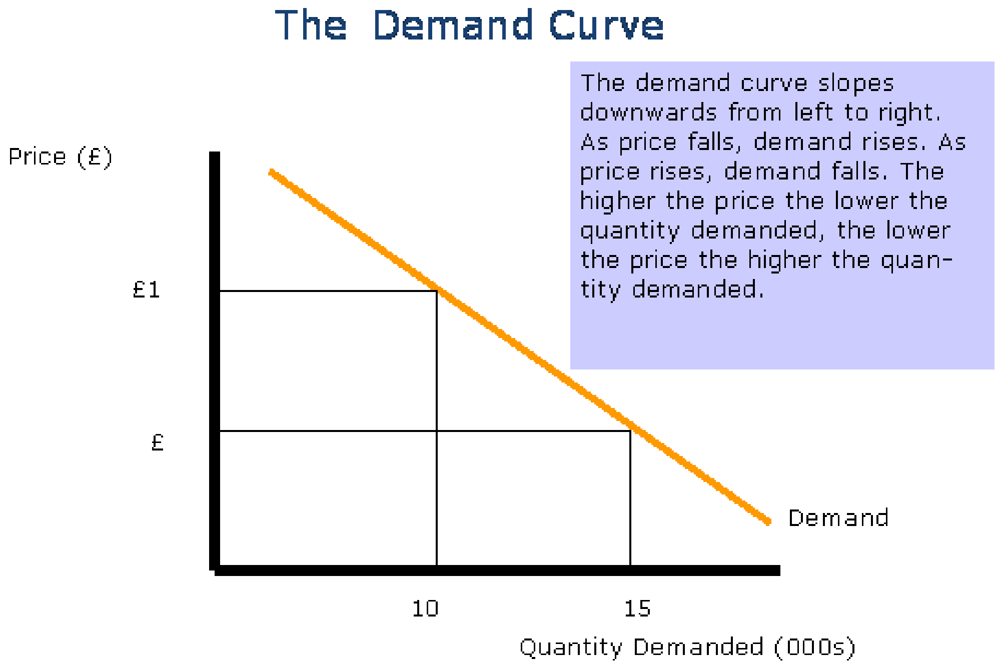
Demand And Supply

Within any market, price is determined by the interaction of demand and supply. How much consumers are willing to buy, combined with how many goods suppliers are willing to produce, will set the market price.

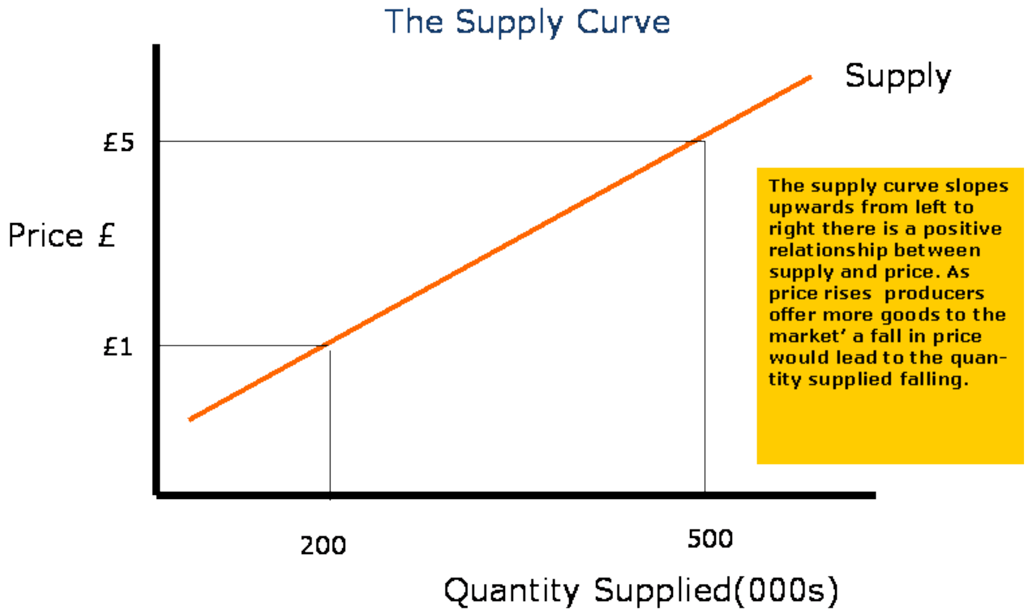


The Demand Curve

The demand curve slopes downwards from left to right. As price falls, demand rises. As price rises, demand falls. The higher the price the lower the quantity demanded, the lower the price the higher the quantity demanded.

Demand

Demand is defined as the quantity of goods consumers are willing and able to purchase at each price level. We can represent demand by drawing a demand curve. The demand curve tells us that the higher the price of a good or service, the lower the quantity demanded, and the lower the price the higher the quantity demanded. A change in price cases a movement along the demand curve. Other factors (see next page) can cause the demand curve to shift.



The Supply Curve

The supply curve slopes upwards from left to right there is a positive relationship between supply and price. As price rises producers offer more goods to the market' a fall in price would lead to the quantity supplied falling.

Supply

Supply is defined as the quantity of goods that firms are willing to supply to the market at a given price level. By looking at the supply curve , we see that the lower the price the lower the amount supplied, and the higher the price the higher the quantity supplied. Higher prices encourage firms to supply more—these firms are trying to make more profits. A change in price causes a movement along the supply curve. Other factors can shift the supply curve (see page 3).

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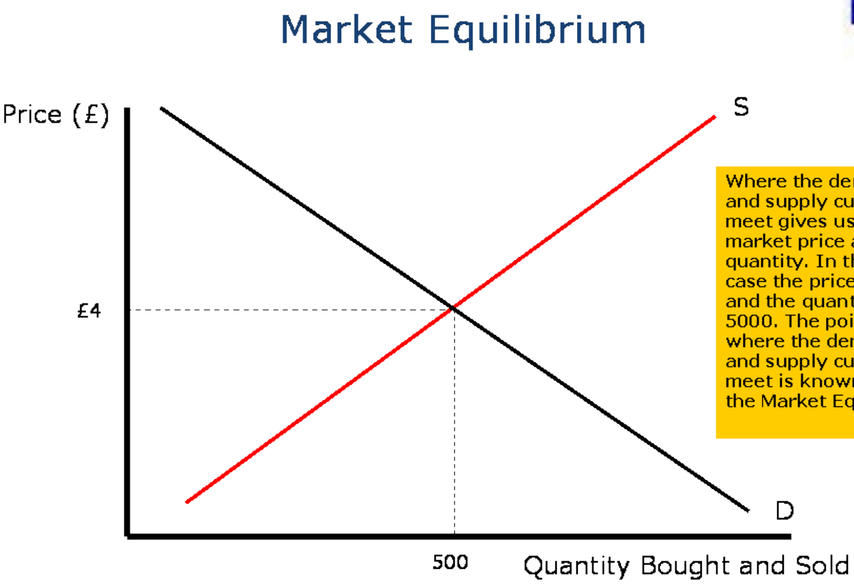
The Market Mechanism

The market mechanism works by the interaction of supply and demand. If there is effective demand (a want backed by ability and willingness to pay), producers will attempt to profitably provide goods to meet that demand. Within any market for goods and services, it is this interaction of supply and demand that decides the price goods are sold at.

We see below a demand curve and a supply curve. The demand curve tells us that the higher the price of a good or service, the lower the quantity demanded, and the lower the price the higher the quantity demanded. By looking at the supply curve, we see that the lower the price the lower the amount supplied, and the higher the price the higher the potential supply

The equilibrium point is where Supply = Demand, the point where the lines cross. At this point all goods produced are sold. We can see that the equilibrium price is £4, and the quantity sold 500



Where the demand and supply curves meet gives us a market price and quantity. In this case the price is £4 and the quantity is 5000. The point where the demand and supply curves meet is known as the Market Equilib-

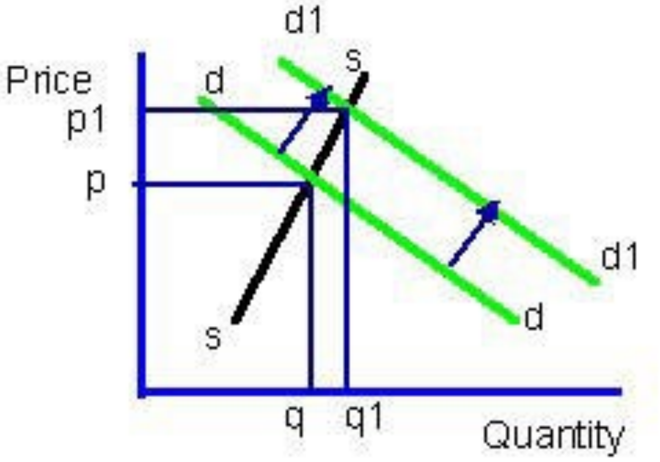
Shifts in the demand curve

In most cases firms must accept the market (equilibrium price) for the goods or services that they produce and sell, - these firms are known as price takers. Some firms though are large enough or have strong enough brands to influence the position of the demand curve. They can do this by using the marketing mix to affect consumer demand for their products. We see how this can work below

The market for the new Mini

Originally the market is at equilibrium, at price P and quantity Q. The demand curve shifts to the right because of an increase in advertising by BMW, increasing demand. This moves the market equilibrium to price P1 and quantity Q1. The firm is able to sell more Minis at a higher price.

So effective advertising—making a good more fashionable, shifts out the demand curve—more are now demanded, at every price level.



Sometimes factors outside a firms control can shift the demand curve for their goods. These factors include;

- A change in peoples disposable incomes—this can arise from an increase in interest rates. In this case for most goods the demand curve will shifty to the right, reducing price and quantity sold. But an increase in wealth can shift out the demand curve.
- increase in competition—if consumers have an new alternative (or substitute good) that they can purchase instead, then the effect is often a shift to the left of the demand curve of the original good.
- change in price of a compliment.— a compliment is a good used with another good eg cars and petrol. A rise in the price of petrol, reduces demand for cars, shifting in the demand curve. A fall in petrol prices would likely shift out the demand curve for cars.

All these shifts would cause a new equilibrium price and quantity demanded in the market.

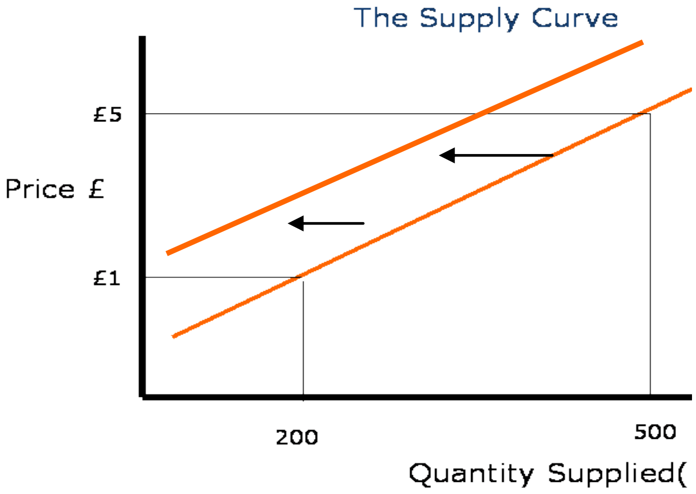
Supply.

Supply is defined as the amount that producers are willing to offer for sale at a given price in a given time period. The basic law of supply states that ‘the higher the price the greater the quantity supplied, and the lower the price the lower the quantity supplied. Suppliers/ producers chase profit, a farmer seeing prices of pork rise, will produce more pigs.

Shifts in the Supply Curve.

Sometimes just like the demand curve the supply curve can shift, more of less is produced at each price level. The main causes of these shifts are

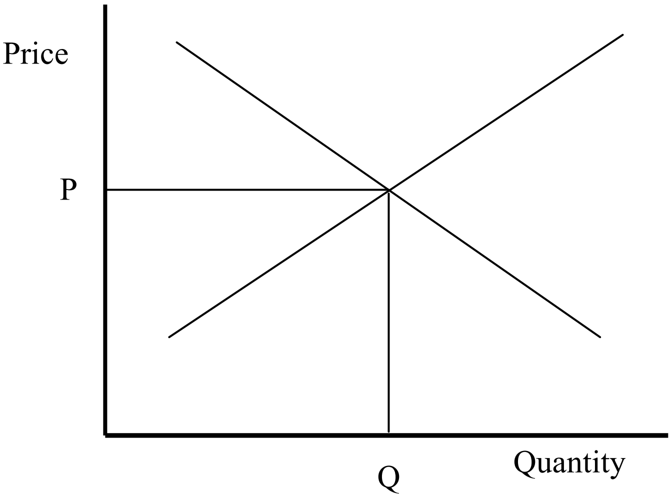
- An increase in costs of production or supply will lead to the supply curve shifting to the left. This means that at each and every price, less is supplied to the market. Factors that can cause a shift to the left include;
- An increase in the cost of raw materials
- An increase in labour costs
- An increase in tax on goods produced
- Poor harvest of crops
- A fall in the costs of production will cause a shift to the right of the supply curve. This means that at each and every price a greater quantity will be supplied to the market. Factors which cause this shift to the right include
- Introduction of new technology
- Fall in the price of raw materials
- Increase in productivity
- Fall in tax on the goods produced.
- New firms entering the market



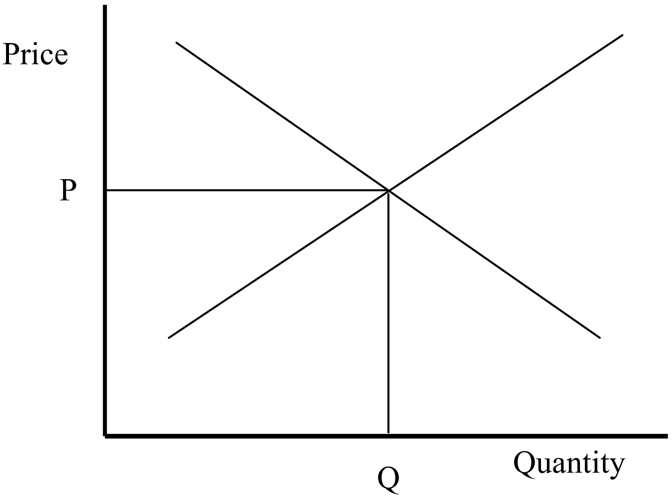
Above is a shift in, in the supply curve caused by increased costs, less is now supplied at each price level.

Example shifts in Demand and Supply and a new equilibrium.

1. An increase in consumer incomes on the market for foreign holidays.



2. A poor harvest of grapes on the price of wine



3,. New firms from China starting to supply laptop computers to the UK market.