Supply, Demand and Market Equilibrium

Law of Demand

Principle of diminishing marginal value – the higher the rate of consumption of a good the lower would be marginal use value of an additional unit of a good (MB of additional unit decreases as you continue more)

Law of Demand

Holding other relevant factors constant, the lower/higher the price of a good the greater/less the quantity demanded of that good.

Demand curve shows us the quantity demanded of this good at each price.

Food: seasonal fruits and vegetables. Prices of these goods fall when crops are harvested. To convince people to buy them is to cut the price.

Larger drinks have lower priced per once. To get you to drink more, low the price.

Income (or wealth)

Most goods are superior (normal) goods; that is changes in income lead to changes in demand in the same direction.

An increase in income lead to an increase in demand. Decrease in income leads to a decrease in demand (shift to the left)

Inferior goods – a change in income or wealth leads to a change in demand in the inverse direction.

Prices of other goods.

Substitutes (Ps) – change in the price of a substitute leads to a change in demand for other goods in the same direction (bikes, cars)

Complements (Pc) – a change in the price of complement leads to a change in demand of other goods in the contrary direction.

Law of Supply

Decision rule for suppliers: choose a rate of output that drives the MC into equality with the price in which the good can be sold. (choose Q such – maximizes profit - as MC=P)

If high MC compared to price then it will not sell. If firms do not behave as P=MC they go out of business.
To get market supply curve we add the supply curves of an individual suppliers (horizontal summation)

Note:
- Law of supply is a ceteris paribus proposition
- Supply curves have positive slope
- Quantity supplied (changes in P leads to changes in Q supplied)