Lecture 8: Market Equilibrium

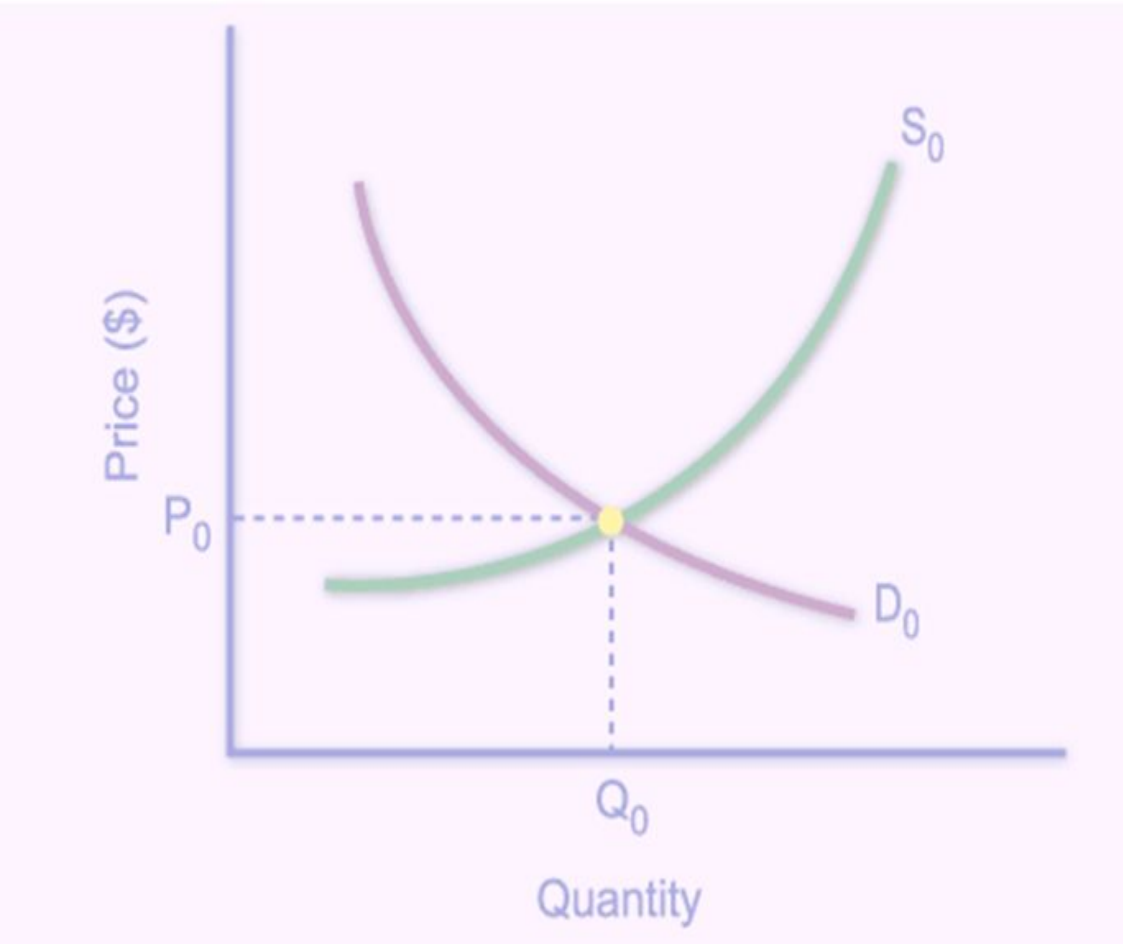
ECO101: Introduction to microeconomics

BRAC University

Market Equilibrium

The *market equilibrium price* is the price at which the quantity demanded equals the quantity supplied.

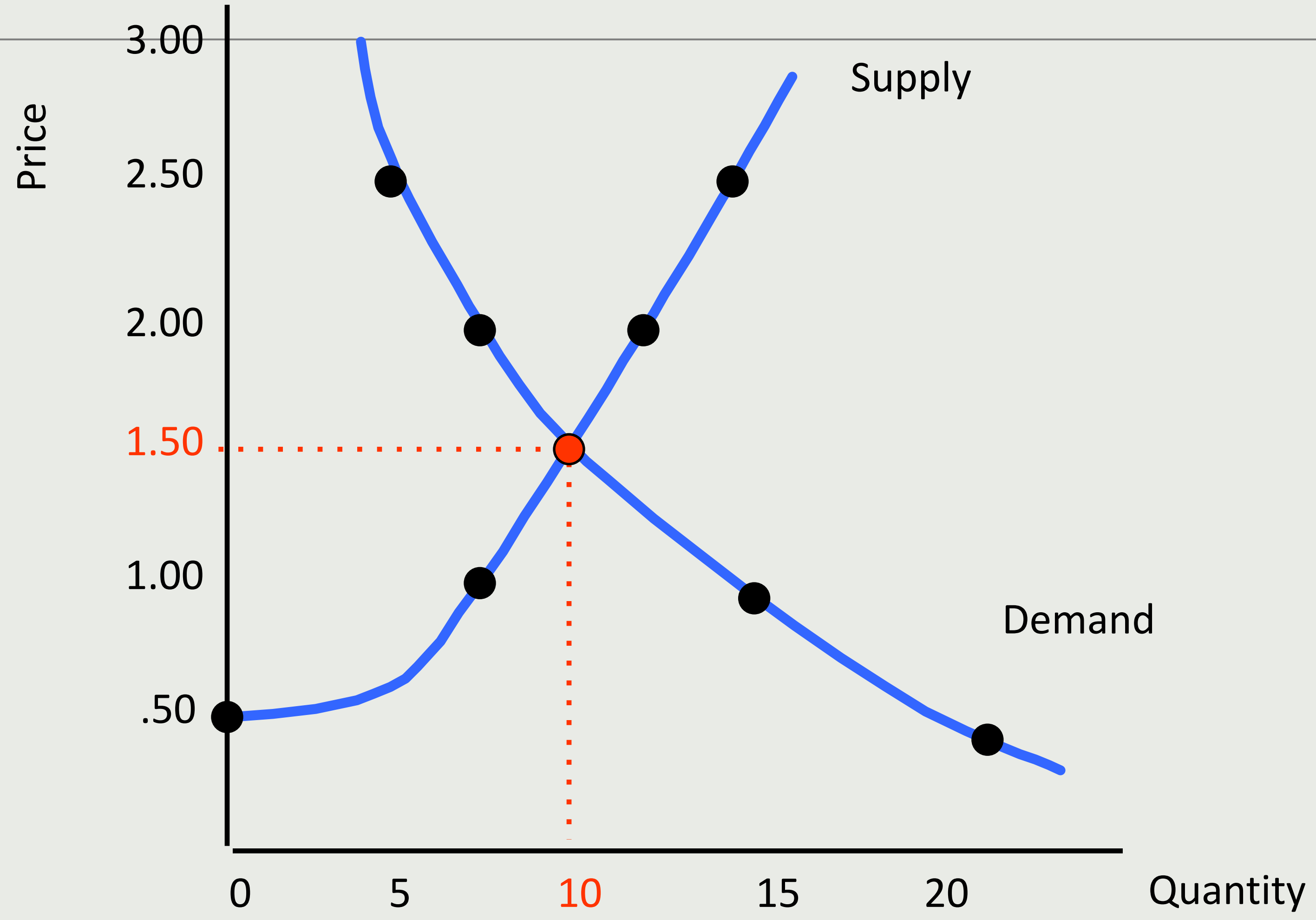
The *market equilibrium quantity* is the quantity bought and sold at the equilibrium price.



Market Equilibrium

Price (dollars of bars)	Quantity demanded	Quantity supplied	Shortage(–) or surplus(+)
	(millions	of bars	per week)
0.50	22	0	–22
1.00	15	6	–9
1.50	10	10	0
2.00	7	13	+6
2.50	5	15	+10

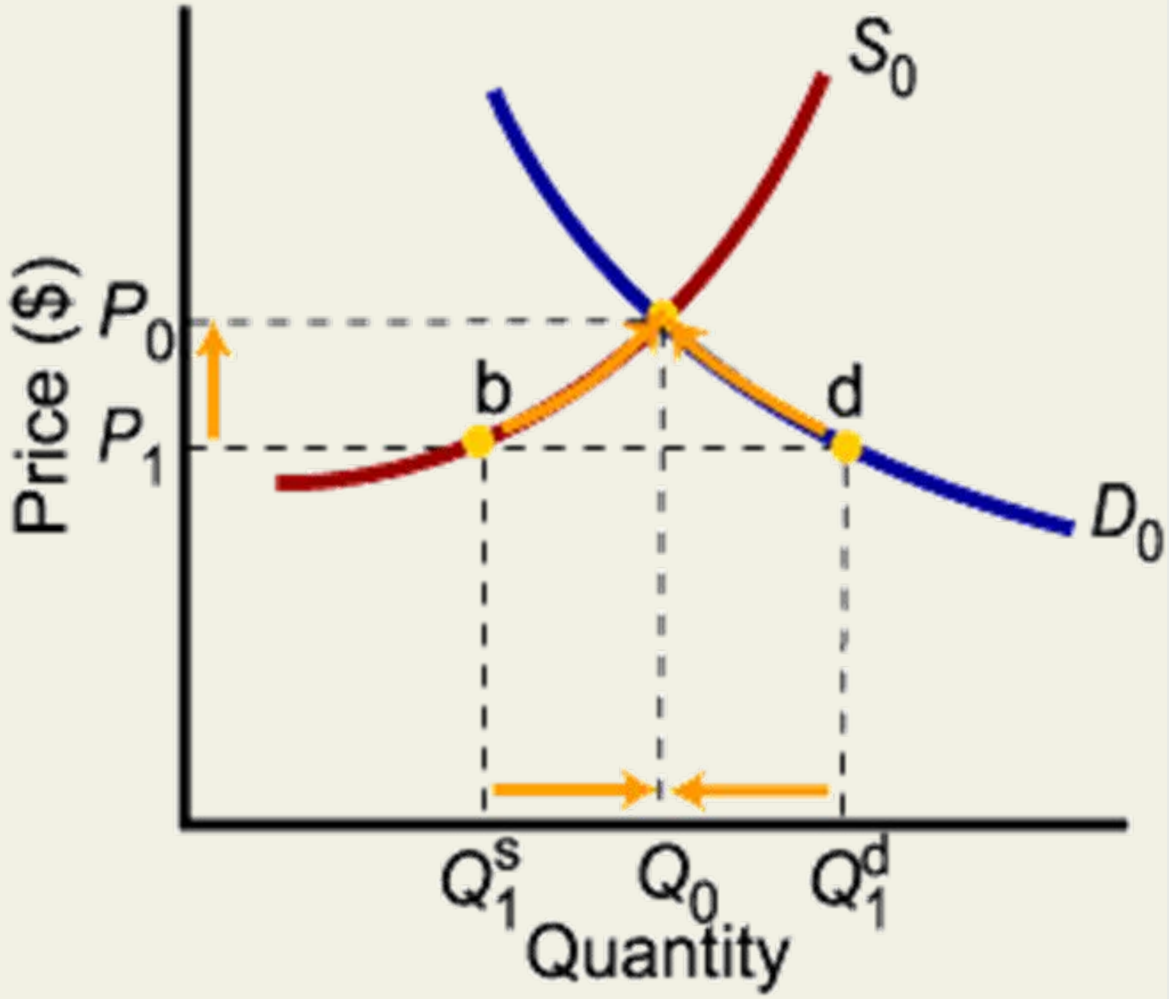
Market Equilibrium



Market Disequilibria: Shortages

If the price is too low, the quantity demanded exceeds the quantity supplied. People are willing to pay more for the good.

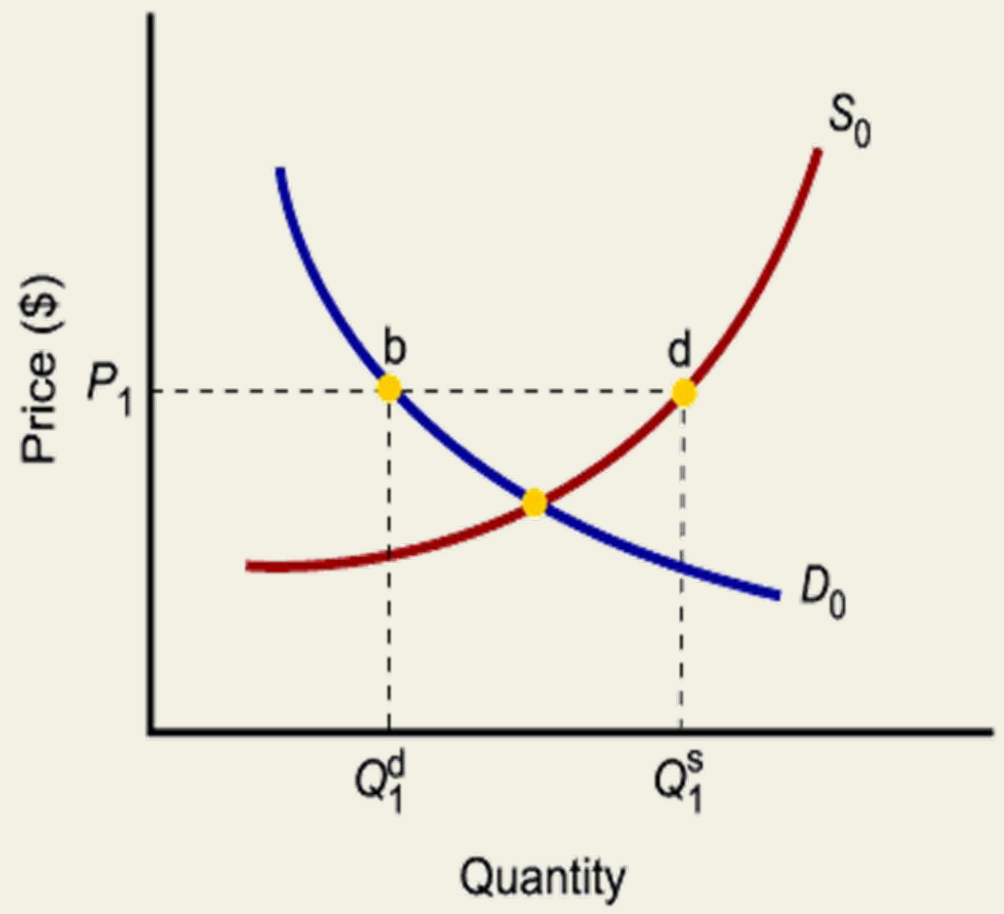
To eliminate this *shortage*, sellers will raise the price, increasing the quantity supplied and reducing the quantity demanded.



Market Disequilibria: Surpluses

If the price is too high, the quantity supplied exceeds the quantity demand. Inventories pile up.

To eliminate this *surplus*, sellers will lower the price, reducing quantity supplied and increasing quantity demanded.



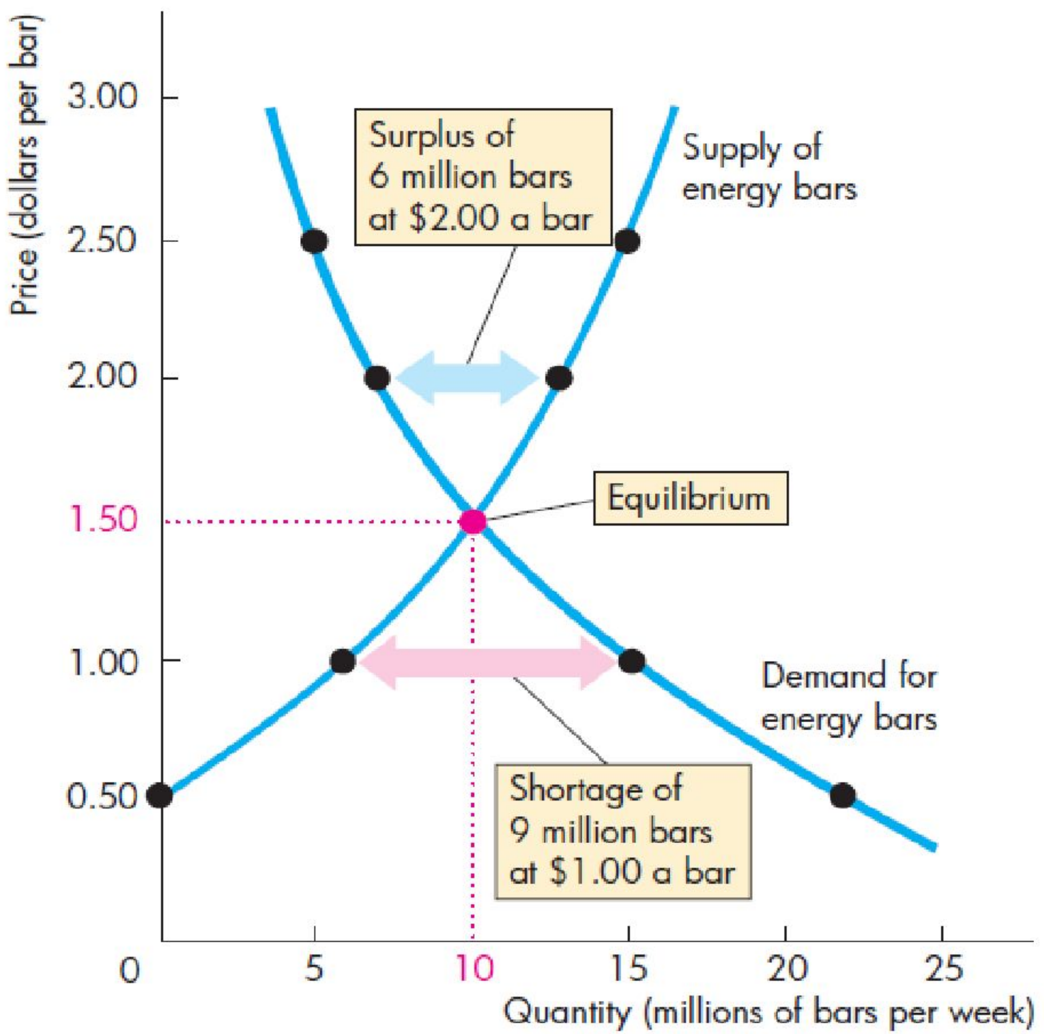
A Shortage Forces the Price Up

- If demand exceeds supply, sellers will raise price, decreasing quantity demanded.

A Surplus Forces the Price Down

- If supply exceeds demand, sellers will see their inventories of unsold goods piling up and will cut price to sell them.

FIGURE 3.7 Equilibrium



Lecture 9: Predicting changes in Market Equilibrium

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Predicting Changes in Price and Quantity

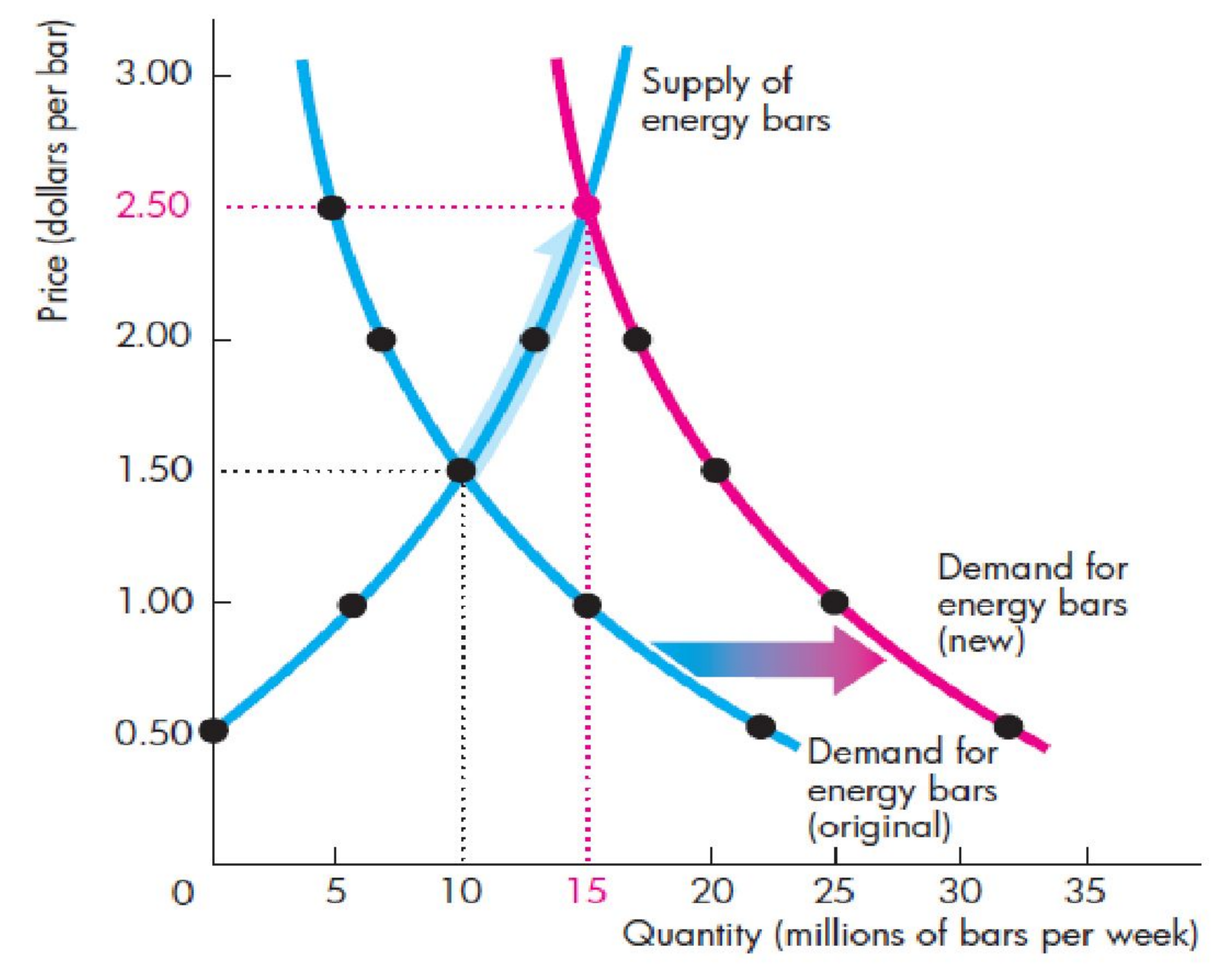
A change in price and quantity must be caused by either a change in demand or a change in supply or both!

Demand Increases if:	**Demand Decreases if:**
The price of a substitute rises	The price of a substitute falls
The price of a complement falls	The price of a complement rises
The expected future Price or income rises	The expected future Price or income falls
Income rises*	Income falls*
No of consumer/ population increases	No of consumer/ population decreases
*considering normal goods	*considering normal goods

Effect of An Increase in Demand on Equilibrium Price and Quantity

An increase in demand shifts the demand curve to the right (outward shift in demand).

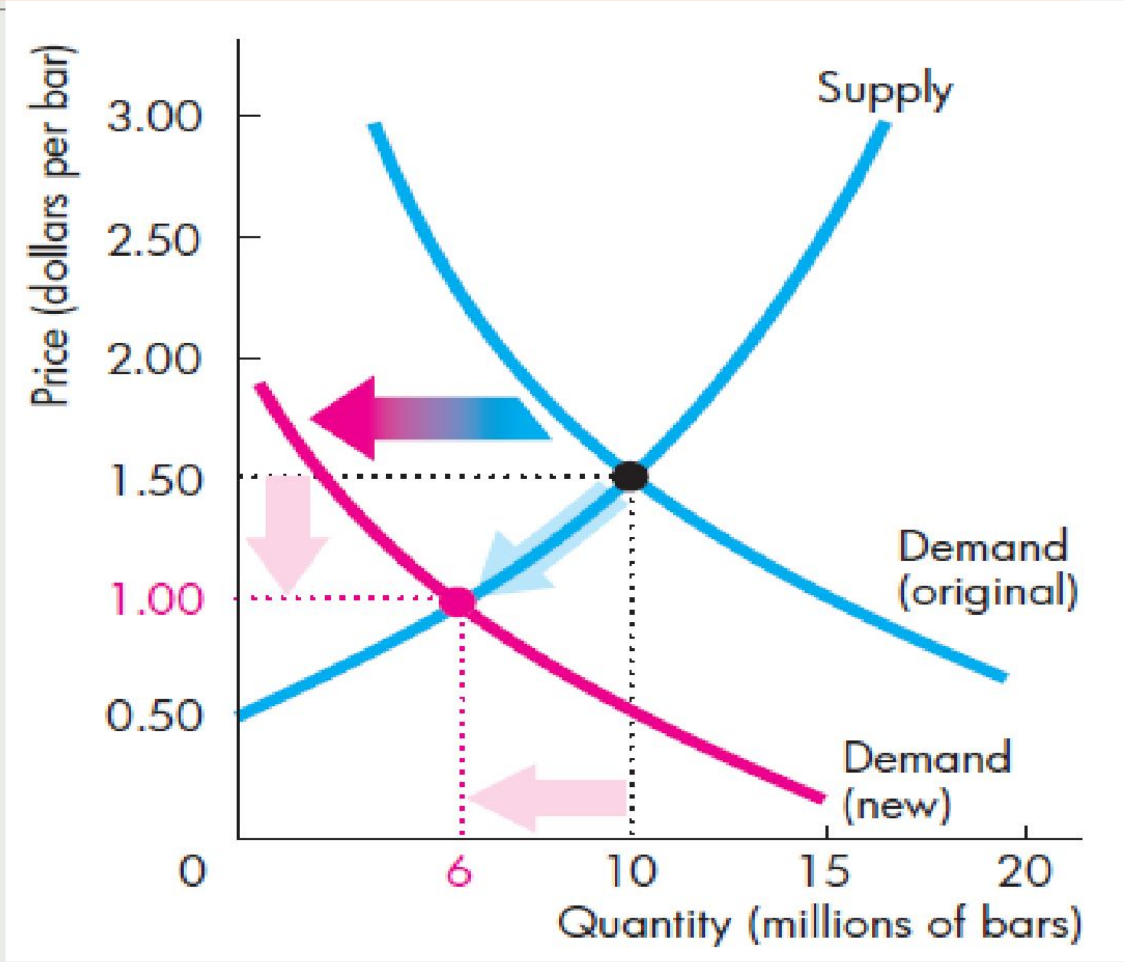
The new equilibrium price and quantity are higher.



Effect of A decrease in Demand on Equilibrium Price and Quantity

A decrease in demand shifts the demand curve to the left (inward shift in demand).

The new equilibrium price and quantity are lower.



Supply Increases if:

- The price of a factor of production (input price, technology) falls
- Favorable govt. policy
- The expected future price falls
- The number of suppliers of bars increases
- The price of a substitute in production falls
- The price of a complement in production rises
- A favorable natural event increases production

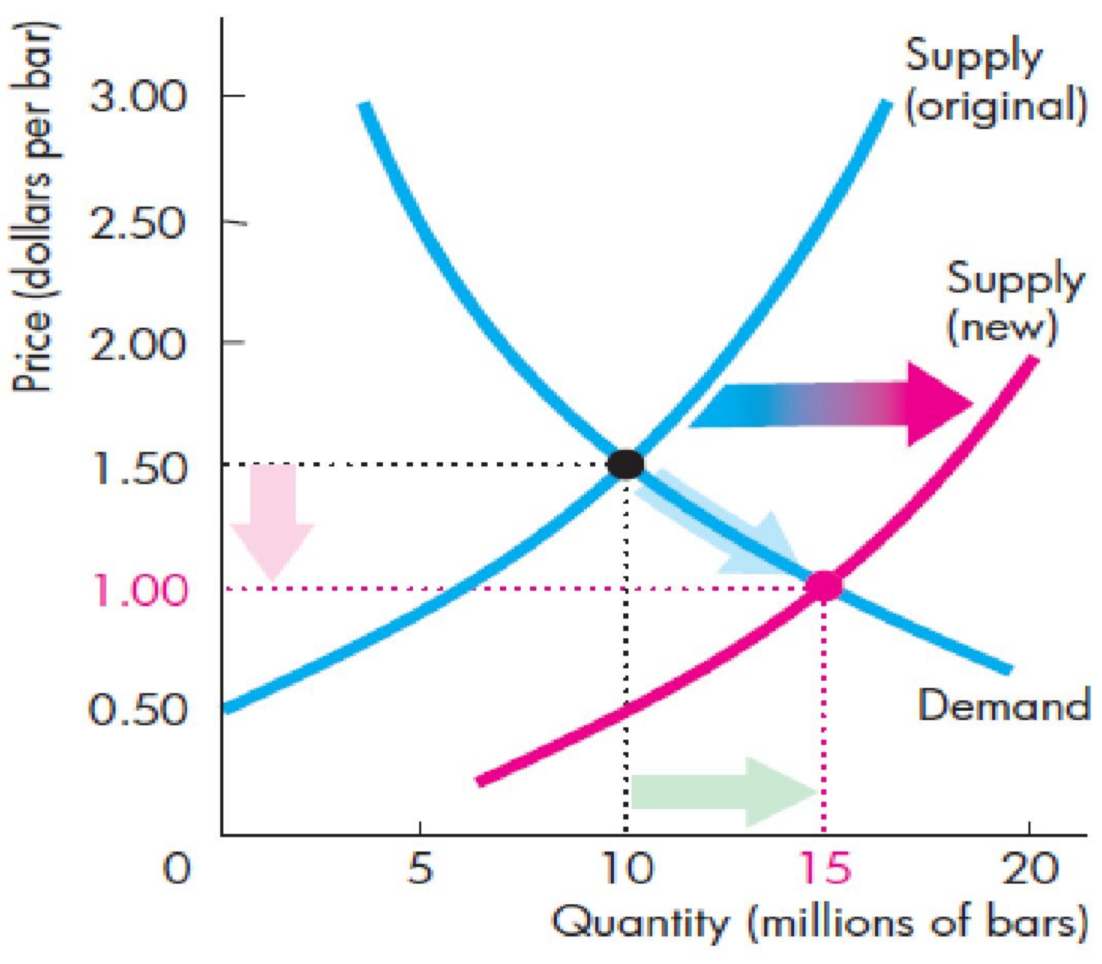
Supply Decreases if:

- The price of a factor of production (input price, technology) rises
- Unfavorable govt. policy
- The expected future price falls
- The number of suppliers of bars increases
- The price of a substitute in production rises
- The price of a complement in production falls
- A unfavorable natural event decreases production

Effect of An Increase in Supply on Equilibrium Price

An increase in supply shifts the supply curve to the right (outward shift in supply).

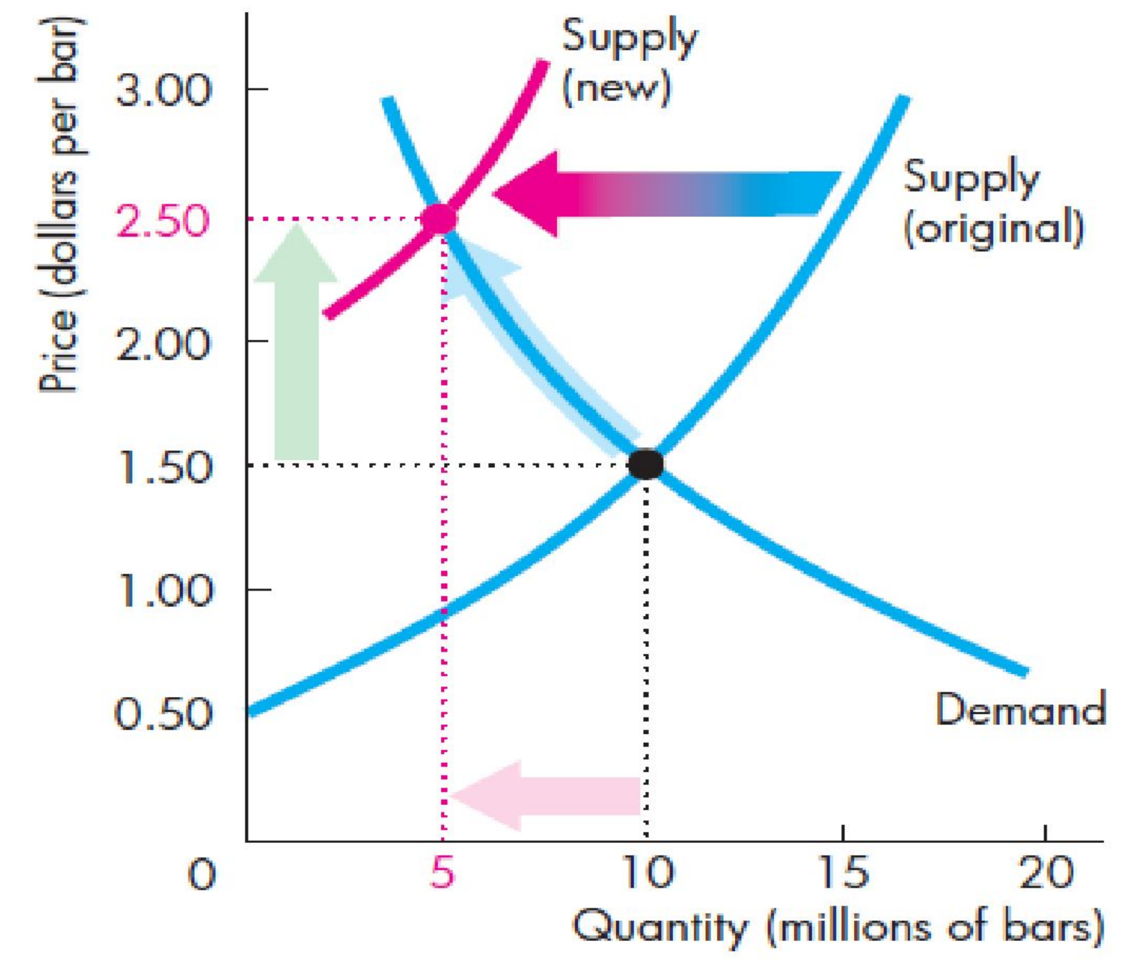
The new equilibrium price is lower, but the equilibrium quantity is higher.



Effect of An Decrease in Supply on Equilibrium Price

A decrease in supply shifts the supply curve to the left (inward shift in supply).

The new equilibrium price is higher, but the equilibrium quantity is lower.



A Change in Both Demand and Supply

There are four possible scenarios-

1. Both demand and supply increase
2. Both demand and supply decrease
3. Demand increases and supply decreases
4. Demand decreases and supply increases

Effects-

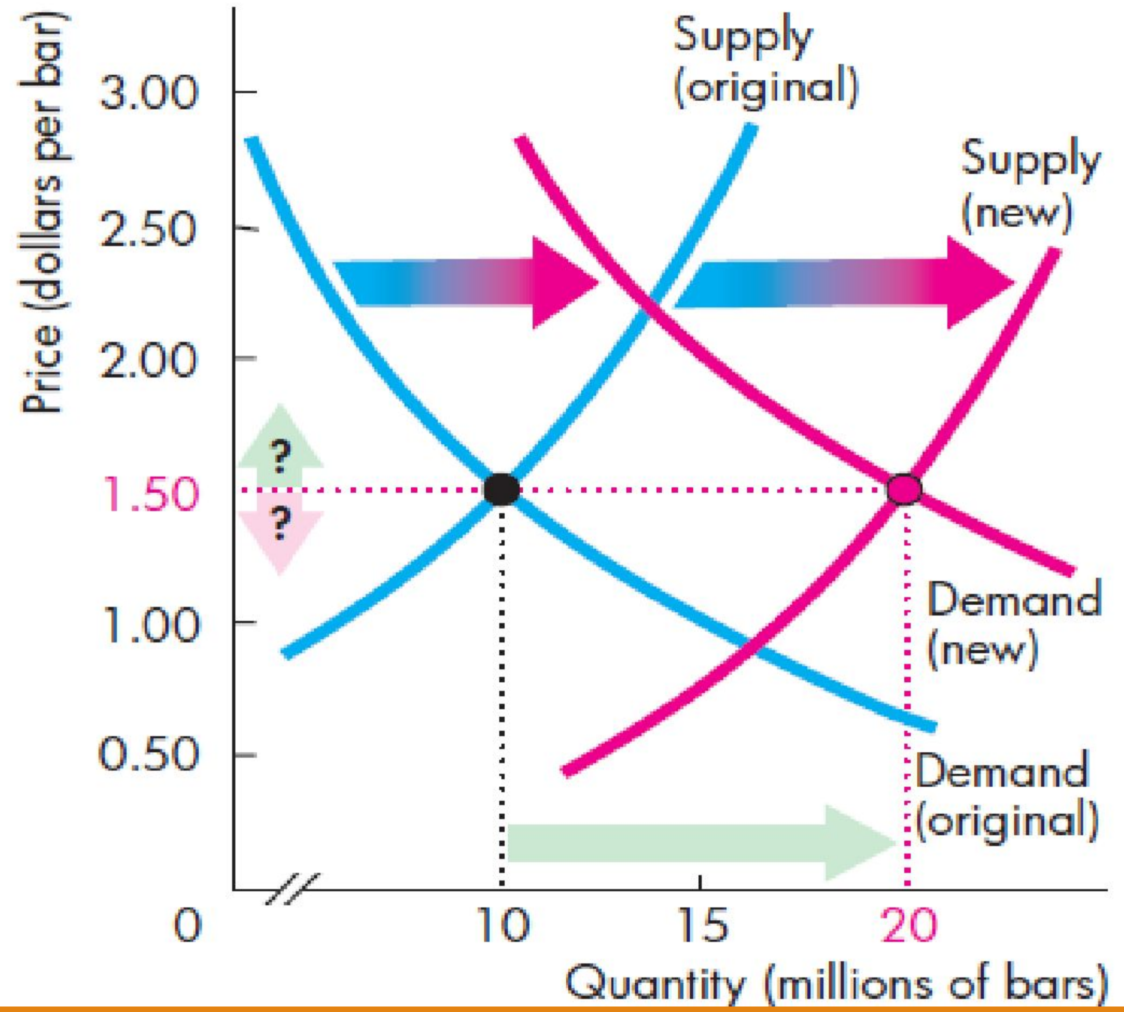
- Both curves shift.
- Price and quantity change will depend on how each curve shifts on which direction.

1. Both demand and supply increase

If demand and supply increase, both the demand and supply curves shift to the right (outward).

Effect on equilibrium price and quantity

- The new equilibrium quantity will be higher.
- The new equilibrium price may be higher, lower, or it may remain the same.

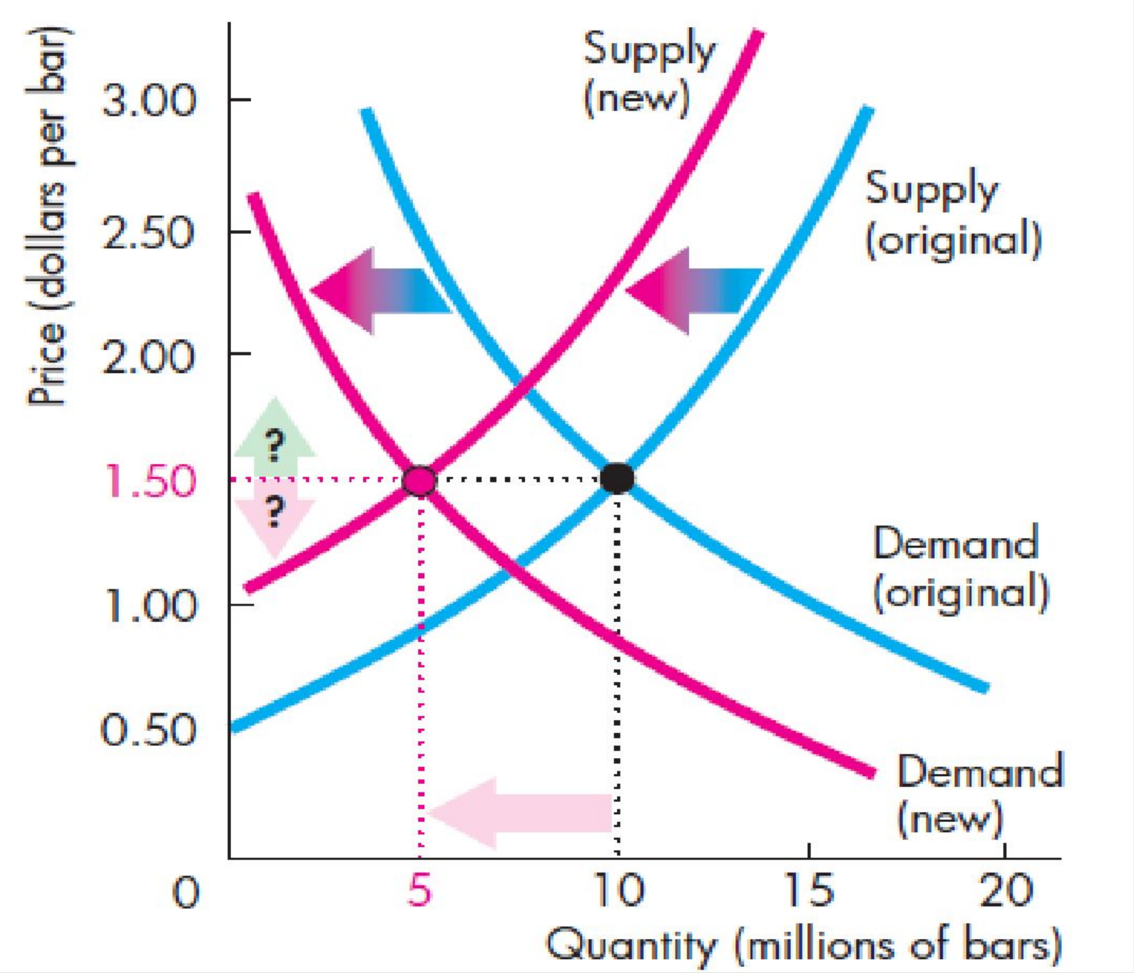


2. Both demand and supply decrease

If demand and supply decrease, both the demand and supply curves shift to the left (inward).

Effect on equilibrium price and quantity

- The new equilibrium quantity will be lower.
- The new equilibrium price may be higher, lower, or it may remain the same.



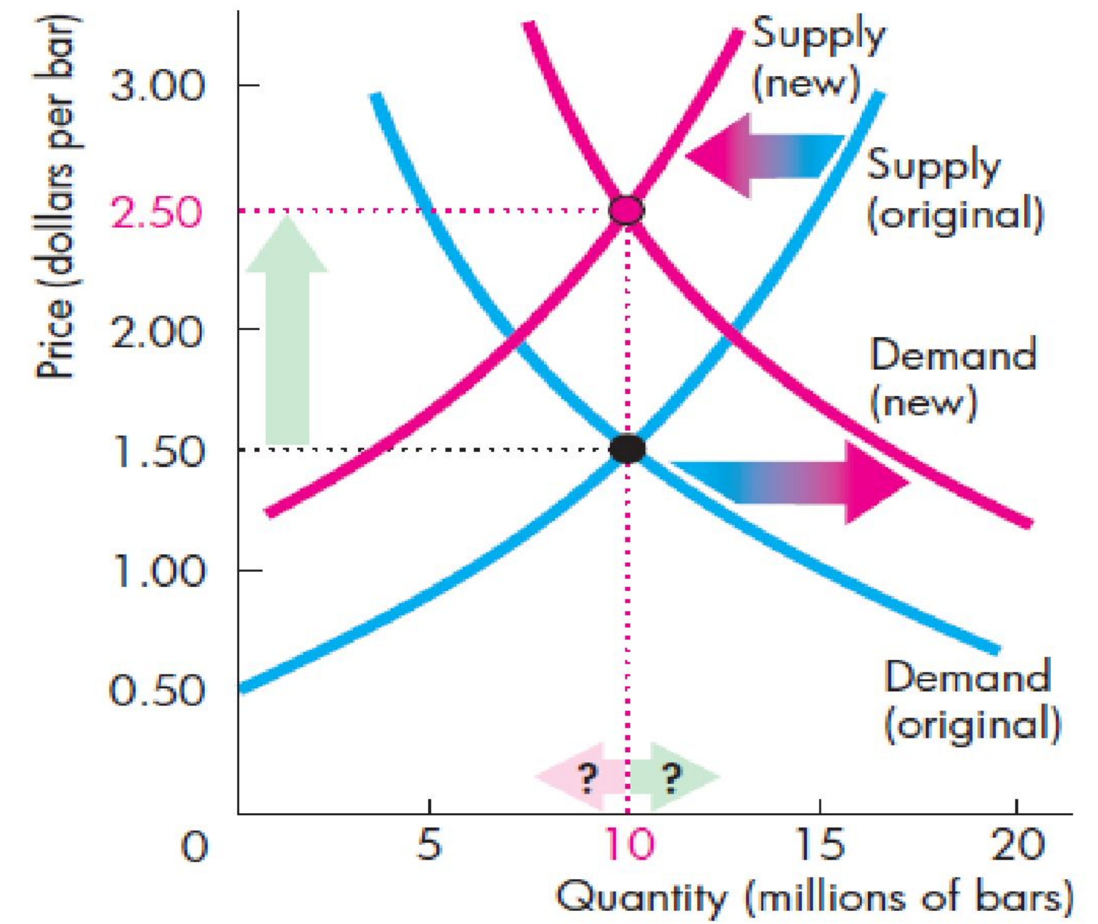
3. Demand increases and supply decreases

When demand increases, demand curve shifts to the right (outward).

When supply decreases, supply curves shift to the left (inward).

Effect on equilibrium price and quantity

- The new equilibrium price will be higher.
- The new equilibrium quantity may be higher, lower, or it may remain the same.



4. **Demand decreases and supply increases**

When demand decreases, demand curve shifts to the left (inward).

When supply increases, supply curves shift to the right (outward).

Effect on equilibrium price and quantity

- The new equilibrium price will be lower.
- The new equilibrium quantity may be higher, lower, or it may remain the same.