF CHANGES IN DEMAND

- ▶ Section 8.1 of the text book :
  - Increase of a substitute price:
    - Demand increases
  - Increase in the price of a complement:
    - Demand decreases
  - Decrease in the price of a substitute:
    - Demand decreases
  - Decrease in the price of a complement:
    - Demand increases

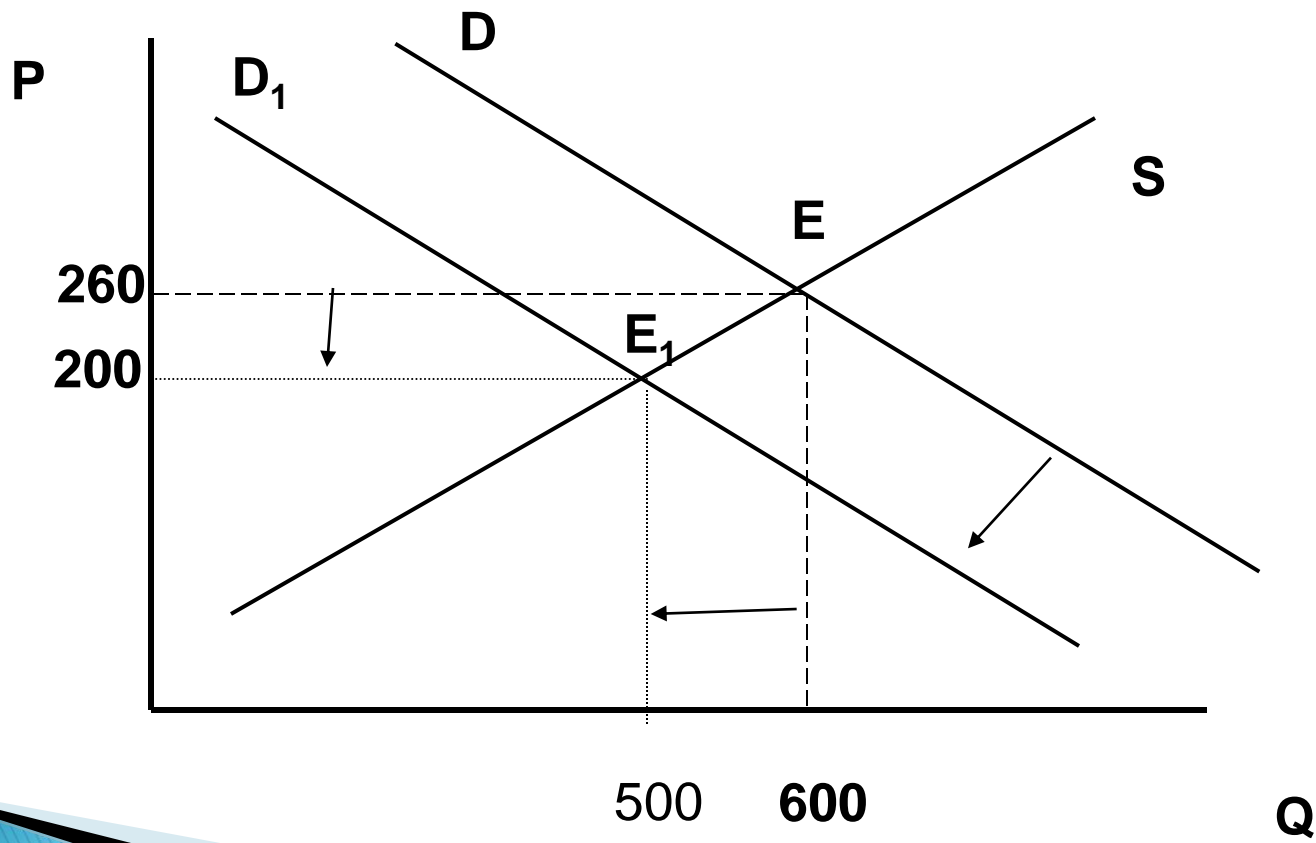
# INCREASE IN THE DEMAND FOR BEEF – Due to an increase in the price of a substitute good



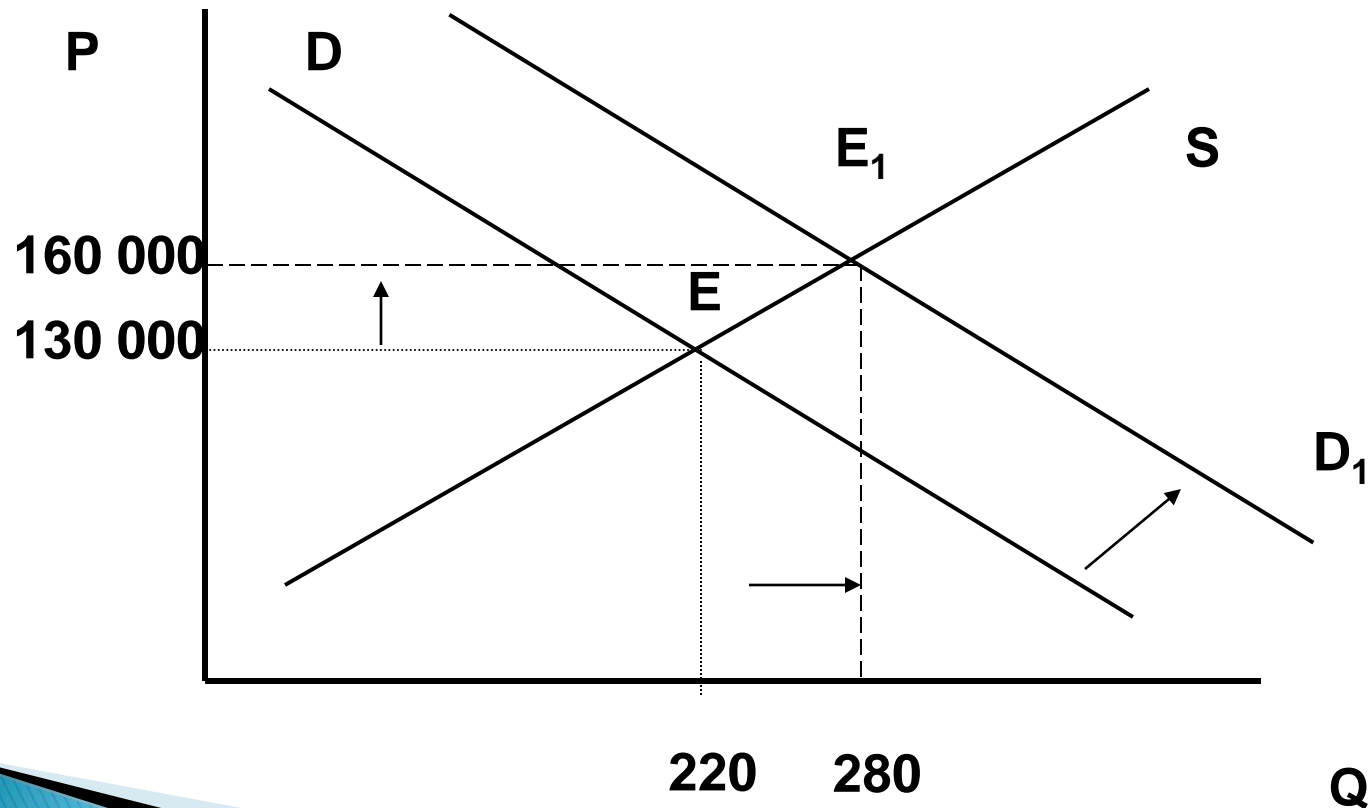
# DECREASE IN THE DEMAND FOR BOLTS – Due to an increase in the price of nuts (a complement)



# DECREASE IN THE DEMAND FOR DRESSES – Due to a decrease in the price of skirts (a substitute)



# INCREASE IN THE DEMAND FOR COMPUTER MONITORS – Due to a decrease in the price of keyboards (a complement)





# CHANGE IN SUPPLY

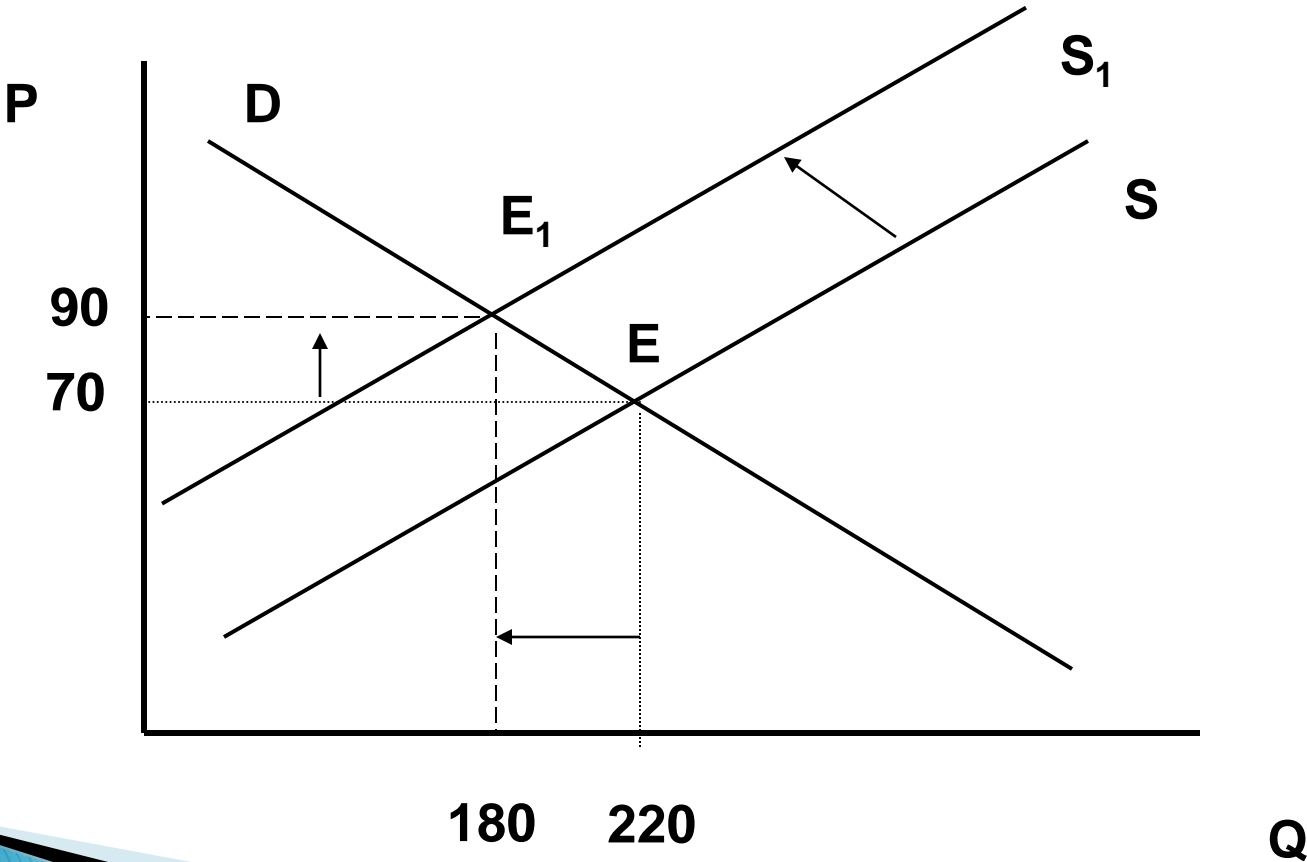
## ❑ INCREASE IN SUPPLY

- ❑ Rightward shift of the supply.
- ❑ Caused by other determinants of supply, other than price of the good.
- ❑ Demand remains unchanged.

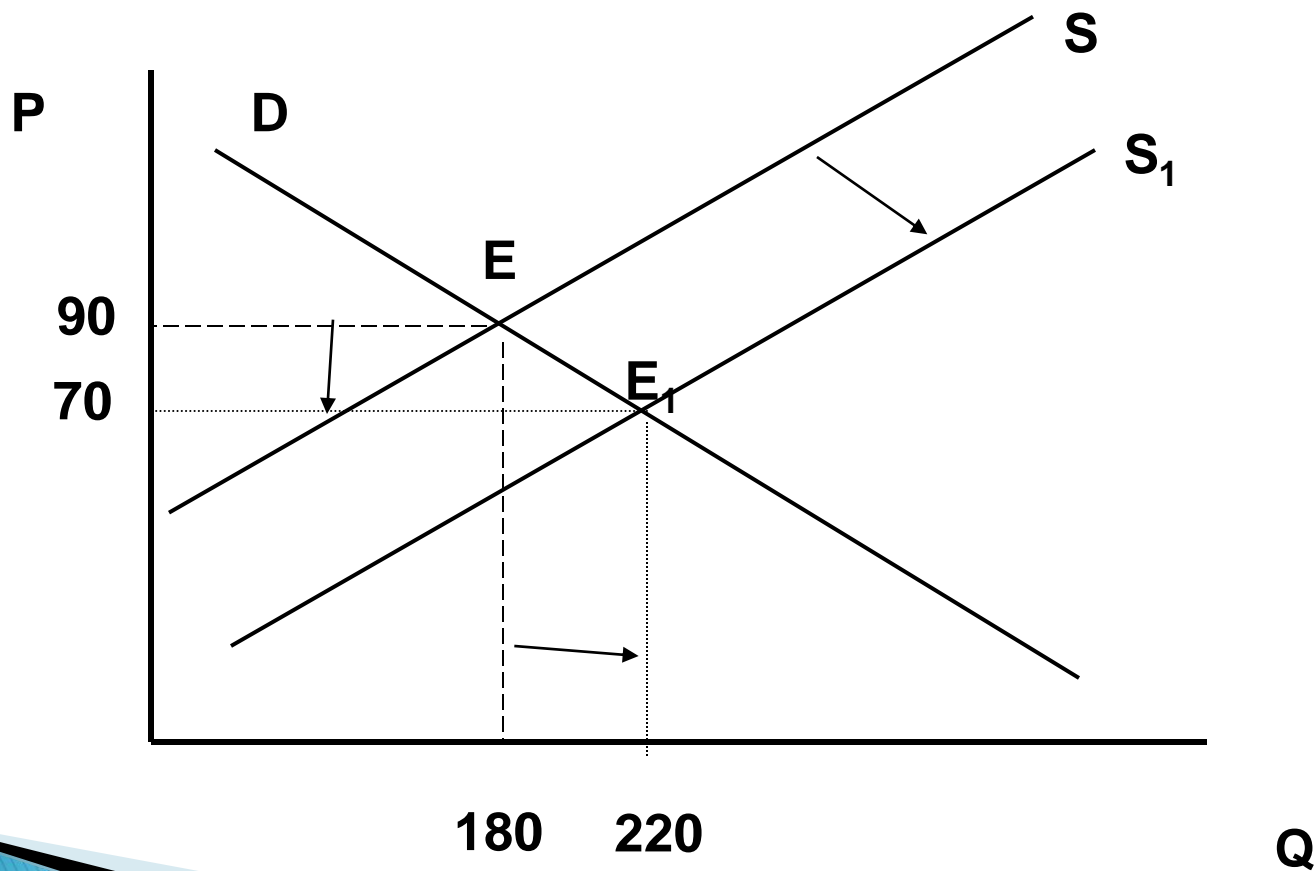
## ❑ DECREASE IN SUPPLY

- ❑ Leftward shift of the supply curve.
- ❑ Caused by other determinants of supply, other than price of the good.
- ❑ Demand remains unchanged.

# DECREASE IN SUPPLY



# INCREASE IN SUPPLY



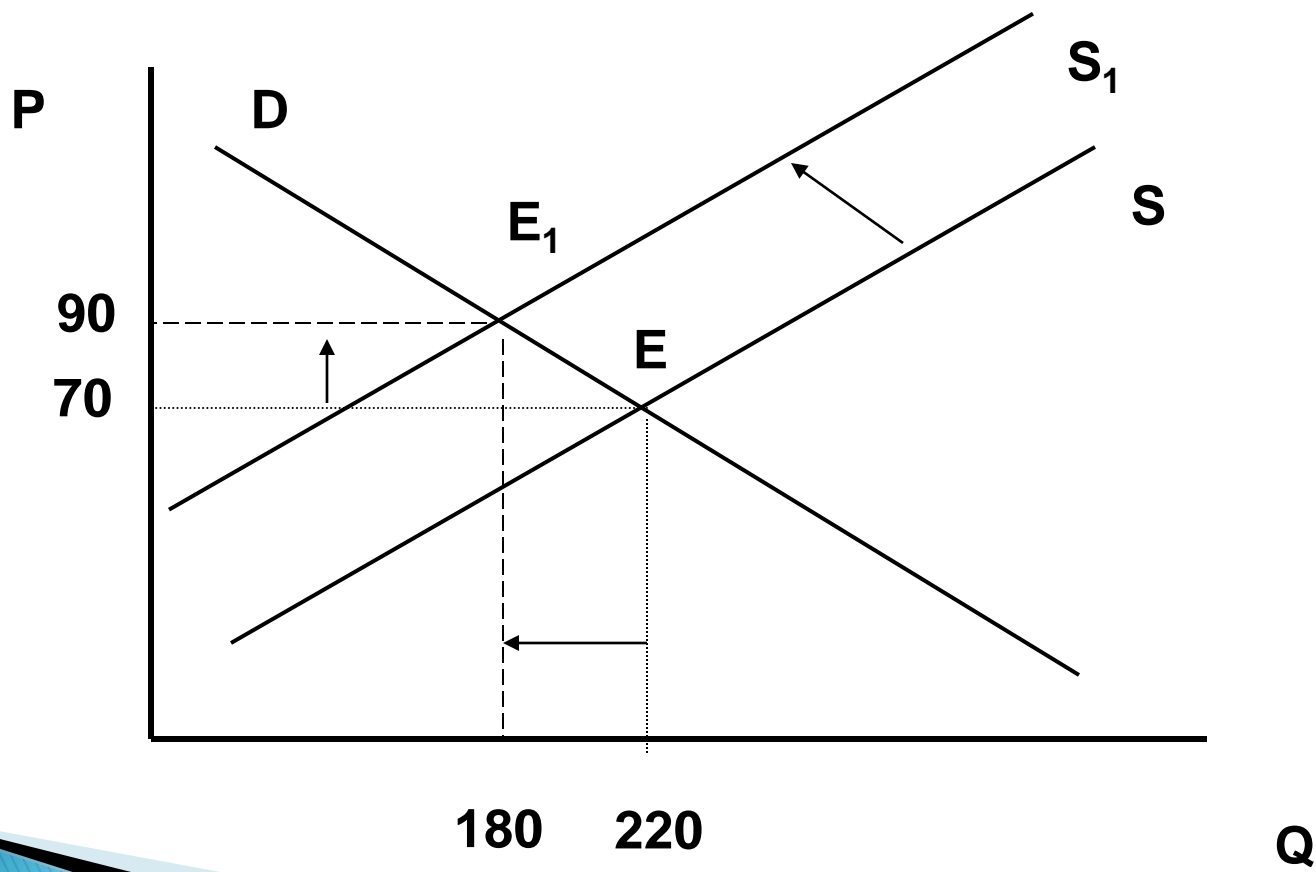
# Change in supply: summary

1. What is the effect of an increase in supply on:
  - equilibrium price and
  - equilibrium quantity?
  
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  - equilibrium quantity?

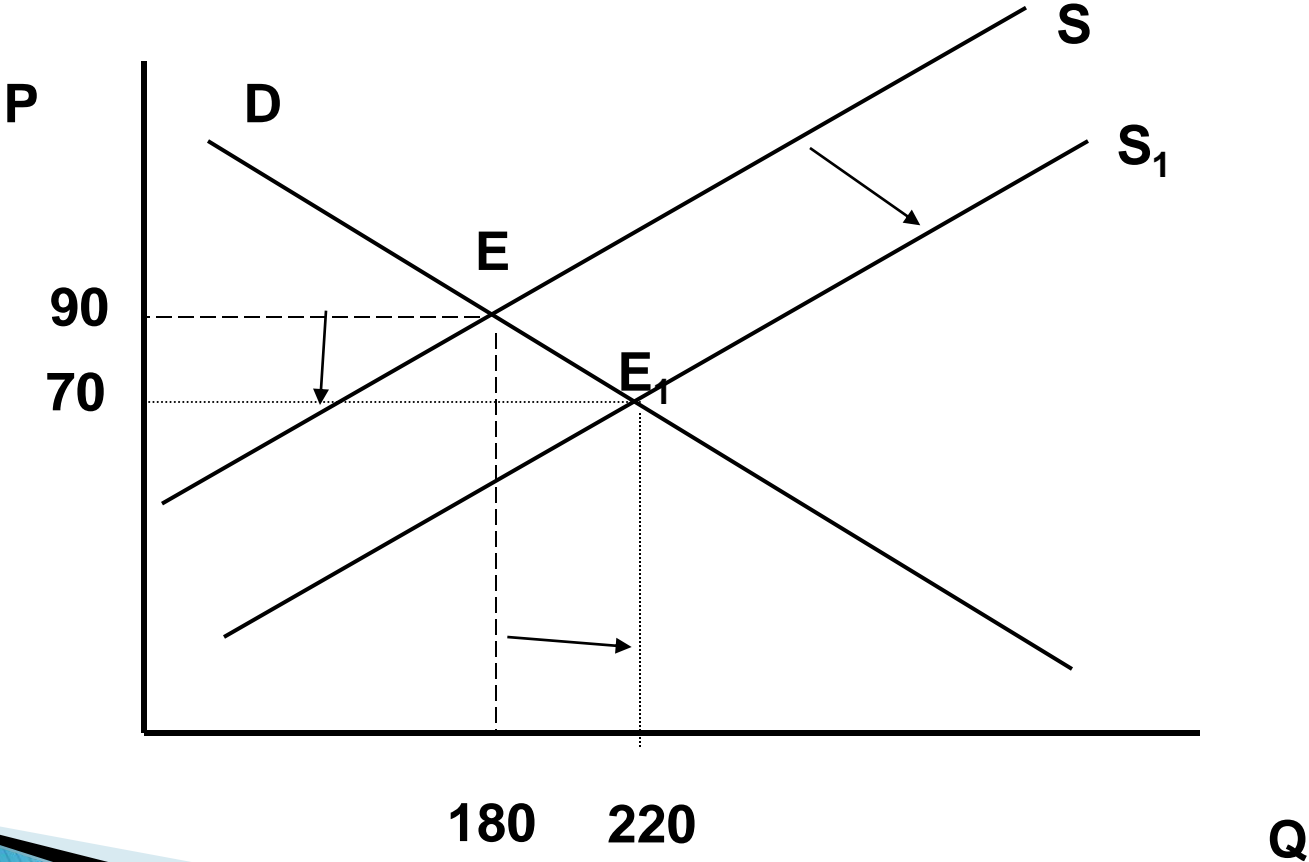
# Examples of changes in supply

- ▶ Figure 8-4 in the text book:
  - Increase in prices of factors of production
    - Supply decreases
  - Decrease in price of factors of production
    - Supply increases
  - Increase in productivity
    - Supply increases
  - Decrease in productivity
    - Supply decreases

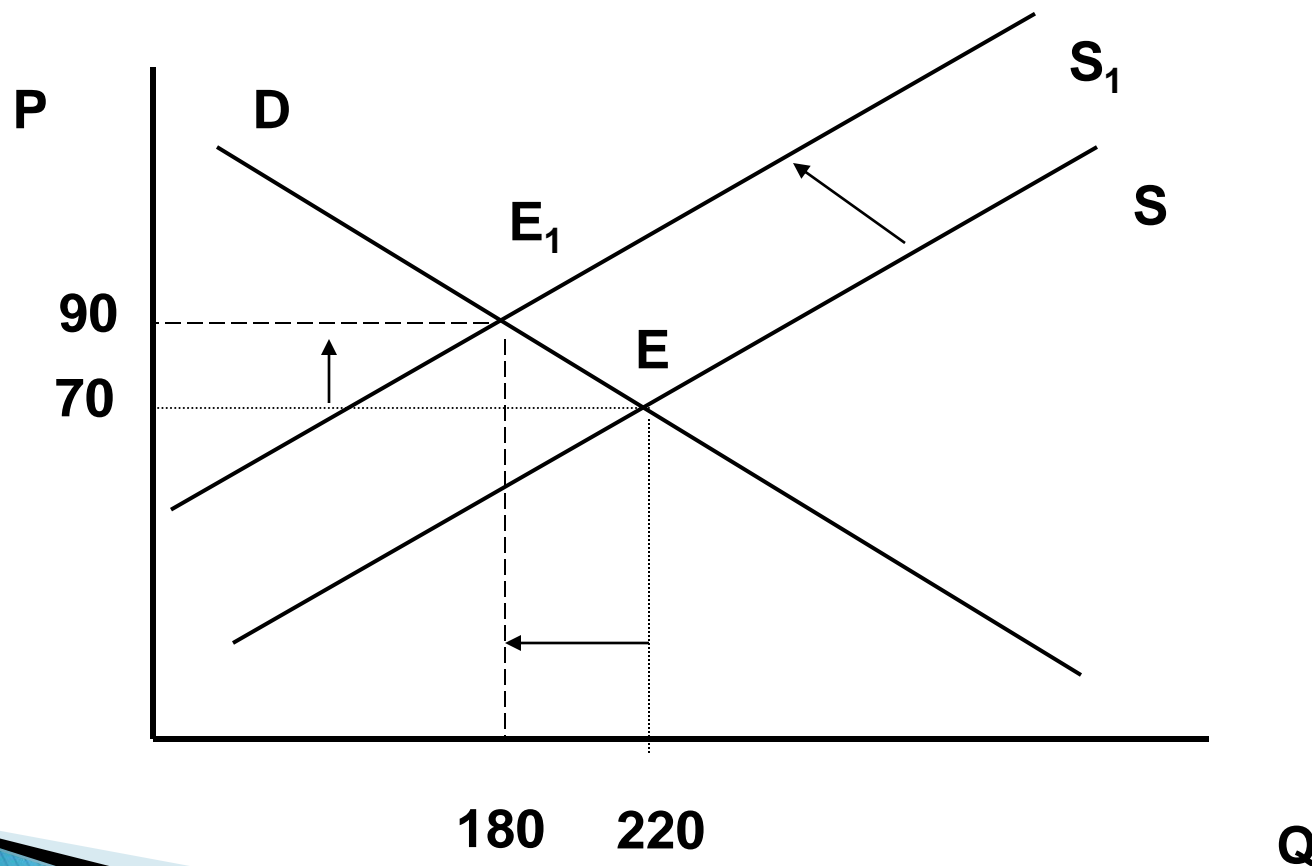
# DECREASE IN SUPPLY - Due to an increase in the price of factors of production



# INCREASE IN SUPPLY – Due to a decrease in the price of factors of production

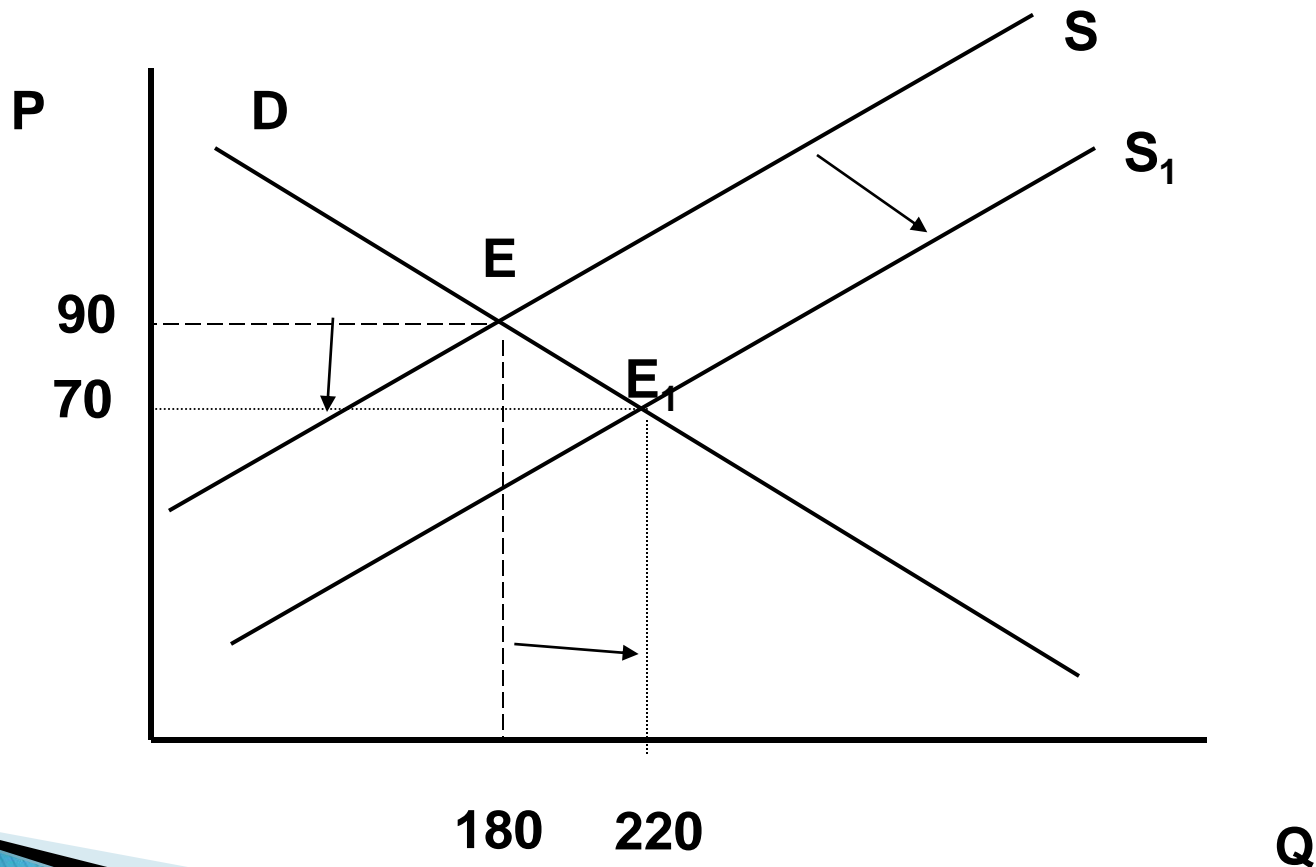


# DECREASE IN SUPPLY (Due to a decrease in productivity)





# INCREASE IN SUPPLY (Due to an increase in productivity)



# **SIMULTANEOUS CHANGES IN DEMAND AND SUPPLY (SUMMARY) – TABLE 8.1**

<b>CHANGE IN DEMAND</b>	<b>CHANGE IN SUPPLY</b>	<b>CHANGE IN PRICE</b>	<b>CHANGE IN QUANTITY</b>
<b>INCREASE</b>	<b>INCREASE</b>	<b>UNCERTAIN</b>	<b>INCREASE</b>
<b>INCREASE</b>	<b>DECREASE</b>	<b>INCREASE</b>	<b>UNCERTAIN</b>
<b>DECREASE</b>	<b>INCREASE</b>	<b>DECREASE</b>	<b>UNCERTAIN</b>
<b>DECREASE</b>	<b>DECREASE</b>	<b>UNCERTAIN</b>	<b>DECREASE</b>

# Simultaneous changes in demand and supply: **CONCLUSION**

- The impact on quantity or price depends on the relative magnitudes of the changes in demand and supply.

# INTERACTION BETWEEN THE RELATED MARKETS

- ▶ SUBSTITUTES (fresh milk & powdered milk)
- ▶ If there is a decrease in the demand for fresh milk:
  - In the market for fresh milk
    - Equilibrium price of fresh milk decreases
    - Equilibrium quantity of fresh milk decreases:
  - In the market for powdered milk:
    - Demand for powdered milk increases, WHY?
    - Equilibrium price of powdered milk increases
    - Equilibrium quantity of powdered milk increases

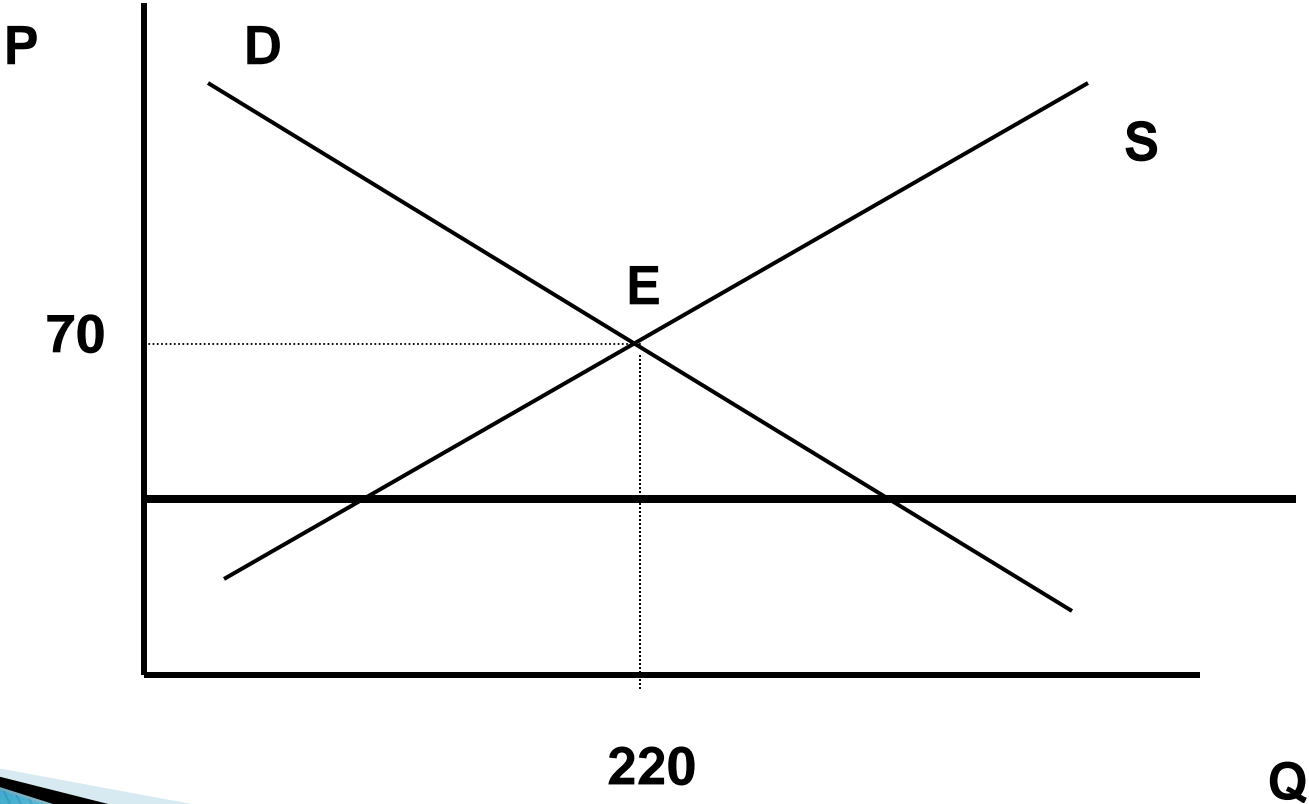
# INTERACTION BETWEEN THE RELATED MARKETS

- ▶ COMPLEMENTS (curtain hook & eyelet)
- ▶ If there is a decrease in the supply of curtain hooks:
  - In the market for curtain hooks
    - Equilibrium price of hooks increases,
    - Equilibrium quantity of hooks decreases.
  - In the market for curtain eyelets:
    - Demand for eyelets decreases, WHY?
    - Equilibrium price of eyelets decreases,
    - Equilibrium quantity of eyelets decreases.

# Government intervention – maximum prices (price ceilings)

- ▶ Objectives
- ▶ Effective maximum price:- observed below equilibrium price.
- ▶ Effects of maximum prices
- ▶ Solutions

# PRICE CEILINGS

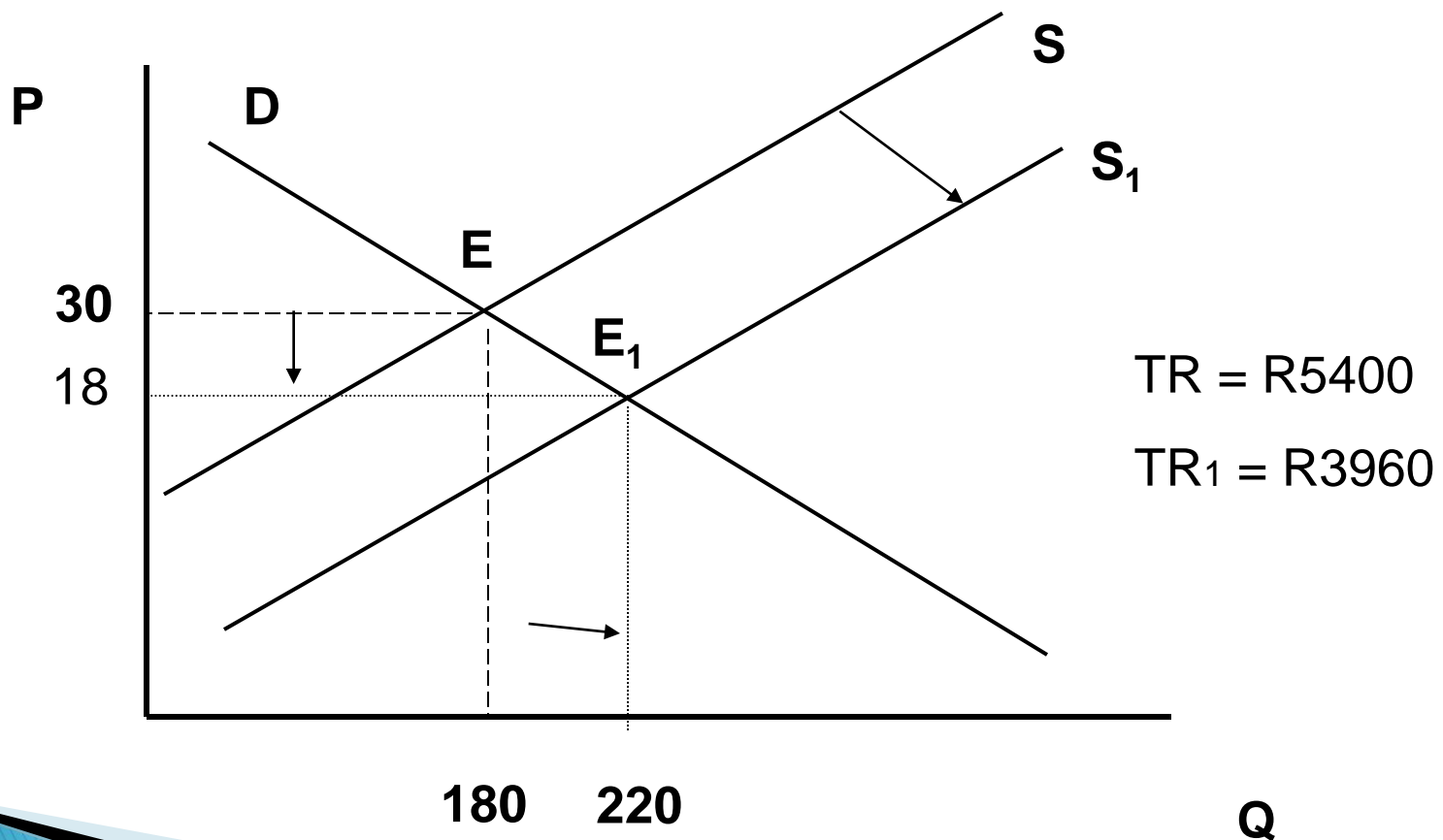


# Government intervention – minimum prices (price floors)

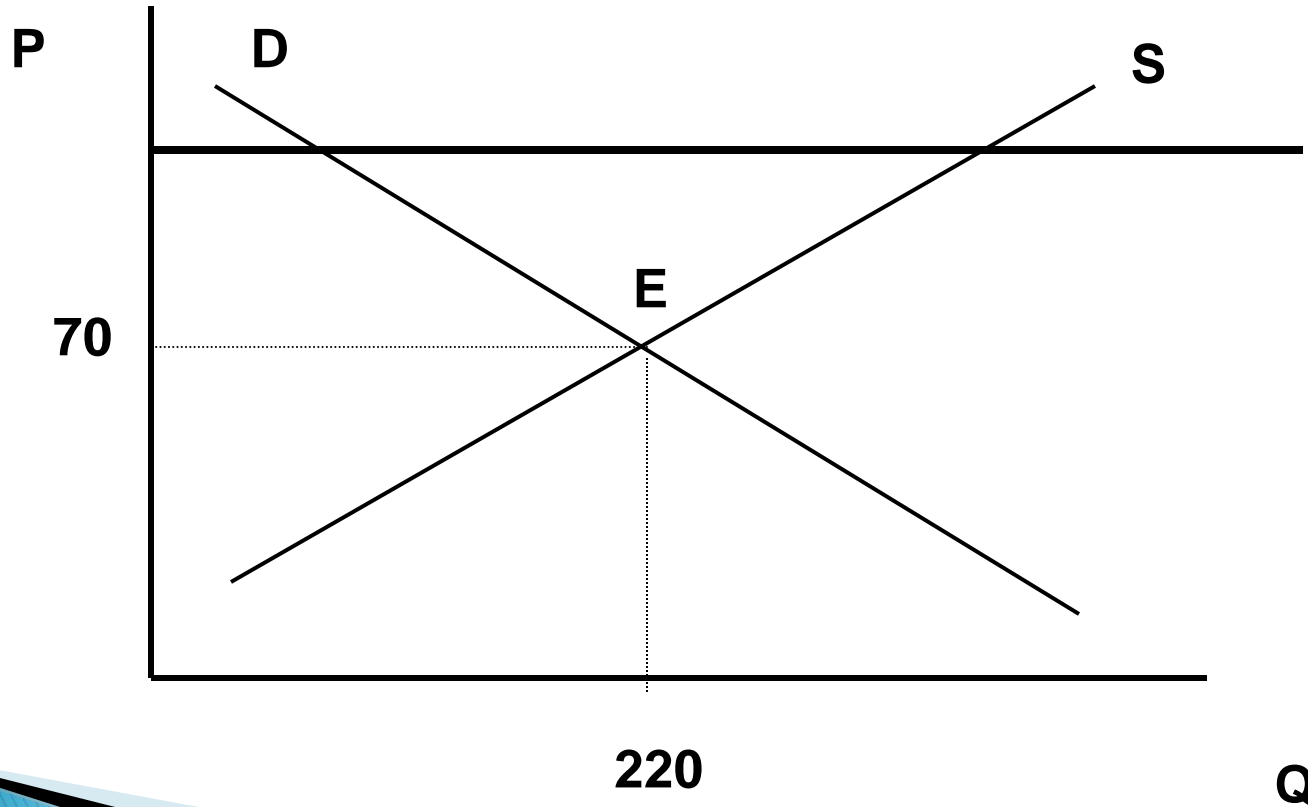
- ▶ Objectives
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- ▶ Solutions



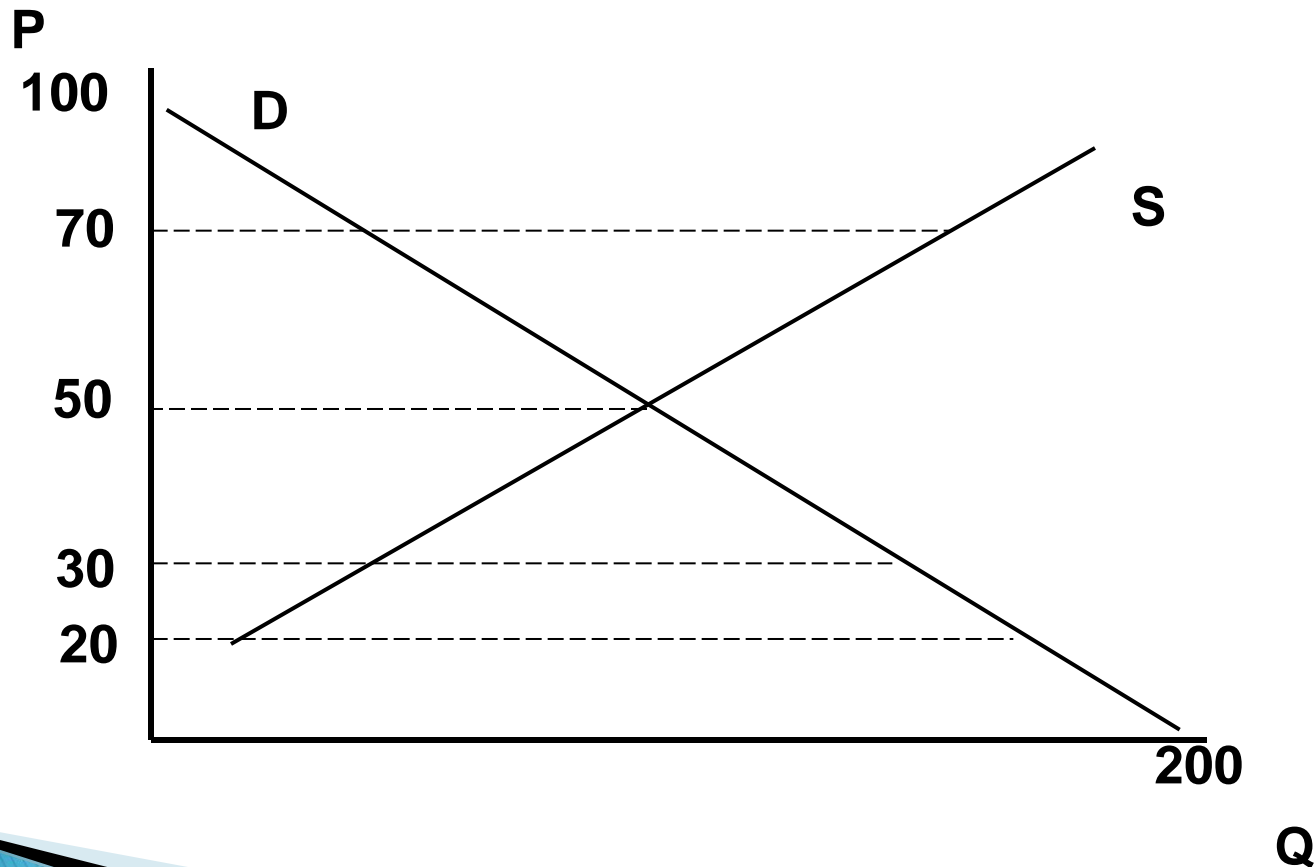
# APPLICATION OF MINIMUM PRICES- AGRICULTURAL PRICES



# PRICE FLOORS



# SELF-EVALUATION QUESTIONS



# QUESTIONS

- ▶ Suppose government wants to set a minimum wage. At which price will an effective minimum wage be set in the market?
- ▶ In support of higher learning, government wants to set rent controls on student's accommodation. At which of the specified prices will an effective maximum price be set?
- ▶ At which price(s) will black market activity develop?