



Introduction to Economics

Microeconomics

Price Determination



Key terms

- Market equilibrium
- Price mechanism
- Market clearing price
- Shortage, excess demand
- Surplus, excess supply

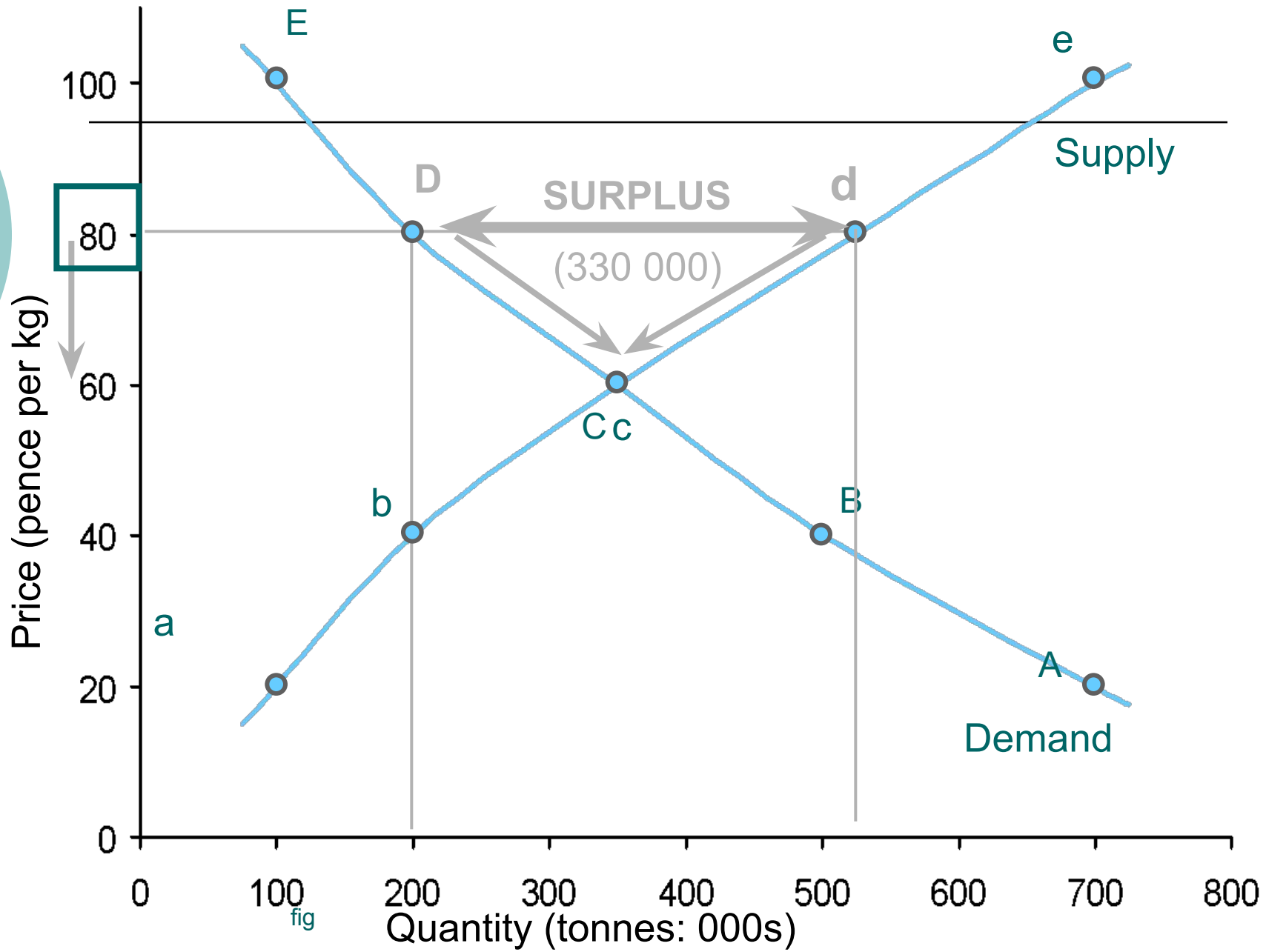


Equilibrium price and output

- Combines analysis of demand and supply
- Market clearing – when supply matches demand
- Equilibrium is the point where conflicting interests are balanced
- Price is determined by the INTERACTION BETWEEN demand and supply in a competitive market

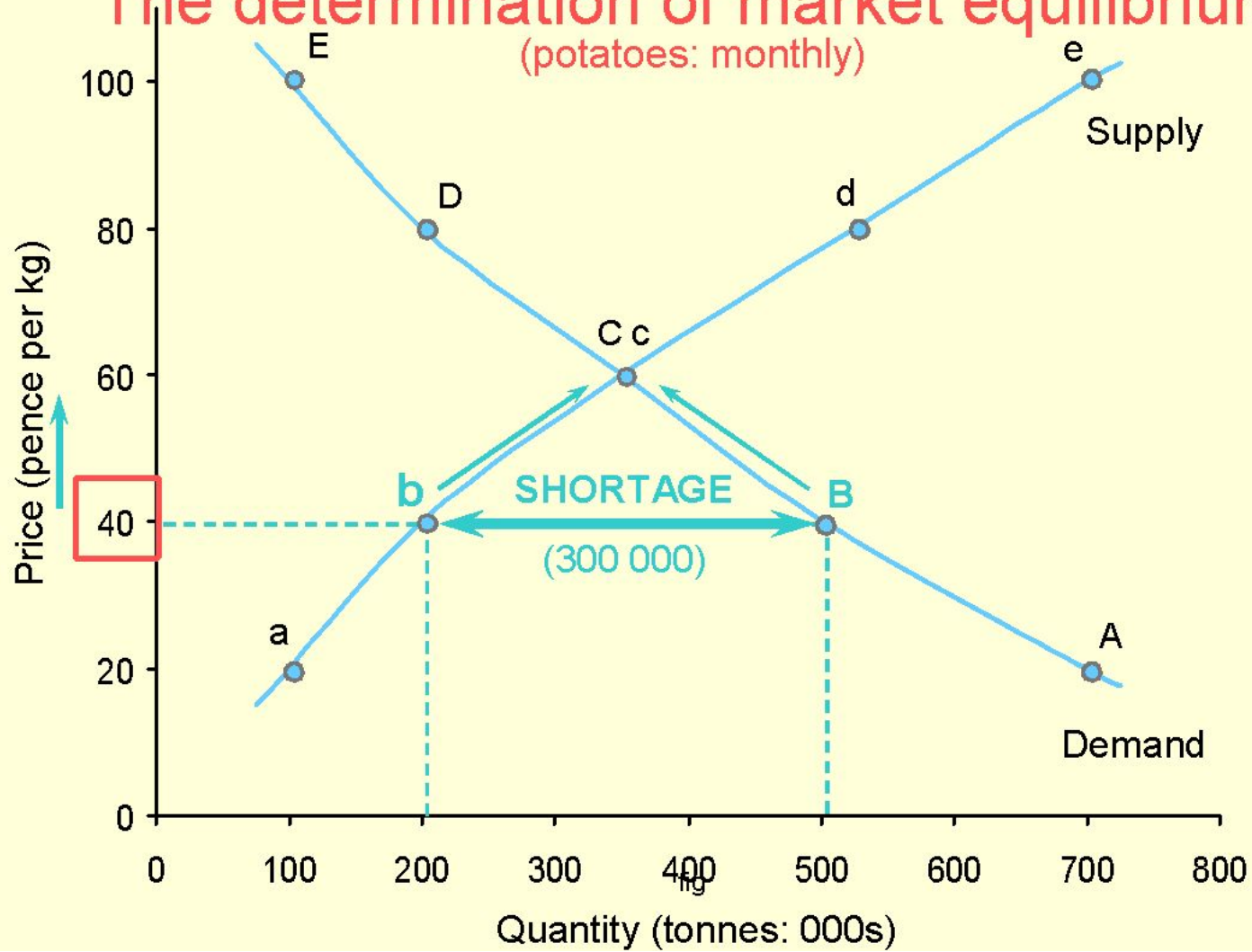
The determination of market equilibrium

(potatoes: monthly)



The determination of market equilibrium

(potatoes: monthly)





The Determination of Price and Output

- Demand and supply curves
 - effect of price being above equilibrium
 - price falls

Why does the price fall if above equilibrium?



Change in demand

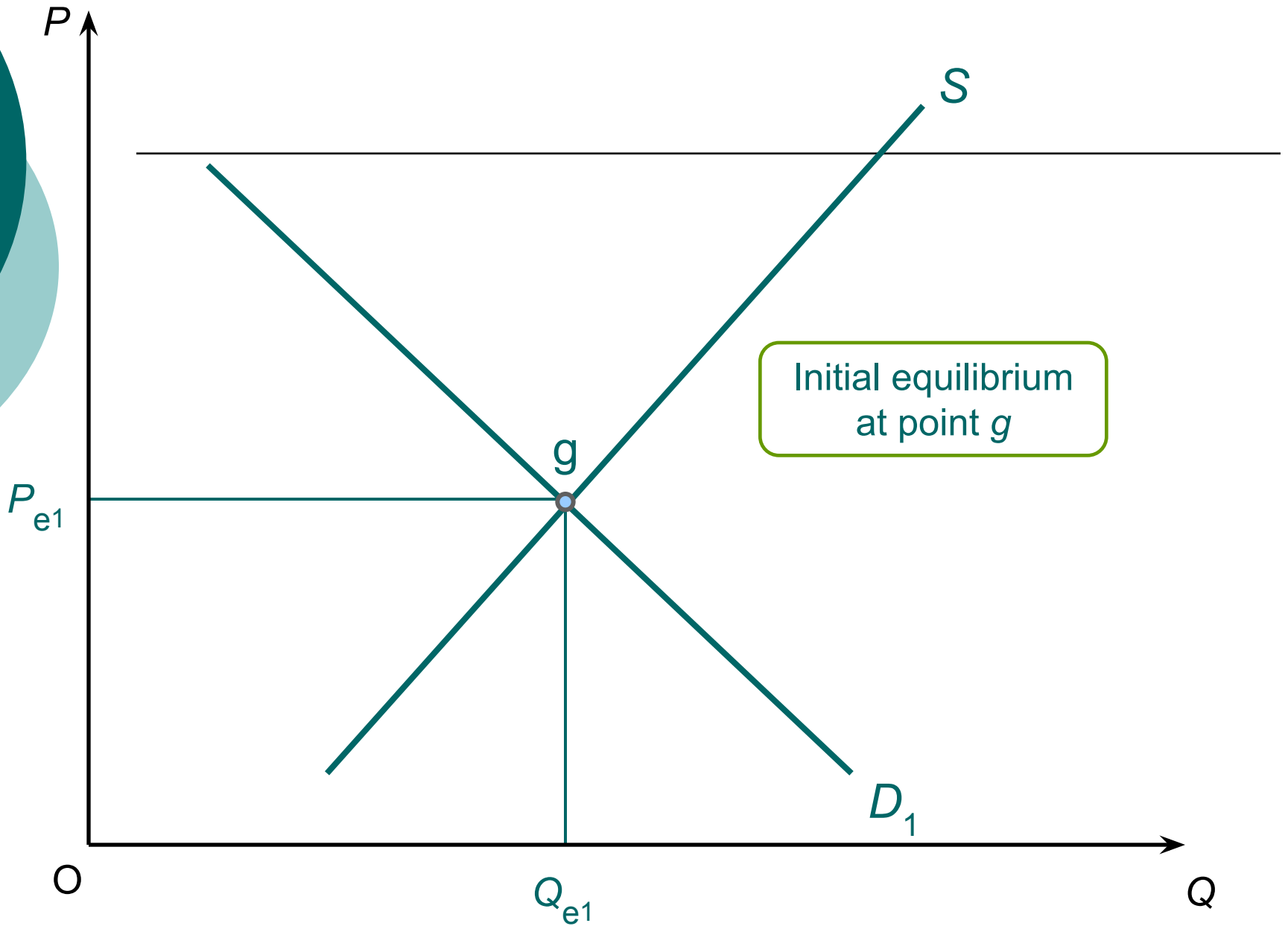
- Determinant other than price changes
- Demand curve shifts
 - Right if demand increases
 - Left if demand decreases



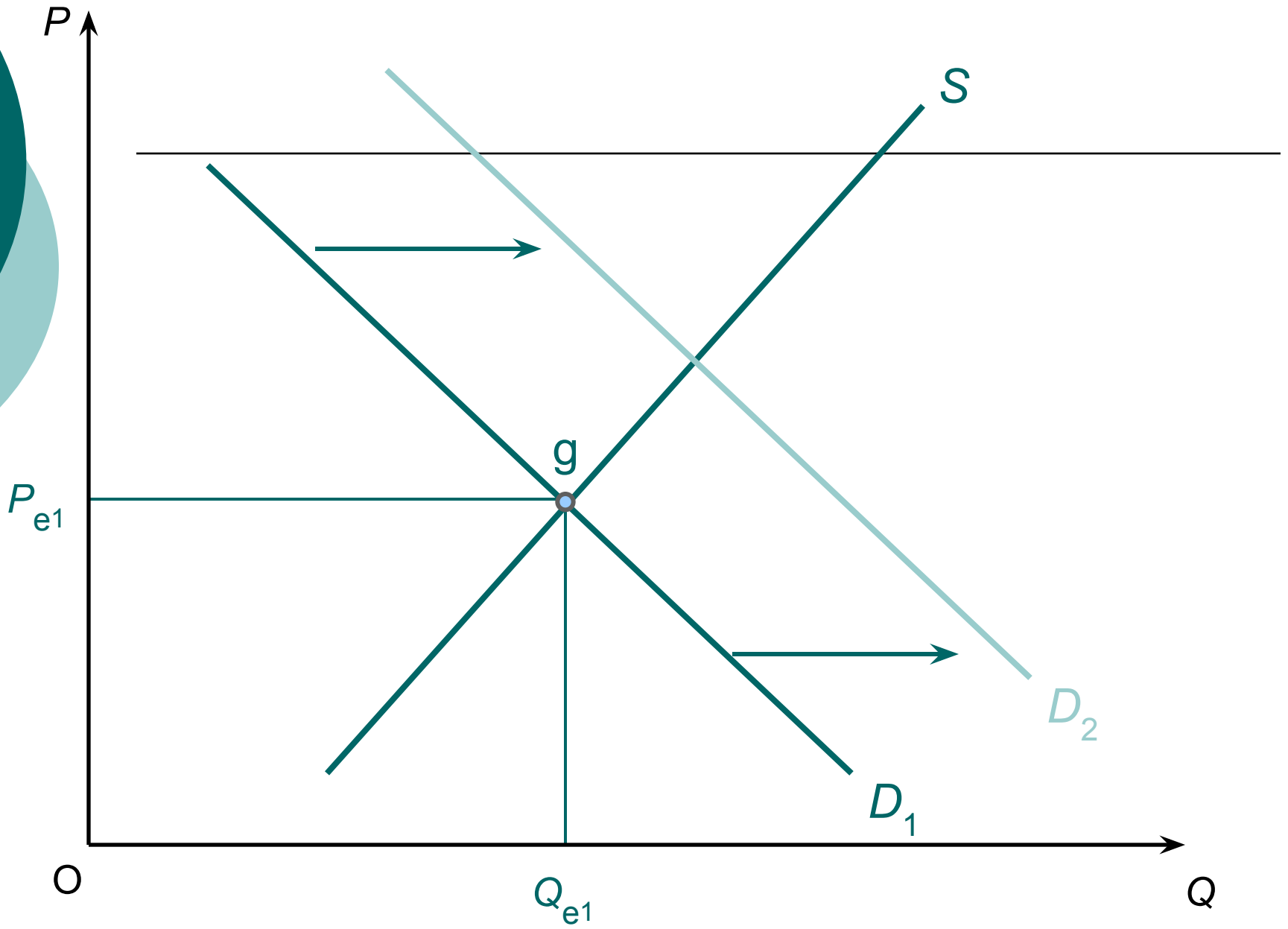
Change in supply

- Determinant other than price changes
- Supply curve shifts:
 - Right if supply increases
 - Left if supply decreases

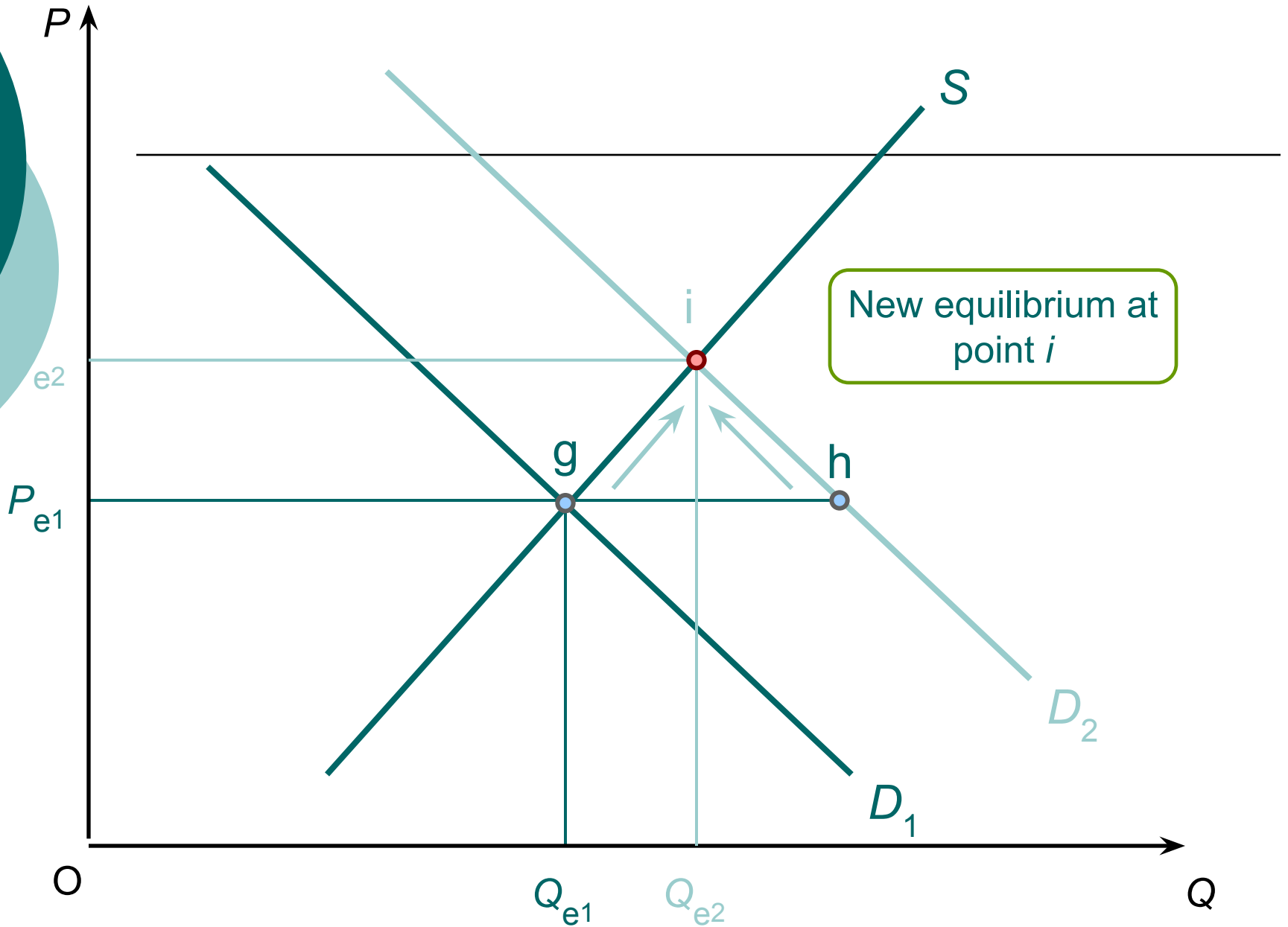
Effect of a shift in the demand curve



Effect of a shift in the demand curve



Effect of a shift in the demand curve



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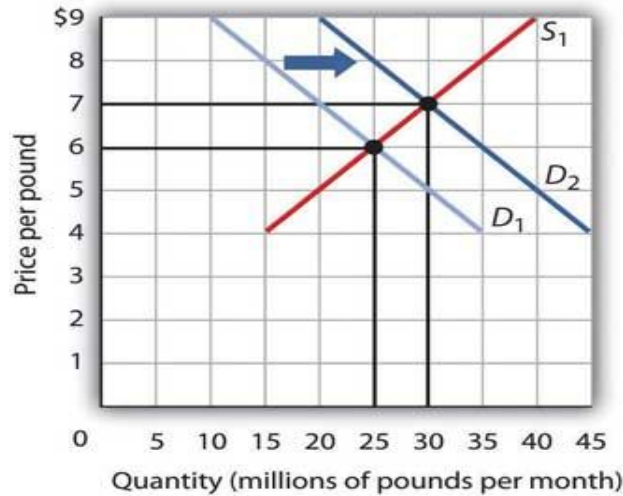


Movement to a new equilibrium

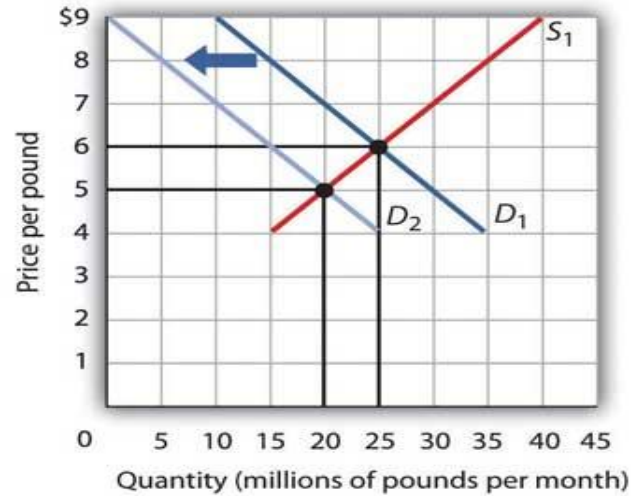
- Shift in one curve means movement along the other
- New intersection is the new equilibrium
- Changes in more than one determinant means BOTH curves can shift
- If both curves move, new equilibrium is where the NEW curves meet

Movement to a new equilibrium

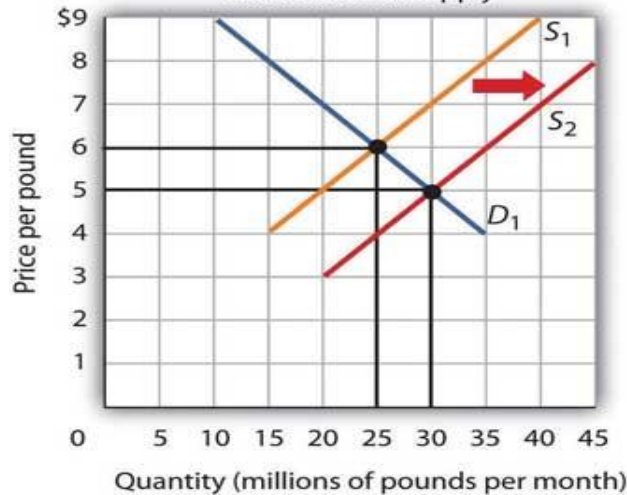
Panel (a)
An increase in demand



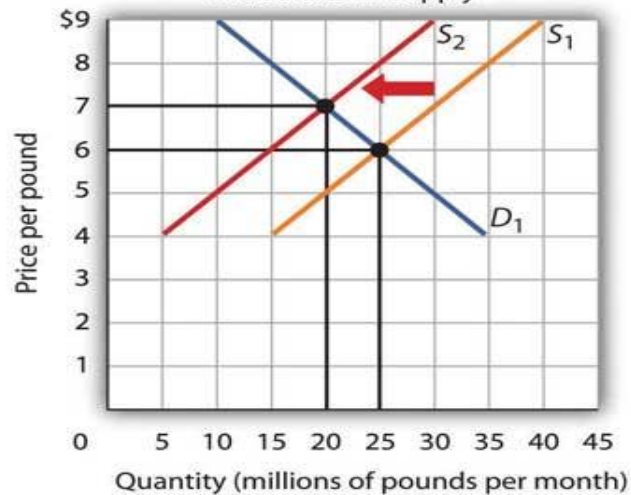
Panel (b)
A decrease in demand



Panel (c)
An increase in supply



Panel (d)
A decrease in supply



Discussion

- Is the following statement true?

'An increase in demand will cause an increase in price. This increase in price will cause a reduction in demand, until demand is reduced back to its original level'.

Summary

- Demand exceeds supply = shortage, leads to a rise in price
- Supply exceed demand = surplus, leads to fall in price
- Price settles at equilibrium i.e. where demand = supply
- Demand or supply curve shifts, leads to shortage or surplus – price moves to new equilibrium where supply and demand curves now intersect