Module 19 Article

What is Supply & Demand?

The Law of Supply & Demand

Especially when it comes to the economy, the law of supply and demand are the backbone of the finance industry. In all, the theory of supply and demand is the overall interaction between the corporations, and their consumers, but more importantly, how this relationship is balanced. Like any scale, the law of supply and demand must be balanced, even though this is rarely the case. Nevertheless, in terms of the economy, supply and demand relate to the availability and price of a resource or asset, and, once again, how accessible this commodity is.

Let's take gasoline as an example. If there is a limited source of gasoline, then the price will increase, as there is not as much gasoline to go around to the consumers. On the other hand, when there is an abundance of gasoline, the prices will tend to decrease, as there is an abundance, and there will be more for the general population. While this is the simpler version, supply and demand can get quite complicated, especially when you visit other sectors!

In all, the model of supply and demand is often interpreted in three different elements, shown in graphs: the supply curve, the demand curve, and equilibrium. In this article, we will tackle these three concepts, and distinguish the differences between them. But first, read the two separate definitions for both the law of demand, and the law of supply.

The law of demand reads that the higher the price of a commodity, the lower quantity of goods will be sold. The law of supply, in turn, states that the higher the price of a commodity, the higher the supply will be.

The Supply Curve

Simply put, the supply curve easily shows the change in price for a particular service, good, commodity, or asset, and how it drastically impacts the quantity available. Here, it is important to note that while there can be some deviations, for the most part, the supply curve will show a positive trend, showing a direct relationship between the price, and the quantity. Within supply curves, there are two types: the individual and market curves - and they are exactly what they sound like! Within an individual curve, the graph or display would concern only one singular supplier for a given commodity or asset, while on the other hand, a market curve will show the overall trend for the entire trade.

The overall concept of a supply curve is able to profit based on exactly that - profit! If a company is selling a good that is high in demand, they are typically able to raise the price, and the company is able to profit much more on the same commodity. As the profit margin increases, the demand will (hopefully) stay the same!

The Demand Curve

Similar to the supply curve, the demand curve represents the relationship between the price of the good, commodity, service, or asset, and demand of this said product via the general public or targeted population. Although, differing from the supply curve, the demand curve usually isn't so straightforward with a noticeable trend. In turn, a demand curve typically shows that when the price rises, the demand can drop, sometimes, more intensely than others. Here, we can consider the term demand elasticity, which is a measurable degree regarding the relationship between a rising price, and a falling demand. Simply put, if a commodity rises in a 10% trend in terms of price, but the demand simultaneously drops in a matching 10%, the demand elasticity will be 1, as there is a 1:1 ratio there.

While the curves can change, we can assume that there would be a downward slope, as this concept states that demands will drop with the increase of price. In relation back to the supply curve, there are also sub-curves within the demand curves, being the individual and market curves, that act the same as they would within the supply curve (refer above if you forgot!).

Equilibrium
And finally, a combination of both the supply and demand curves, comes the economic equilibrium curve. As the name implies, the equilibrium curve expresses the condition and trend where the economic terms are balanced! Now, the question is, how is this possible?

And the answer? It isn't! Even though balance is a universal concept, when it comes to supply and demand, it doesn't actually exist. We call this a theoretical construct, because regardless of how close it may seem, the market will never actually reach complete balance, even though it is always working toward it. While this doesn't make too much sense, the suppliers and consumers of the market make it a common ideal, as the fluctuating prices and demand of items are changing drastically, trying to find a balance that benefits the corporation, but is also suitable to the consumers.

So, what's the point?
In all, without the concept of supply and demand, investors wouldn't have a way to show trends of consumption, and its relation to both supply and pricing. Of course, all of this can and will be affected by external factors, anything from national to international changes, but in the end, supply and demand trends follow us everywhere we go, and it's important to stay aware of them. So, what supply and demand trends have you experienced? Was it designer shoes with expensive tags, or a paper shortage during the COVID-19 pandemic? Supply and demand is all around us, and the industries are only growing. Can you identify them?