

Supply and Demand

ECO 120: Global Macroeconomics

Goals

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Unit Goals

- Define demand and identify what influences demand
- Define demand and identify what influences demand
- Predict how prices and quantities are determined by supply and demand.
- Use these skills to make predictions about changes in price and quantity.

Learning Objectives

LO 2: Use the supply and demand model to predict price and quantity outcomes for markets for products and services.

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LO 2: Use the supply and demand model to predict price and quantity outcomes for markets for products and services.

Reading and Exercises

2 / 23

- Textbook: Demand, Module 5
- Textbook: Supply and Equilibrium, Module 6
- Textbook: Changes and Equilibrium, Module 7
- **Canvas Quiz due Wed Sept 15, 11:59 PM.**
Multiple-choice, 10 questions, unlimited attempts allowed, only best score counts
- **Homework/In-class Exercise due Fri Sept 17 11:59 PM.**
We will work together in class on Thursday.

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Demand

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- The **quantity demanded** of a good or service is the amount consumers are willing and able to buy in a given time period at a particular price.
- **Law of demand:** All other things remaining equal, the higher (lower) the price of the good, the smaller (higher) is the quantity demanded.

Demand

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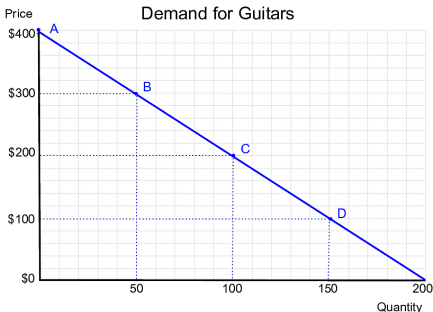
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Demand

Demand Schedule For Guitars

Point	Price	Q_D
A	\$400	0
B	\$300	50
C	\$200	100
D	\$100	150

Demand Curve for Guitars



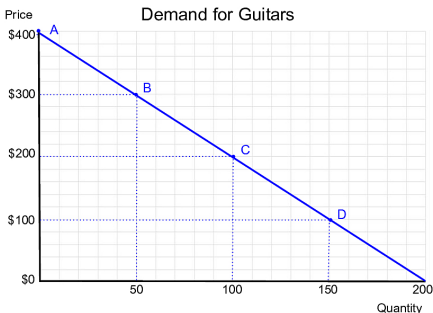
- Law of demand makes the demand curve **downward sloping**.
- **Change in quantity demanded:** when there is a **change in price** causing a **movement** from one point on the demand curve to another point.

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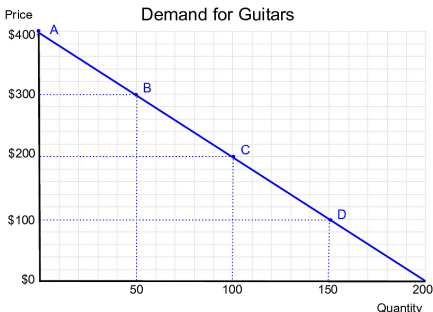
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Income and Substitution effects

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- The demand curve is downward sloping because of the income and substitution effect.
- **Substitution effect:** when the price of a good rises, people may buy substitute goods instead.
- **Income effect:** When the price of a good rises, the real purchasing power of your income decreases. When the real value of your income decreases, you buy less of everything.
- Close to correct. More on the income effect later.

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Supply

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- The **quantity supplied** of a good or service is the amount producers are willing and able to produce and sell in a given time period at a given price.
- **Law of supply:** All other things remaining the same, the higher (lower) is the price of a good, the higher (lower) is the quantity supplied.

Supply

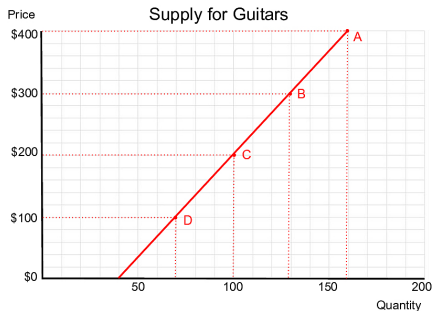
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B	\$300	130
C	\$200	100
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Supply Curve for Guitars



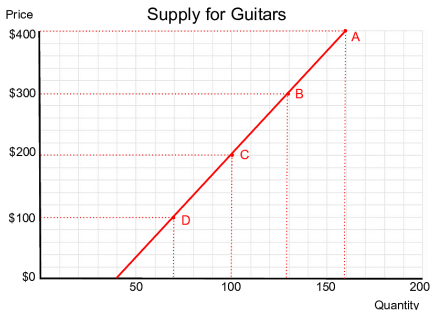
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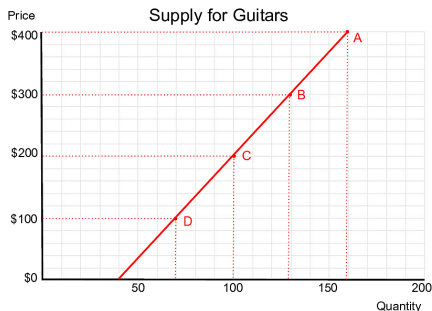
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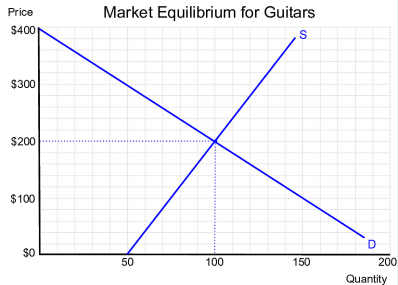
Equilibrium

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Equilibrium Definition

- The **equilibrium price** is the price where the quantity supplied is equal to the quantity demanded.
- The **equilibrium quantity** is the corresponding quantity.
- This is the price and quantity that will prevail in an unregulated market.

Graphical Equilibrium



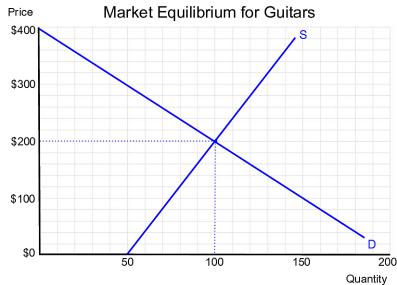
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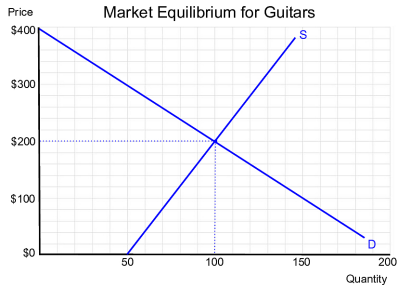
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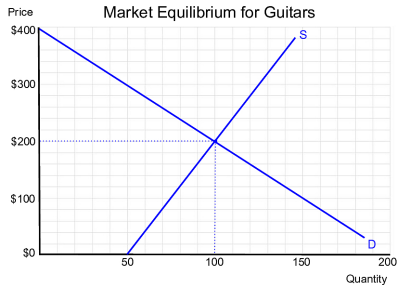
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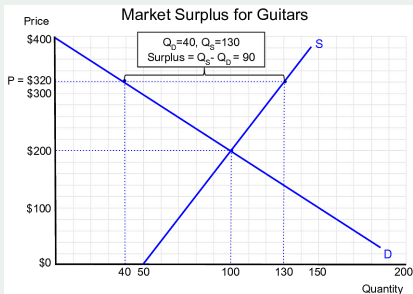
Surplus

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Surplus Definition

- When the prevailing price is **above** equilibrium price, quantity supplied exceeds quantity demanded
- Difference is the surplus
- In an unregulated market, market forces will push price lower toward equilibrium

Graphical Surplus



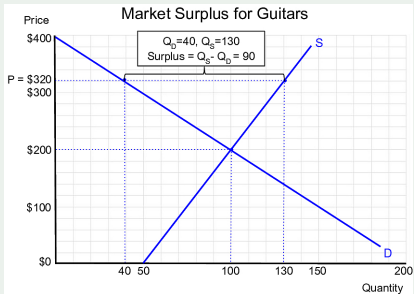
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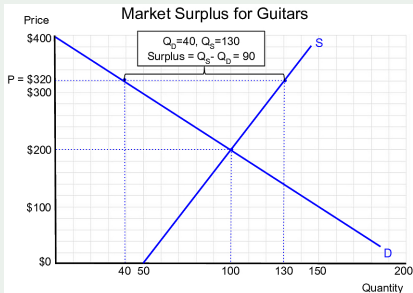
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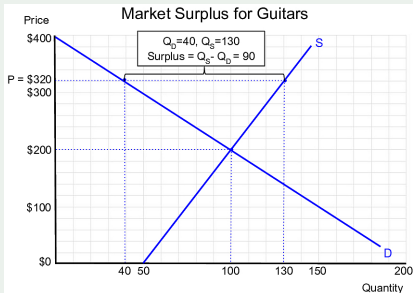
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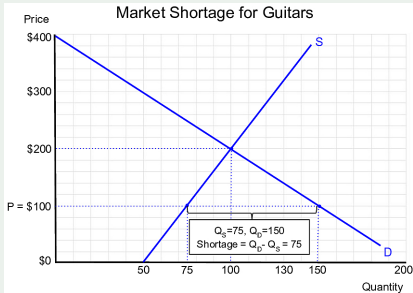
Shortage

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Shortage Definition

- When the prevailing price is **below** equilibrium price, quantity demanded exceeds quantity supplied
- Difference is the shortage
- In an unregulated market, market forces will push equilibrium price higher

Graphical Shortage



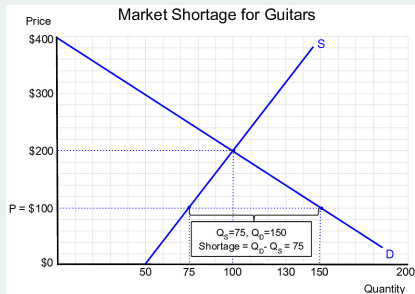
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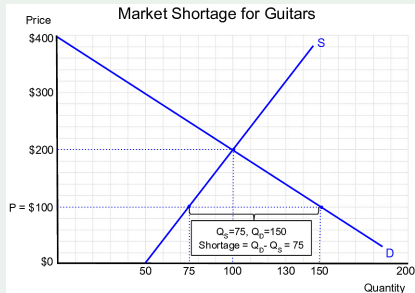
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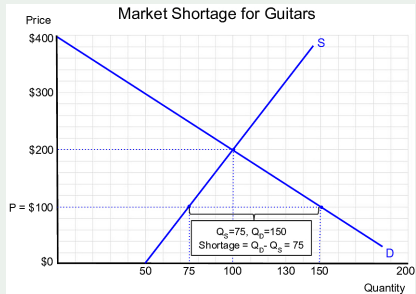
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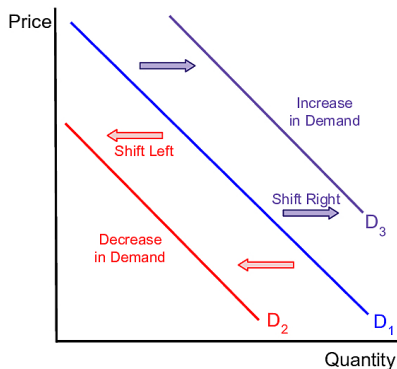
Demand Curve Shifts

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Shifts in Whole Demand Curve

- When something *besides the price of the good* effects demand, we say there is a *change or shift in demand*.
- Something that **increases** demand shifts the demand curve to the **right**
- Something that **decreases** demand shifts the demand curve to the **left**

Shifts in Demand



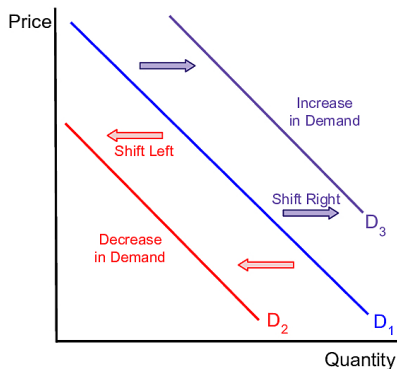
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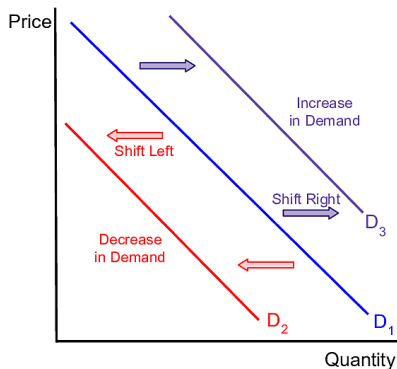
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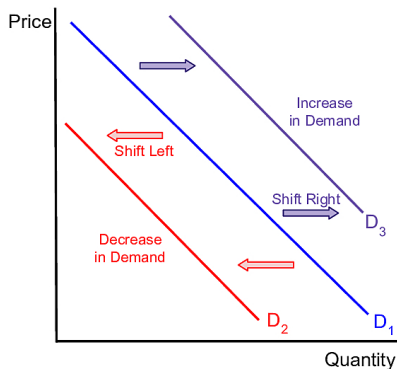
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Substitute Goods

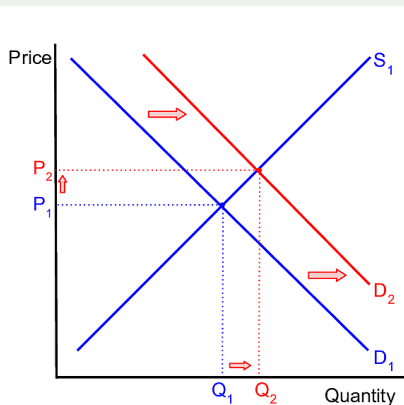
12/ 23

Price of Substitute Goods

- **Substitutes:** a substitute good is a good that can be consumed instead of another good.
- Examples: hamburgers and hot dogs, iPhones and Samsung smartphones, E-books and print books
- If the price of a **substitute increases**, this will **increase demand** for a good
- Eqm price increases, quantity increases

Price of Samsung phones increase

Market for iPhones



Substitute Goods

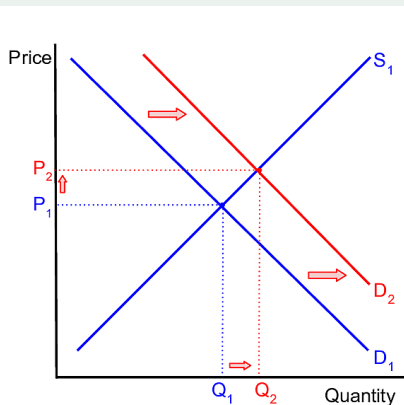
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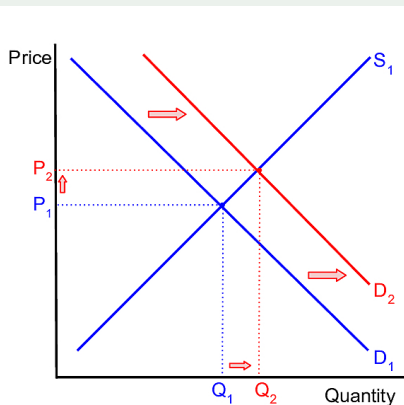
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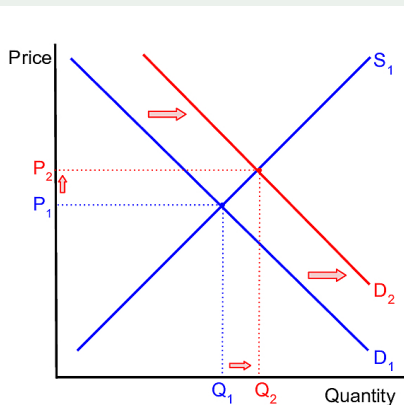
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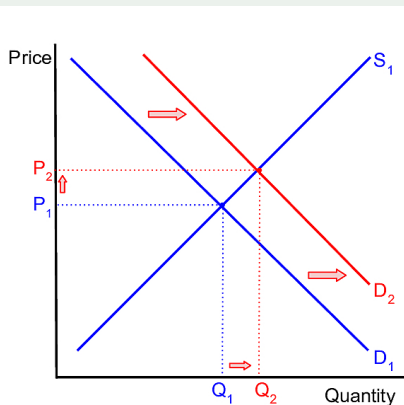
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Complement Goods

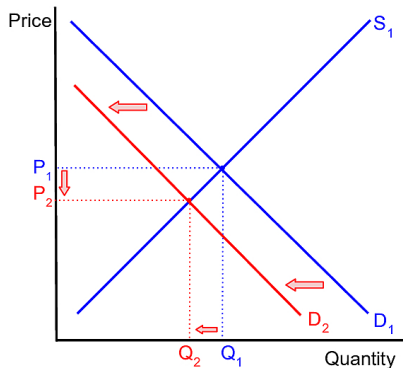
13 / 23

Price of Complement Goods

- **Compelement:** a complement good is a good that is often consumed together with another good.
- Examples: peanut butter and jelly, iPads and Ebooks, smartphones and apps
- If the price of a **complement increases**, this will **decrease demand** for a good
- Eqm price decreases, quantity decreases

Price of Samsung phones increase

Market for Andriod Apps



Complement Goods

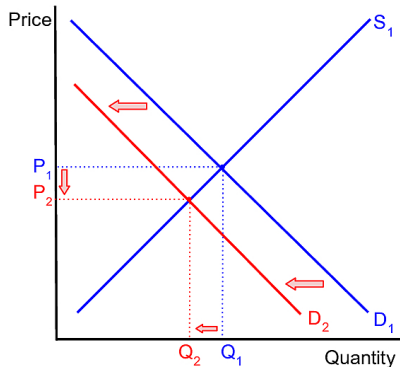
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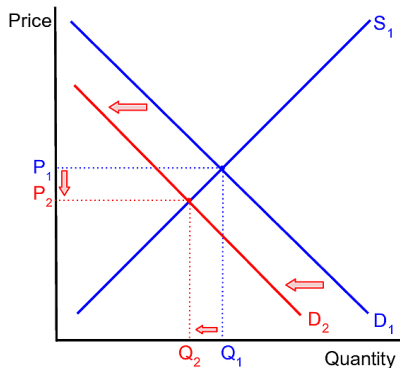
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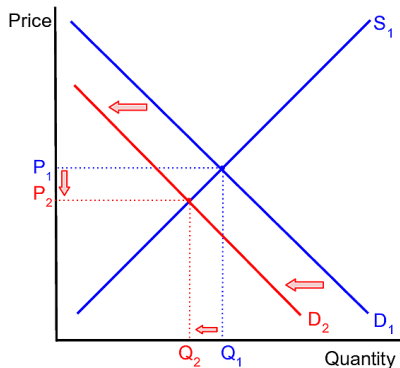
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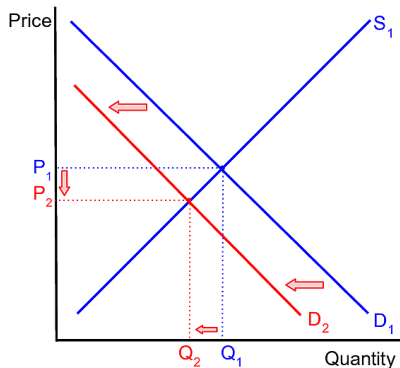
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Changes in Income

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- **Normal good:** a good whose demand increases when consumers' incomes increase.
- **Inferior good:** a good whose demand decreases when consumers' incomes increase.
- Can you think of examples of an inferior good?

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Changes in Income: Normal Goods

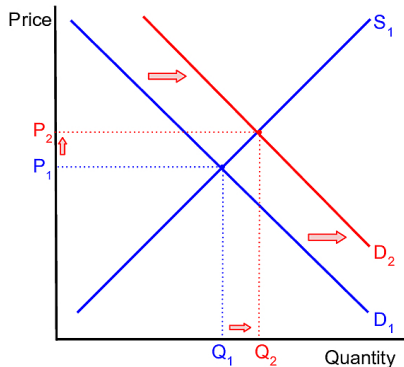
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Income Effect on Normal Goods

- **Normal good**: a good whose demand increases when consumers' incomes increase.
- Examples: Most things, computers, automobiles, restaurant meals
- If **income increases**, this will **increase demand** for a normal good
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Increase in Income

Market for Automobiles



Changes in Income: Normal Goods

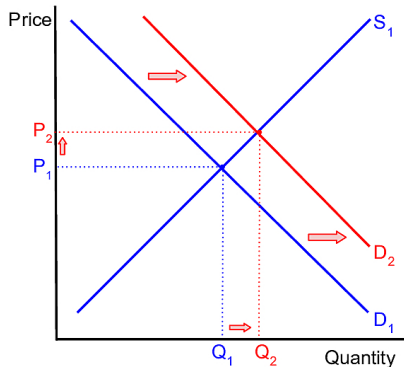
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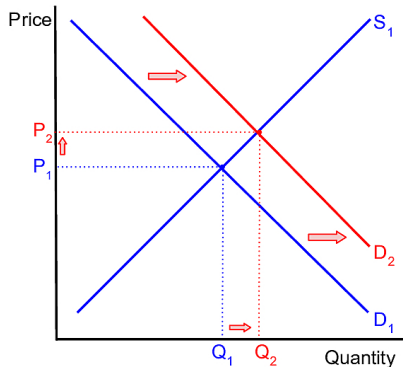
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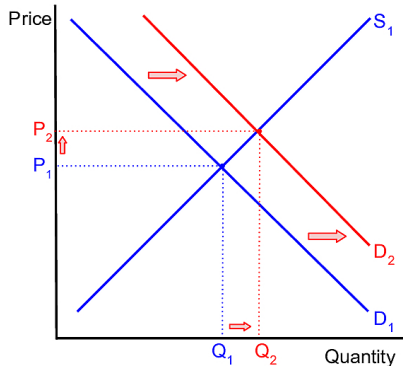
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Changes in Income: Normal Goods

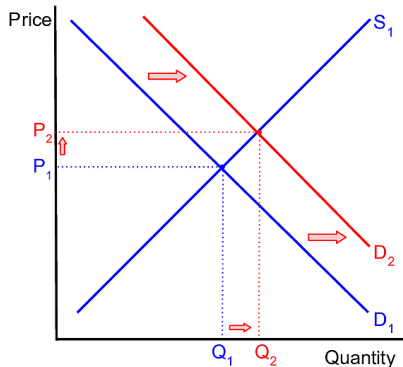
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Income Effect on Normal Goods

- **Normal good:** a good whose demand increases when consumers' incomes increase.
- Examples: Most things, computers, automobiles, restaurant meals
- If **income increases**, this will **increase demand** for a normal good
- Eqm price increases, quantity increases

Increase in Income

Market for Automobiles



Changes in Income: Inferior Goods

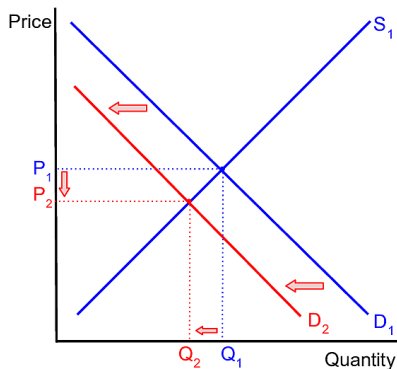
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Income Effect on Inferior Goods

- **Inferior good**: a good whose demand **decreases** when consumers' incomes increase.
- Examples: Used clothing, Ramen noodles
- If **income increases**, this will **decrease demand** for an inferior good
- Eqm price decreases, quantity decreases

Increase in Income

Market for Used Clothing



Changes in Income: Inferior Goods

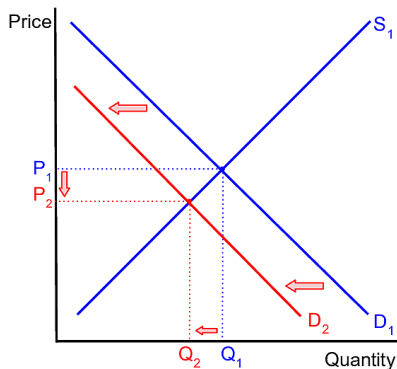
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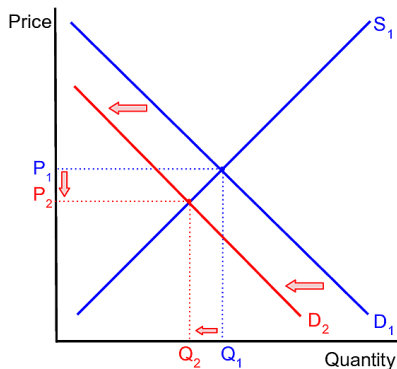
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Market for Used Clothing



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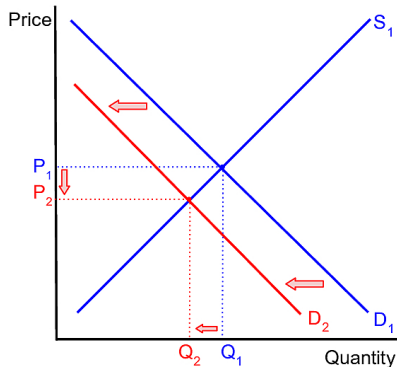
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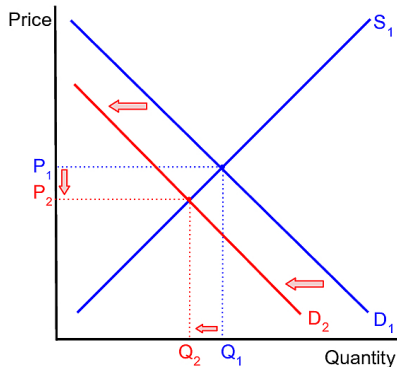
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Market for Used Clothing



Consumers Expect Price Increase

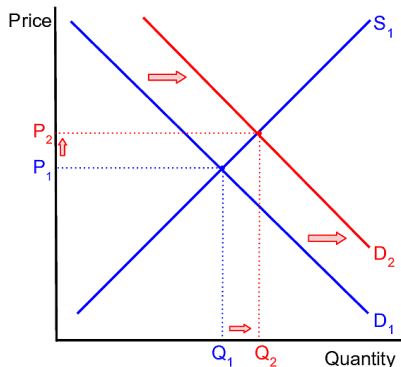
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Expectation of Price Increase

- If consumers expect a price will increase in the future, demand will increase in the present
- The expectation can be well-informed or even unfounded speculation
- Results in higher price, higher quantity
- *Self-fulfilling expectations are possible!*

Expectation of a Price Increase

Market for Gasoline on 9/11/2001



Consumers Expect Price Increase

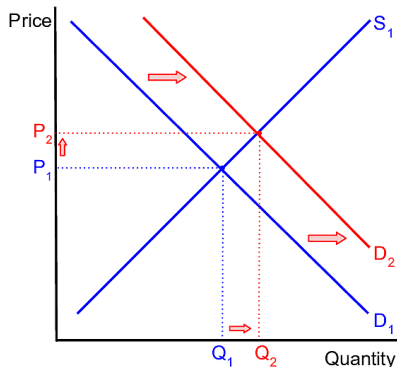
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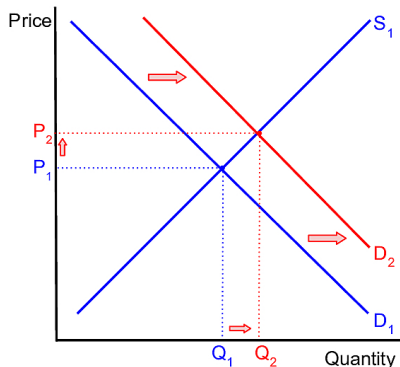
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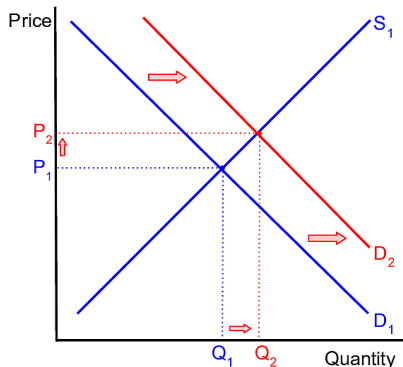
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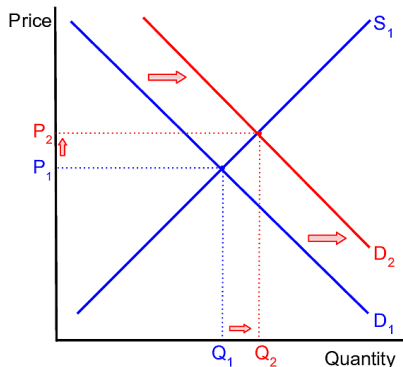
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Consumers Expect Increase in Income

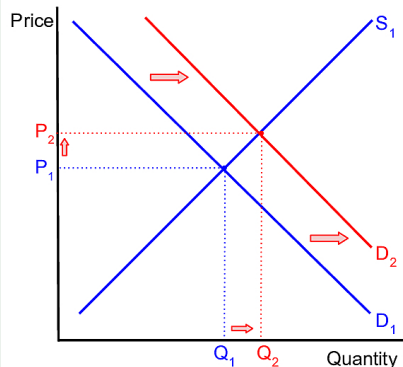
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Expectation of Increase in Income

- If consumers expect higher future income, demand may increase immediately for normal goods
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Expectation of Higher Income

Market for Automobiles (Normal Good)



Consumers Expect Increase in Income

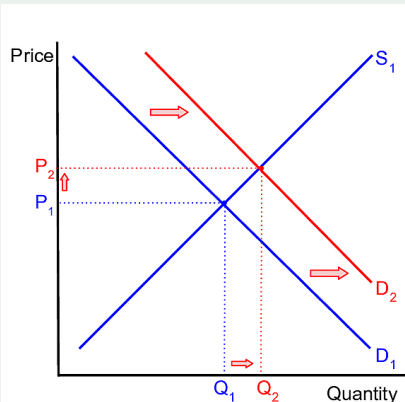
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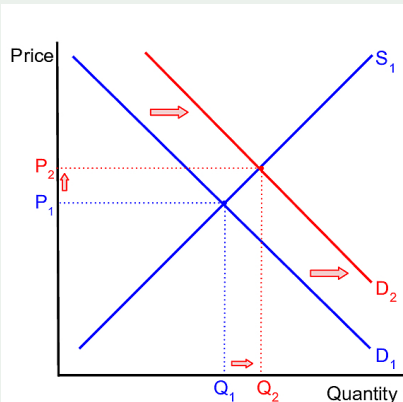
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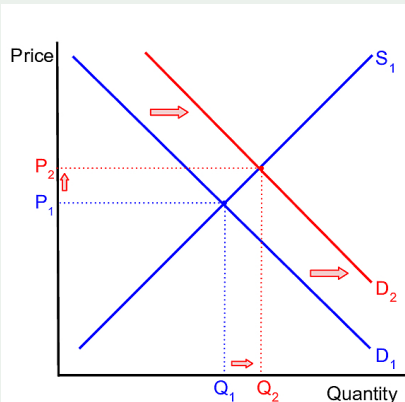
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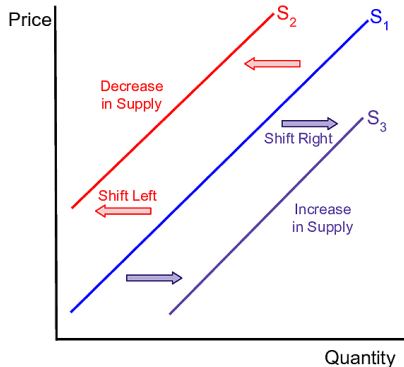
Supply Curve Shifts

19/ 23

Shifts in Whole Supply Curve

- When something *besides the price of the good* effects supply, we say there is a *change or shift in supply*.
- Something that **increases** supply shifts the demand curve to the **right**
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Shifts in Supply



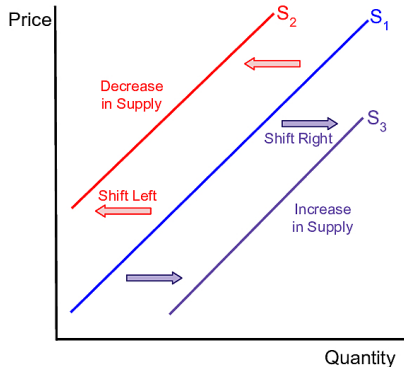
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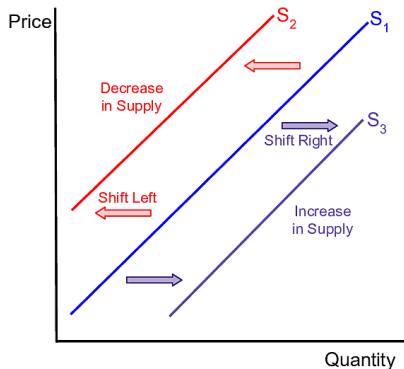
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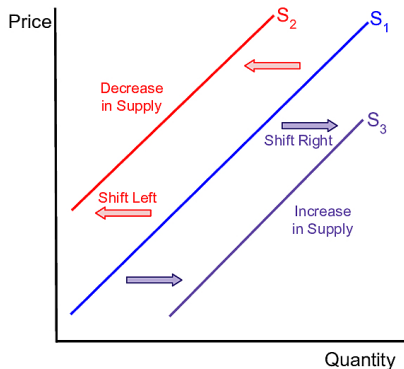
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Improvements in Technology

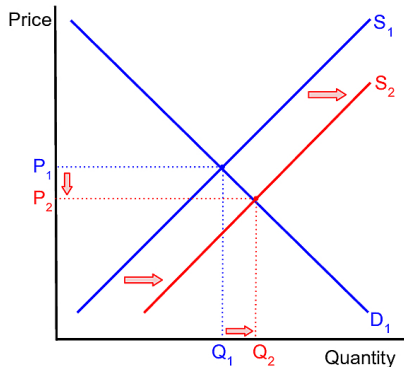
20 / 23

Improvements in Technology

- Improvements in technology can make it possible to produce more
- Improvements in technology can make production easier or less costly
- Shift supply to the right
- Eqm quantity increases, price decreases

Improvement in Technology

Market for Computers



Improvements in Technology

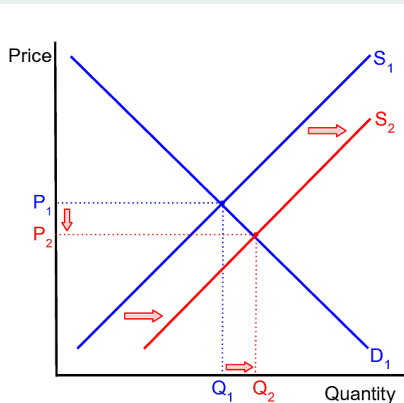
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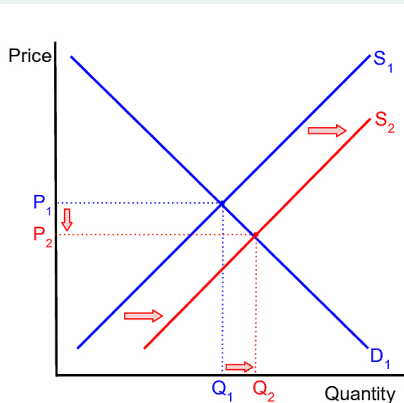
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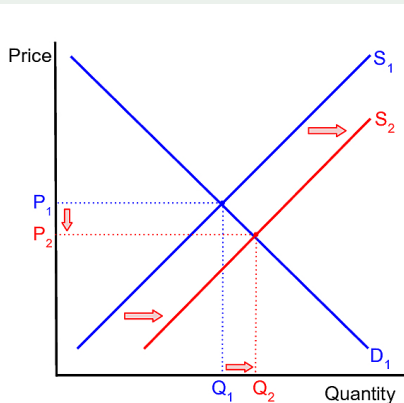
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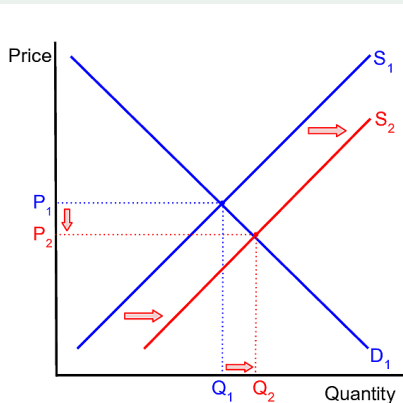
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Increase in Production Costs

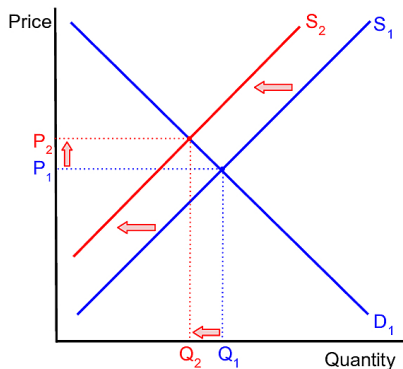
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Increase in Production Costs

- Any increase in production costs causes supply to shift to the left
- For example: Increase in price of lumber for construction of new housing
- Eqm quantity decreases, price increases

Increase in Production Costs: Lumber Used in Construction

Market for New Housing



Increase in Production Costs

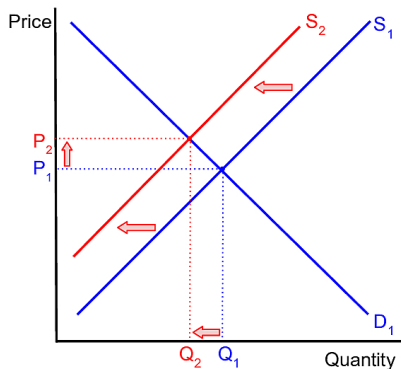
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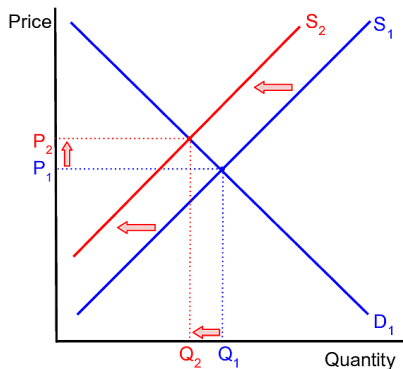
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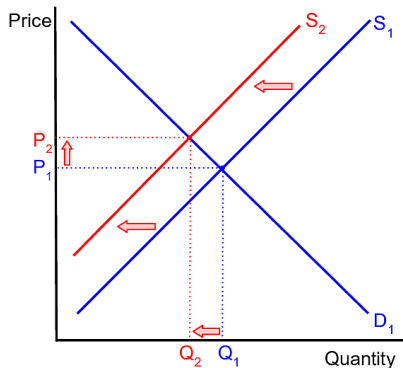
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Producers Expect Higher Prices in Future

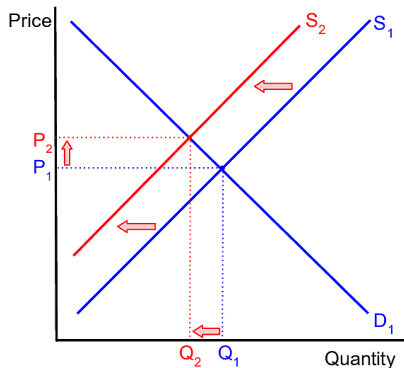
22 / 23

Producer Expectations

- If producers expect an increase in prices, may hold back production or sales until prices are higher
- Easier for goods than can be stored or warehoused
- For example: Agriculture producers expects an increase in price of grain
- Store grain to sell later, supplying less today, supply shifts left
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- *Can lead to self-fulfilling expectations*

Expectation of Higher Future Price of Grain

Market for Grain



Producers Expect Higher Prices in Future

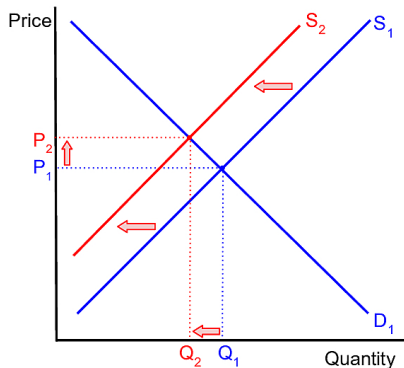
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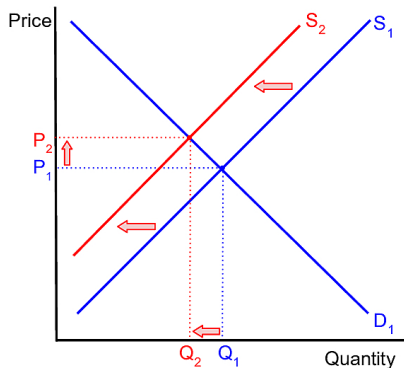
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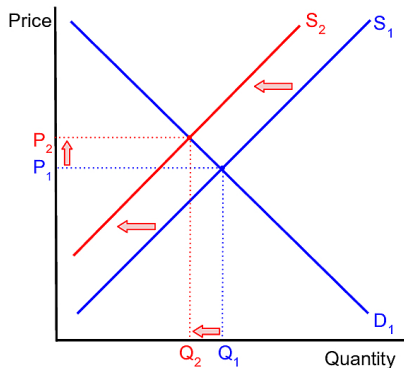
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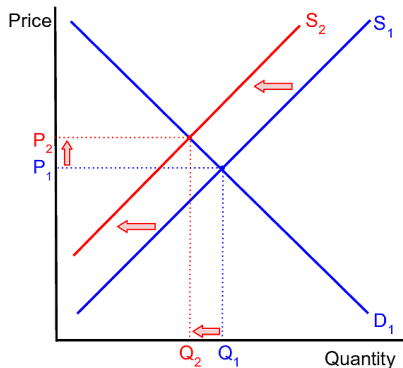
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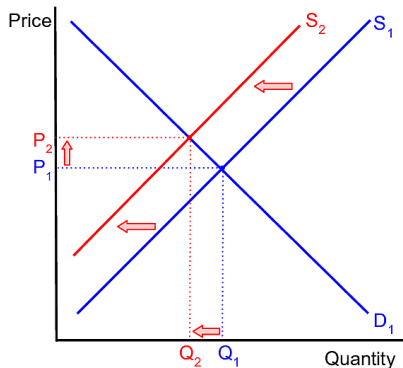
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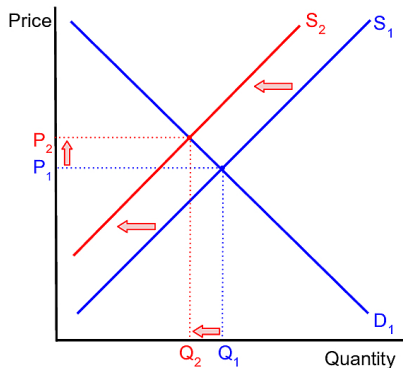
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- Textbook: Supply and Equilibrium, Module 6
- Textbook: Changes and Equilibrium, Module 7
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