

Lecture 6: Market Equilibrium, Demand and Supply Shifts

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Market Equilibrium

- A system is in **equilibrium** when there is no tendency for it to change.
- A competitive market is in **equilibrium** if the **quantity supplied** equals the **quantity demanded** at the market price.
 - In the market equilibrium, the price is called the **equilibrium price**, ...
 - ...and the quantities supplied and demanded are called the **equilibrium quantity**.
 - In equilibrium, the price and quantity do not have a tendency to change (more later).

Example: The Market for Milk

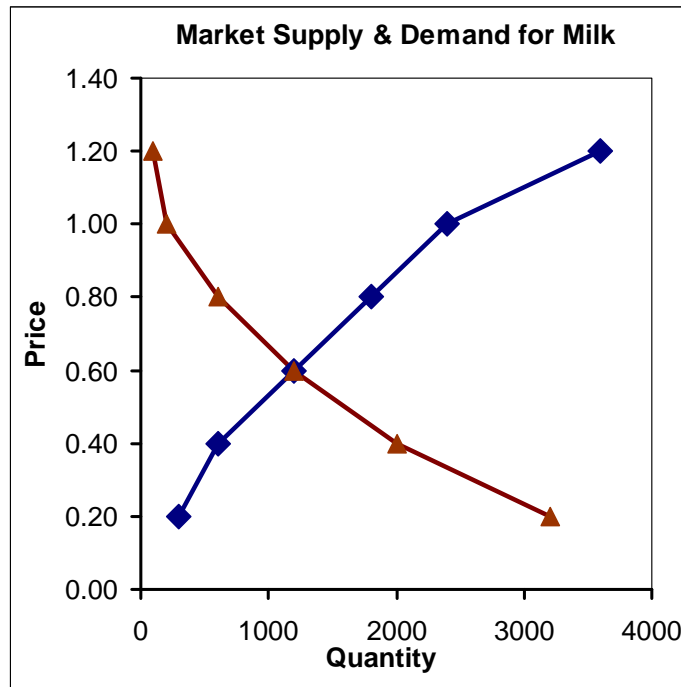
- In the market for milk described previously, market supply and demand are as follows.

Price (\$)	Market Supply (Qts/day)	Market Demand (Qts/day)
0.20	300	3200
0.40	600	2000
0.60	1200	1200
0.80	1800	600
1.00	2400	200
1.20	3600	100

- The market equilibrium is described by a _____ price and a traded quantity of _____ quarts.

Equilibrium in the Market for Milk on a Graph

P	Q_S	Q_D
0.20	300	3200
0.40	600	2000
0.60	1200	1200
0.80	1800	600
1.00	2400	200
1.20	3600	100



Movement towards Market Equilibrium

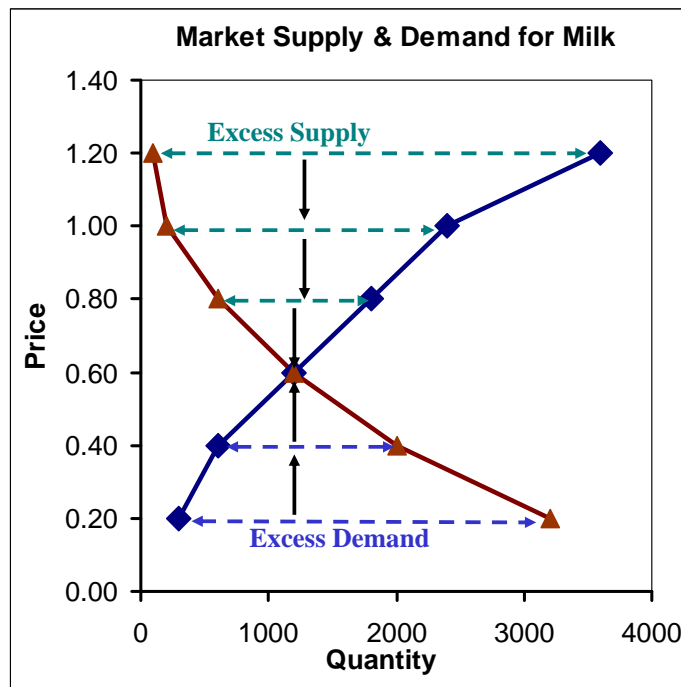
- If the price is **above the equilibrium price**,
 - there will be **excess supply**,
 - sellers cannot sell as much as they want,
 - so they will tend to offer buyers a lower price.
- Therefore, the price will tend to move downwards towards the equilibrium price.

- If the price is **below the equilibrium price**,
 - there will be *excess demand*,
 - buyers will not be able to buy all they want to buy,
 - so they will tend to offer sellers a higher price.
- Therefore, the price will tend to move upwards towards the equilibrium price.

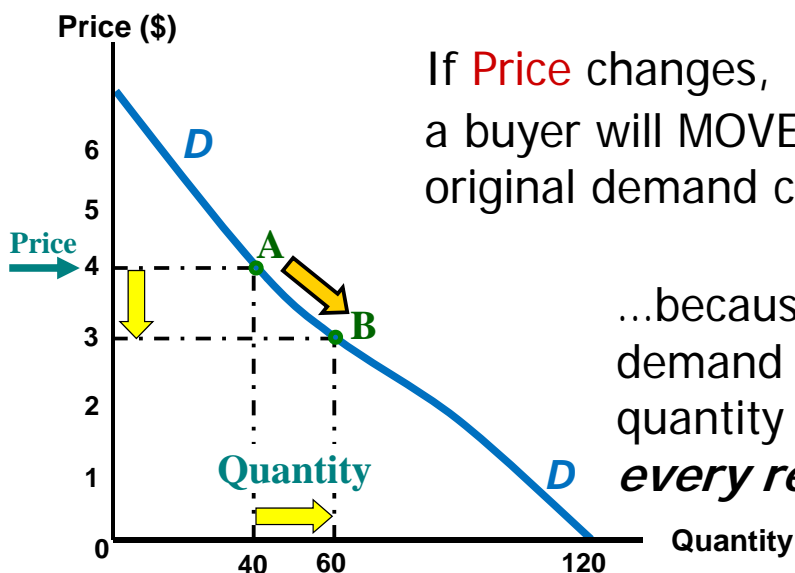
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Movement Towards Equilibrium in the Market for Milk

P	Q_S	Q_D
0.20	300	3200
0.40	600	2000
0.60	1200	1200
0.80	1800	600
1.00	2400	200
1.20	3600	100



The Effect of Price Changes



If **Price** changes, a buyer will **MOVE ALONG** his original demand curve, ...

...because the **same** demand curve yields the quantity demanded at **every reasonable price**.

Likewise, if price changes, a seller will **MOVE ALONG** her original **supply curve**, because the same supply curve yields the quantity supplied at every reasonable price.

Demand-Curve Shifts

- Changes in some demand-related factors affect the quantities demanded **at every price**:
 - Consumer preferences
 - Income
 - Prices of **other** goods
 - Expectations about the future
- Such changes can affect demand in general,...
- ...and they can change the **position** of the entire demand curve.

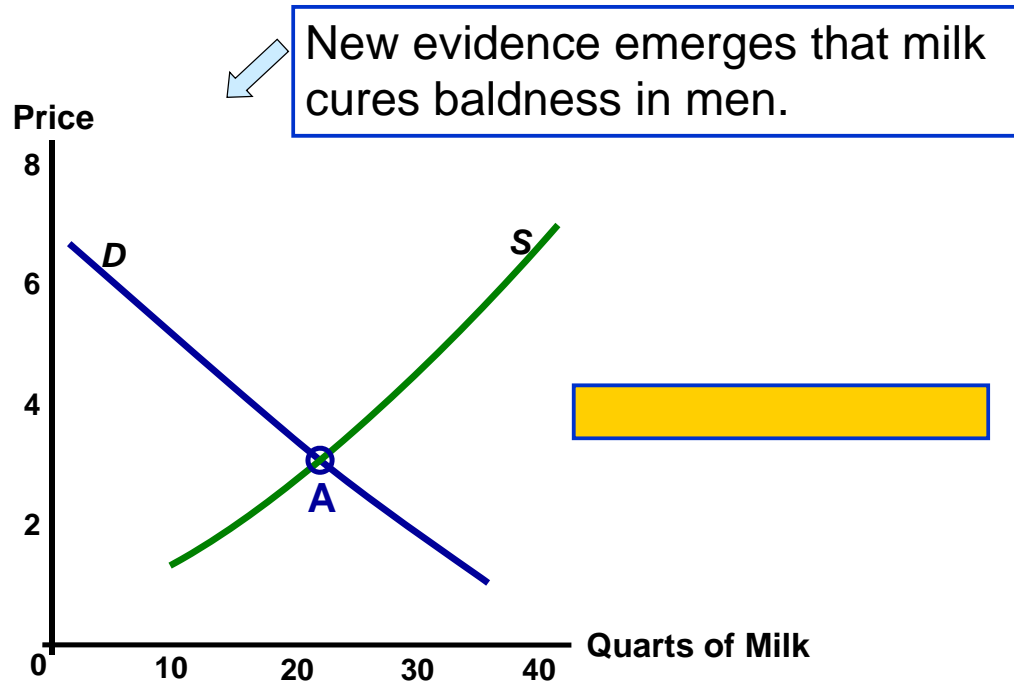
Changes in Consumer Preferences

- Consumer preferences change for many reasons.
 - New information

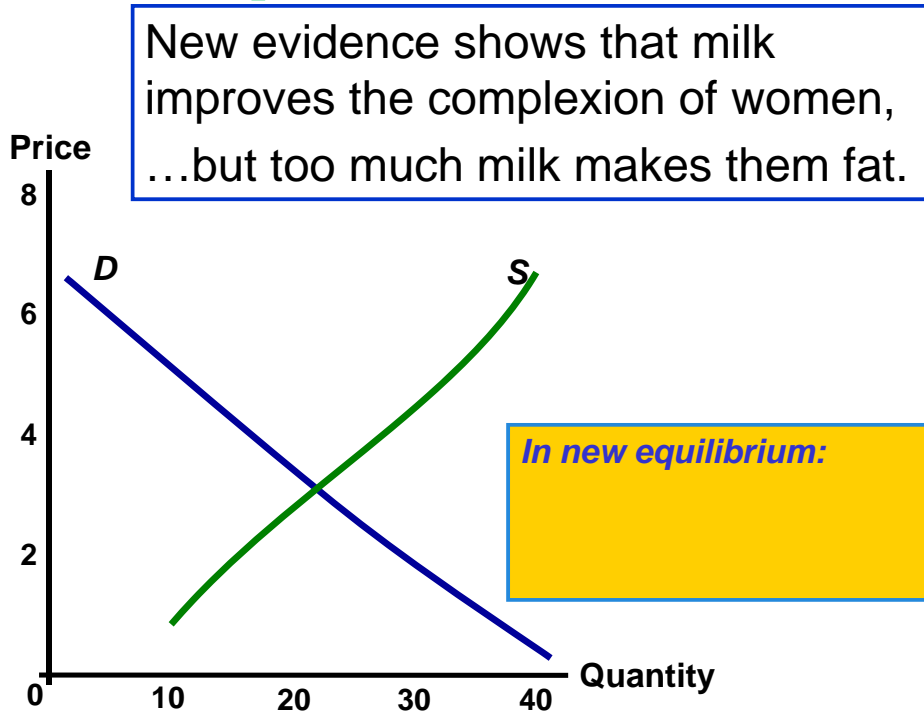
 - Fashion

 - Experience
- These changes can shift demand.

Example: Preference for Milk



Example 2: Preference for Milk



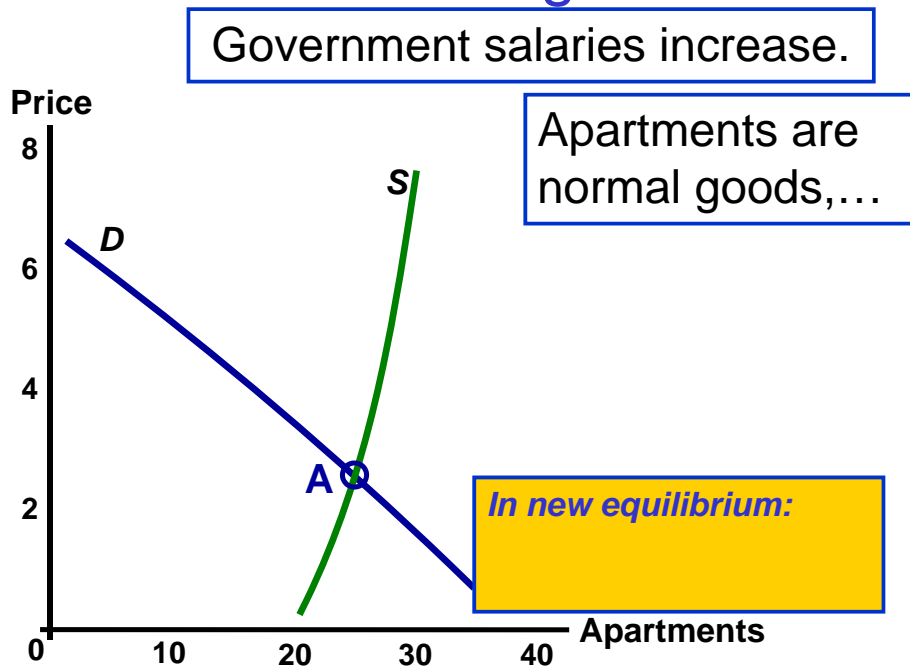
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Income and Demand

- Demand is affected by a person's income.
 - **Normal** goods: demand increases as income rises.

 - **Inferior** goods: demand increases as income falls.

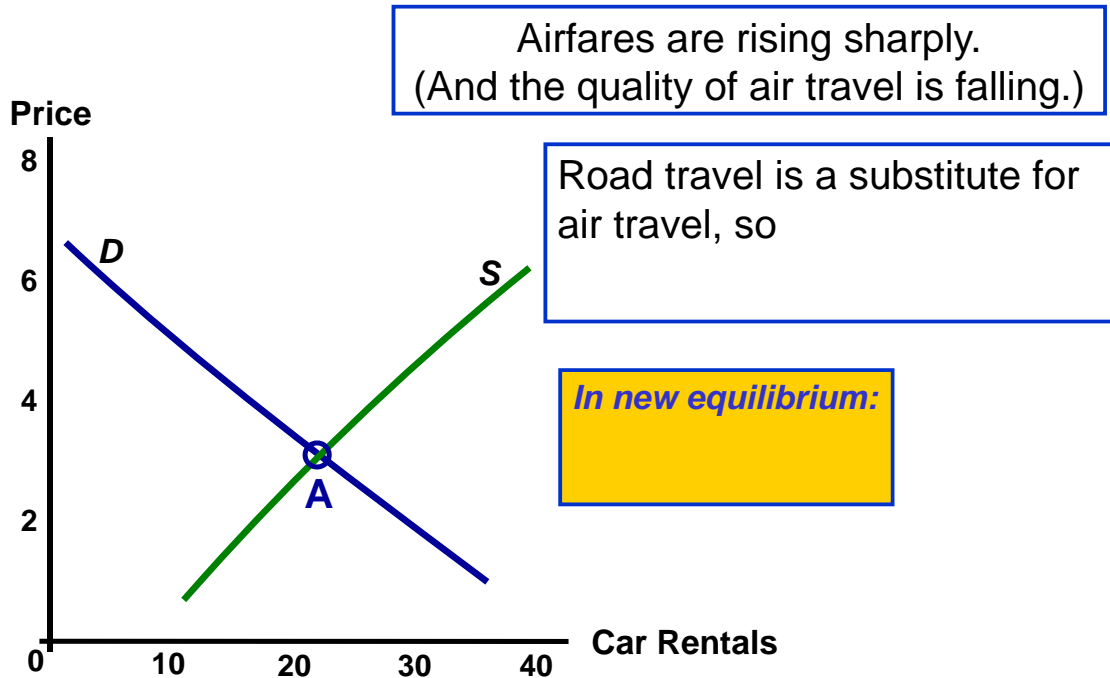
Example: Apartments and Income in Washington DC



Substitutes

- Two goods are **substitutes** if you can use one of them **instead of** the other.
- Demand for a good (chicken) **increases** when the price of a substitute (hamburger) rises, because...

Example: Car rentals and Airfares

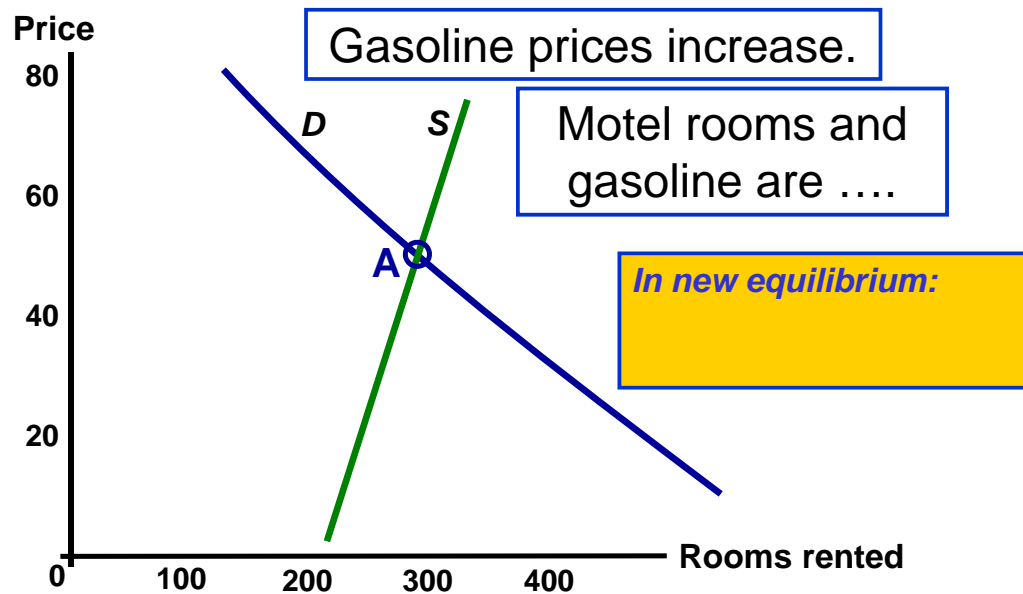


Complements

- Two goods are **complements** if you normally use both of them together.

- Demand for a good **decreases** when the price of a complement rises,...
- because if the complement is too expensive, the first good is less useful.

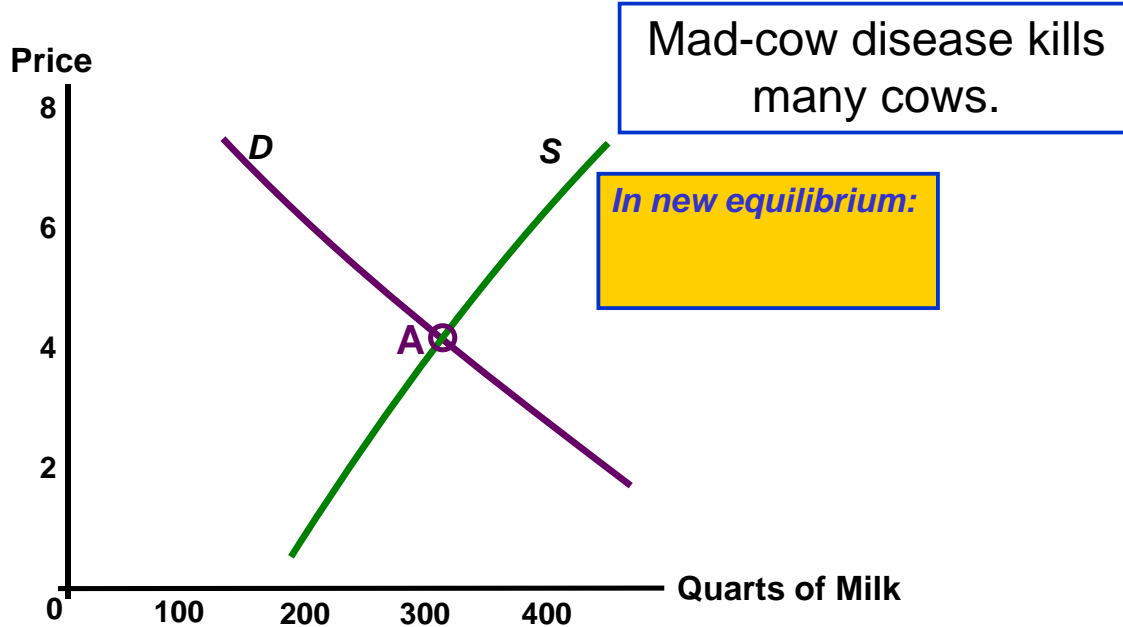
Example: Motel Rooms and Gasoline Prices



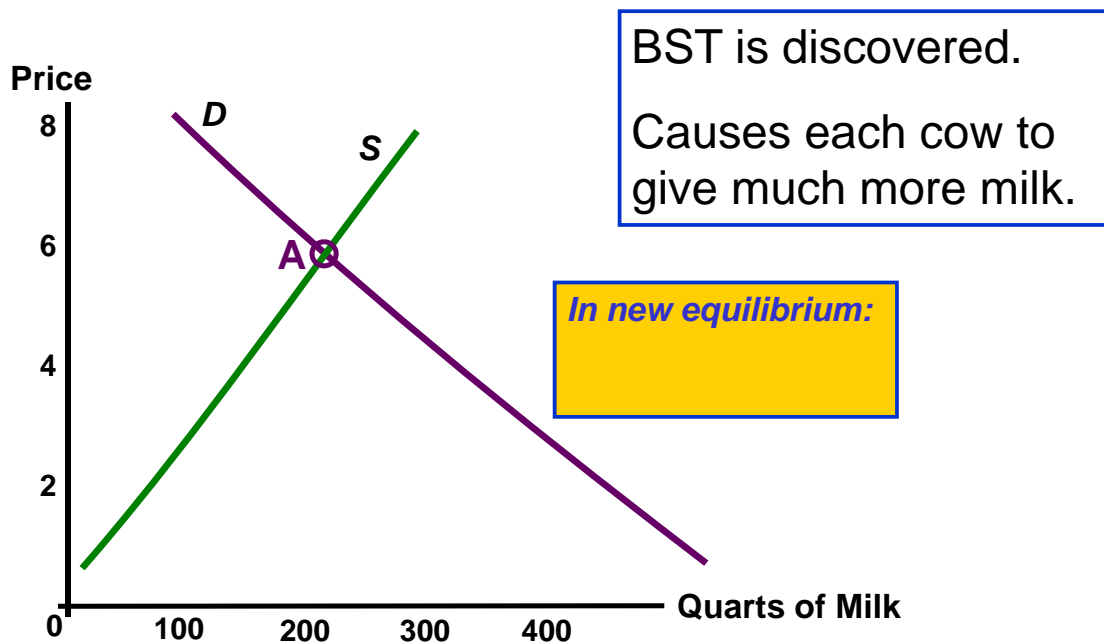
Supply-Curve Changes

- Changes in some supply-related factors will affect the quantities supplied at every price:
 - Prices of Inputs
 - Technology
 - Economic Environment
- Changes in these factors affect supply in general,...
- ...and they can shift the entire supply curve.

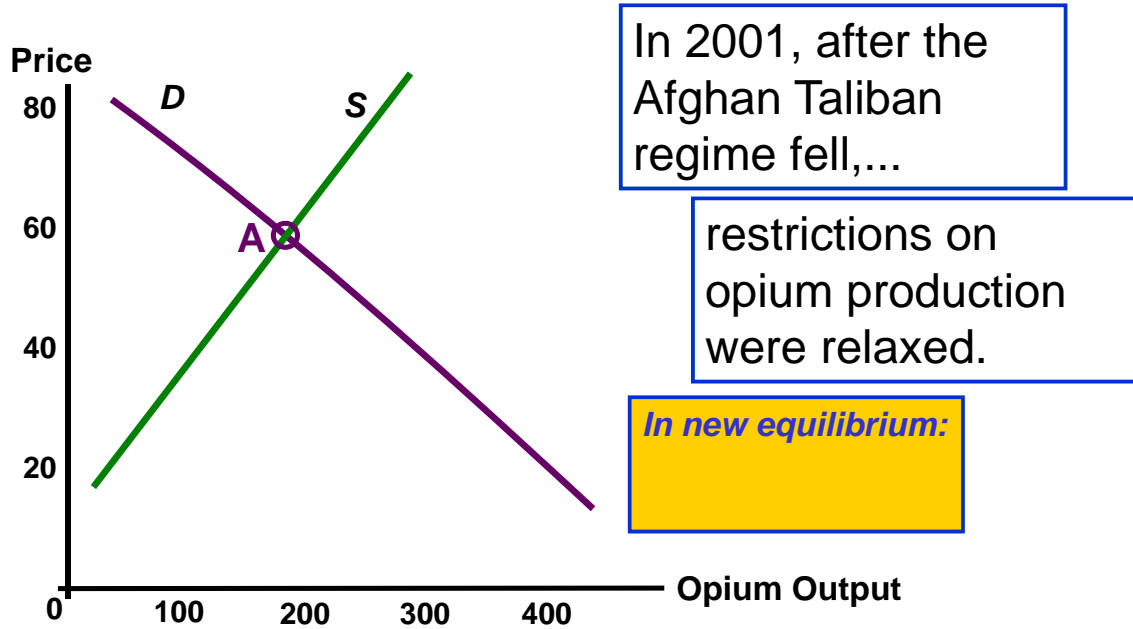
Example: Supply of Milk and Mad Cows



Example: Supply of Milk and Hormones



Example: Opium and the Taliban



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