

4

The Market Forces of Supply and Demand

PRINCIPLES OF
ECONOMICS
FOURTH EDITION

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Premium PowerPoint® Slides
by Ron Cronovich
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In this chapter, look for the answers to these questions:

- § What factors affect buyers' demand for goods?
- § What factors affect sellers' supply of goods?
- § How do supply and demand determine the price of a good and the quantity sold?
- § How do changes in the factors that affect demand or supply affect the market price and quantity of a good?
- § How do markets allocate resources?

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND
1

Markets and Competition

- § A **market**
- § A **competitive market** is one with many buyers and sellers, each has a negligible effect on price.
- § A **perfectly competitive** market:

- § In this chapter, we assume markets are perfectly competitive.

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND
2

Demand

§ The **quantity demanded** of any good

§ **Law of demand:** the claim that

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND3

The Demand Schedule

§ **Demand schedule:**

§ Example:
Helen's demand for lattes.

§ Notice that Helen's preferences obey the Law of Demand.

Price of lattes	Quantity of lattes demanded
\$0.00	16
1.00	14
2.00	12
3.00	10
4.00	8
5.00	6
6.00	4

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND4

Helen's Demand Schedule & Curve

Price of lattes	Quantity of lattes demanded
\$0.00	16
1.00	14
2.00	12
3.00	10
4.00	8
5.00	6
6.00	4

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND5

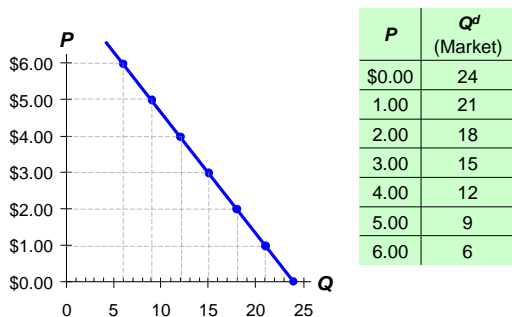
Market Demand versus Individual Demand

§ The quantity demanded in the market

§ Suppose Helen and Ken are the only two buyers in the Latte market. (Q^d = quantity demanded)

Price	Helen's Q^d	Ken's Q^d	Market Q^d
\$0.00	16	8	
1.00	14	7	
2.00	12	6	
3.00	10	5	
4.00	8	4	
5.00	6	3	
6.00	4	2	

The Market Demand Curve for Lattes



CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND 7

Demand Curve Shifters

§ The demand curve shows how price affects quantity demanded, *other things being equal*.

§ These "other things" are non-price determinants of demand (*i.e.*,

§ Changes in them shift the **D** curve...

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND 8

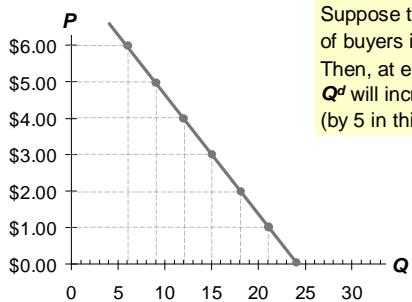
Demand Curve Shifters: # of buyers

§ Increase in # of buyers

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

9

Demand Curve Shifters: # of buyers



Suppose the number of buyers increases. Then, at each P , Q^d will increase (by 5 in this example).

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

10

Demand Curve Shifters: income

§ Demand for a **normal good** is _____ related to income.

- Increase in income causes

(Demand for an **inferior good** is _____ related to income. An increase in income shifts **D** curves for inferior goods to the _____.)

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

11

Demand Curve Shifters: prices of related goods

§ Two goods are **substitutes** if

§ Example:

§ Other examples:

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

12

Demand Curve Shifters: prices of related goods

§ Two goods are **complements** if

§ Example:

§ Other examples:

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

13

Demand Curve Shifters:

§

§ Example:

The Atkins diet became popular in the '90s, caused an increase in demand for eggs, shifted the egg demand curve to the right.

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

14

Demand Curve Shifters: expectations

§ Expectations affect consumers' buying decisions.

§ Examples:

ACTIVE LEARNING 1: Demand curve

Draw a demand curve for music downloads.
What happens to it in each of the following
scenarios? Why?

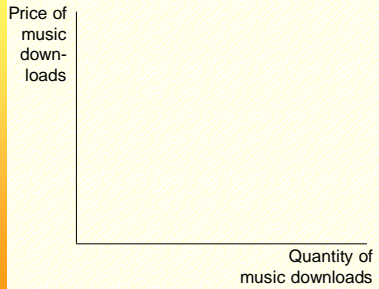
- A. The price of iPods falls
- B. The price of music downloads falls
- C. The price of compact discs falls

ACTIVE LEARNING 1: A. price of iPods falls

Price of
music
down-
loads

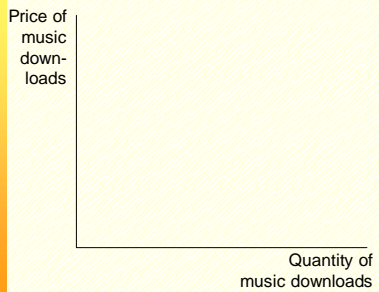
Quantity of
music downloads

ACTIVE LEARNING 1:
B. price of music downloads falls



19

ACTIVE LEARNING 1:
C. price of CDs falls



20

Supply

§ The **quantity supplied** of any good

§ **Law of supply:** the claim that

The Supply Schedule

§ Supply schedule:

Price of lattes	Quantity of lattes supplied
\$0.00	0
1.00	3
2.00	6
3.00	9
4.00	12
5.00	15
6.00	18

§ Example:

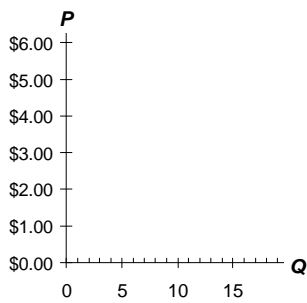
Starbucks' supply of lattes.

§ Notice that Starbucks' supply schedule obeys the Law of Supply.

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

22

Starbucks' Supply Schedule & Curve



Price of lattes	Quantity of lattes supplied
\$0.00	0
1.00	3
2.00	6
3.00	9
4.00	12
5.00	15
6.00	18

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

23

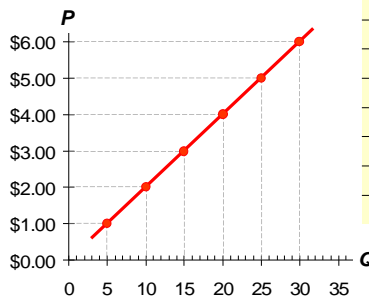
Market Supply versus Individual Supply

§ The quantity supplied in the market is

§ Suppose Starbucks and Jitters are the only two sellers in this market. (Q^s = quantity supplied)

Price	Starbucks		Jitters		Market Q^s
\$0.00	0	+	0	=	0
1.00	3	+	2	=	5
2.00	6	+	4	=	10
3.00	9	+	6	=	15
4.00	12	+	8	=	20
5.00	15	+	10	=	25
6.00	18	+	12	=	30

The Market Supply Curve



P	Q^s (Market)
\$0.00	0
1.00	5
2.00	10
3.00	15
4.00	20
5.00	25
6.00	30

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

25

Supply Curve Shifters

§ The supply curve shows how price affects quantity supplied, *other things being equal*.

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

26

Supply Curve Shifters: input prices

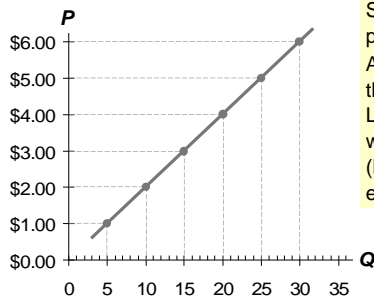
§ Examples of input prices:

§ A fall in input prices

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

27

Supply Curve Shifters: input prices



Suppose the price of milk falls. At each price, the quantity of Lattes supplied will increase (by 5 in this example).

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

28

Supply Curve Shifters: technology

§ Technology determines how much inputs are required to produce a unit of output.

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

29

Supply Curve Shifters: # of sellers

§ An increase in the number of sellers

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

30

Supply Curve Shifters: expectations

Example:

- Events in the Middle East lead to expectations of higher oil prices.
- In response,
-

In general, sellers may adjust supply* when their expectations of future prices change.
(*If good not perishable.)

CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

31

ACTIVE LEARNING 2: Supply curve

Draw a supply curve for tax return preparation software. What happens to it in each of the following scenarios?

- A. Retailers cut the price of the software.
- B. A technological advance allows the software to be produced at lower cost.
- C. Professional tax return preparers raise the price of the services they provide.



33

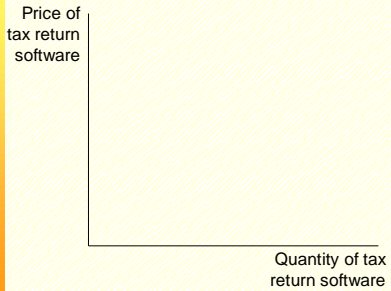
ACTIVE LEARNING 2: A. fall in price of tax return software

Price of
tax return
software

Quantity of tax
return software

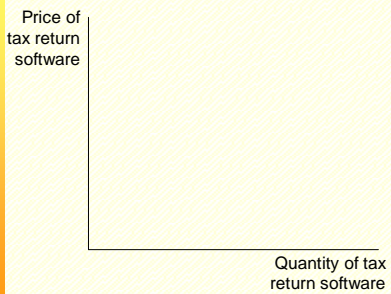
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ACTIVE LEARNING 2:
B. fall in cost of producing the software



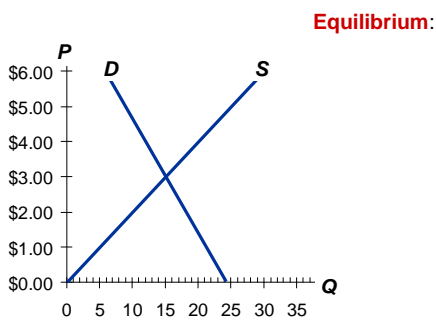
35

ACTIVE LEARNING 2:
C. professional preparers raise their price



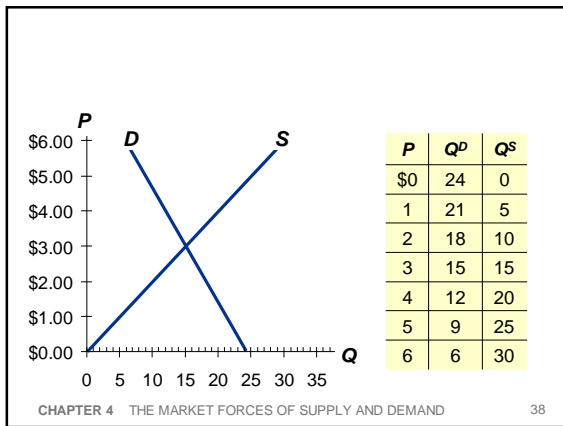
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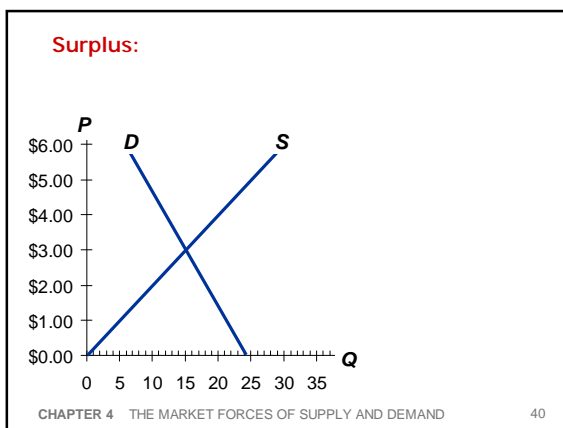
Supply and Demand Together

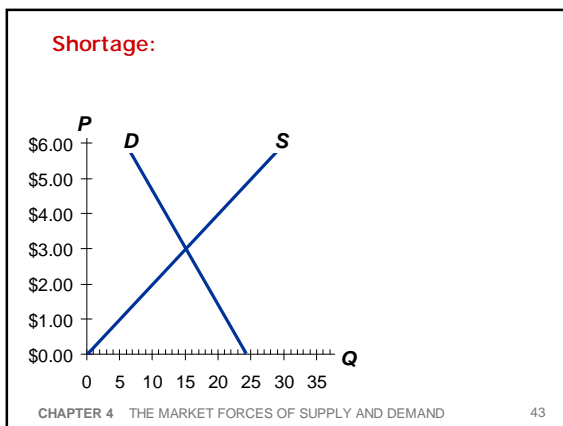


CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

37







Three Steps to Analyzing Changes in Eq'm

To determine the effects of any event,

1.

2.

3.

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46

EXAMPLE 1: A Change in Demand

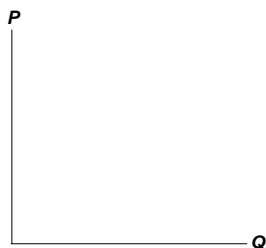
EVENT TO BE ANALYZED:

Increase in price of gas.

STEP 1:

STEP 2:

STEP 3:



CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

48

Terms for Shift vs. Movement Along Curve

§ Change in supply:

- occurs when a non-price determinant of supply changes (like technology or costs)

§ Change in the quantity supplied:

a movement along a fixed **S** curve

- occurs when

§ Change in demand: a shift in the **D** curve

- occurs when

§ Change in the quantity demanded:

a movement along a fixed **D** curve

- occurs when

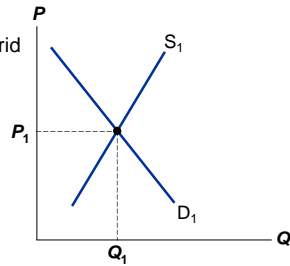
EXAMPLE 2: A Change in Supply

EVENT: New technology reduces cost of producing hybrid cars.

STEP 1:

STEP 2:

STEP 3:



CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

51

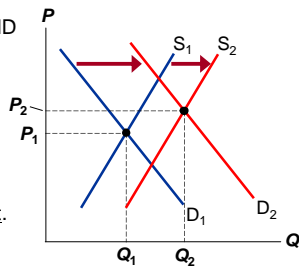
EXAMPLE 3: A Change in Both Supply and Demand

EVENTS: price of gas rises AND new technology reduces production costs

STEP 1: Both curves shift.

STEP 2: Both shift to the right.

STEP 3: Q rises, but



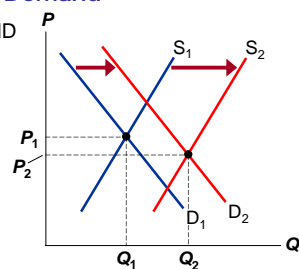
CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

52

EXAMPLE 3: A Change in Both Supply and Demand

EVENTS: price of gas rises AND new technology reduces production costs

STEP 3, cont.



CHAPTER 4 THE MARKET FORCES OF SUPPLY AND DEMAND

53

ACTIVE LEARNING 3: Changes in supply and demand

Use the three-step method to analyze the effects of each event on the equilibrium price and quantity of music downloads.

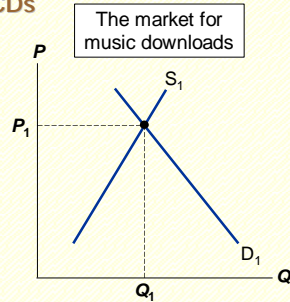
Event A: A fall in the price of compact discs

Event B: Sellers of music downloads negotiate a reduction in the royalties they must pay for each song they sell.

Event C: Events A and B both occur.

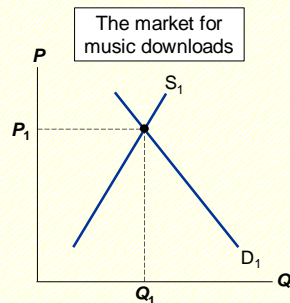
54

ACTIVE LEARNING 3: A. fall in price of CDs



55

ACTIVE LEARNING 3: B. fall in cost of royalties



56

ACTIVE LEARNING 3:

C. fall in price of CDs
AND fall in cost of royalties

57

CONCLUSION:
How Prices Allocate Resources

§ One of the Ten Principles from Chapter 1:

*Markets are usually a good way
to organize economic activity.*



§ In market economies,

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58
