SATPREP
Demand and Supply Curves

Demand or Effective Demand: Demand refers to both the willingness and the ability of customers to pay a given price to buy a good or service.

Quantity Demanded: The amount of a good or service demanded at each price level.

Law of Demand: The quantity demanded falls as price rises, whilst the quantity demanded rises when price falls.

Two reason for this relationship:
1. As price of goods and services falls, customer's real income rises and he is able to buy more.
2. As price of goods and services falls, more customers are able to buy more.

Demand Curves
1. Diagrammatically, the demand curve is shown as a downward – sloping curve to show the inverse relationship between price and quantity demanded.

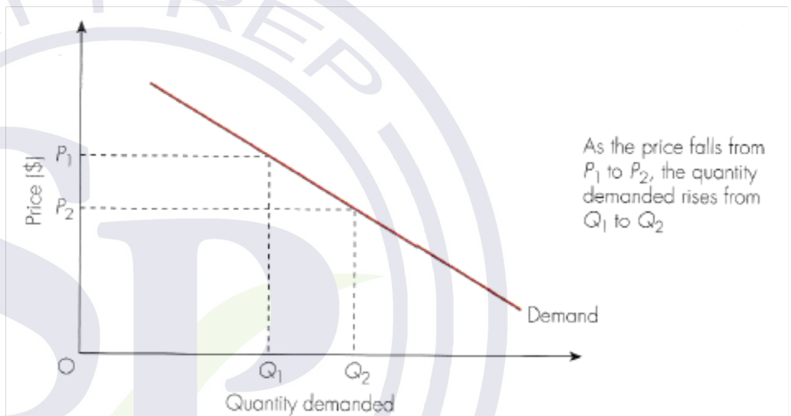

Figure 3.1 The demand curve

2. The **market demand curve** refers to the sum of all individual demand for a product. It is found by adding up all individual demand at each price level.

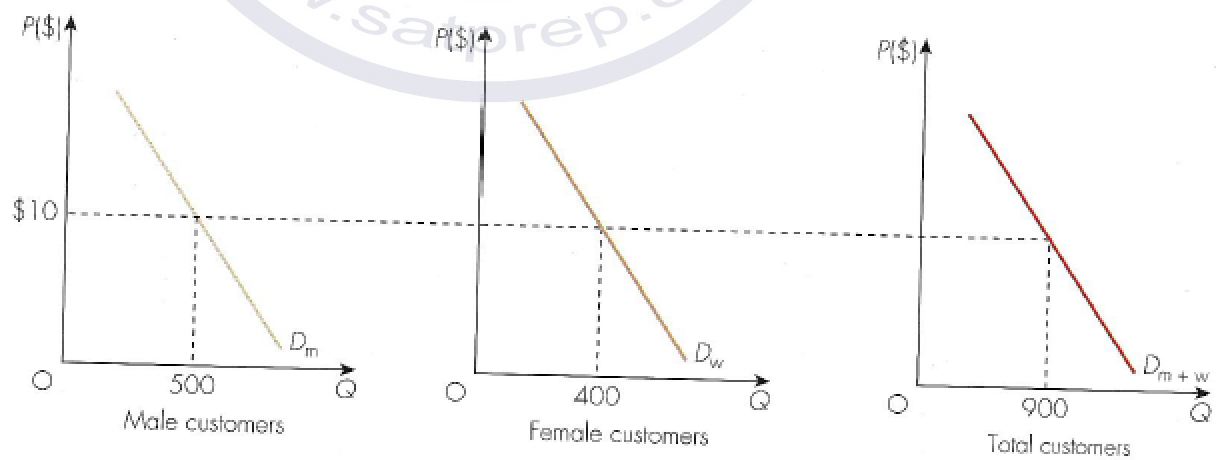

Figure 3.2 The market demand curve

Movements and shifts in demand:

A change in price

1. A change in the price of a good or service causes a **movement along** the demand curve.
2. Price rise will cause a decrease **(contraction)** in the quantity demanded of the product, whereas a reduction in price will cause an increase (expansion) in the quantity demanded.

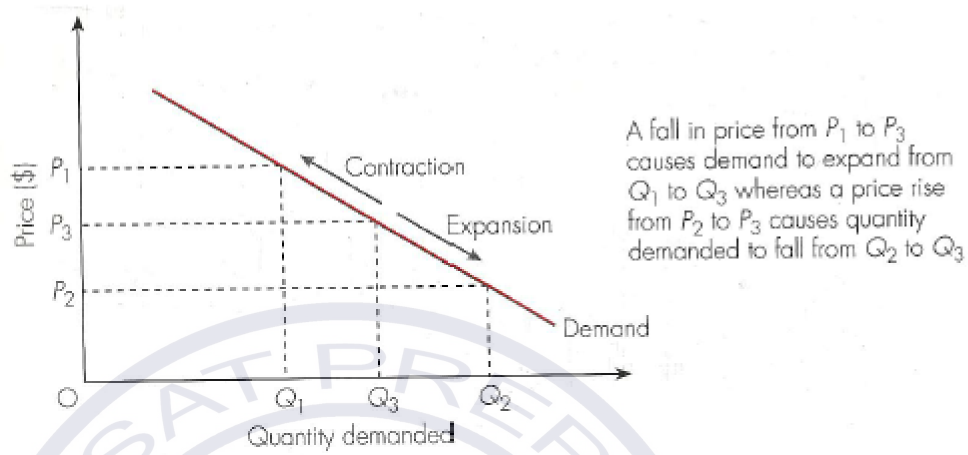

Figure 3.3 Movements along the demand curve

An increase in demand

1. A movement along the demand curve is caused by price changes only. A change in all other (non-price) factors that affect demand, such as income levels, will cause a **shift in demand**.

2. An **increase in demand** (rather than an increase in quantity demanded) is represented by the rightward shift of the demand curve from D_1 to D_3.

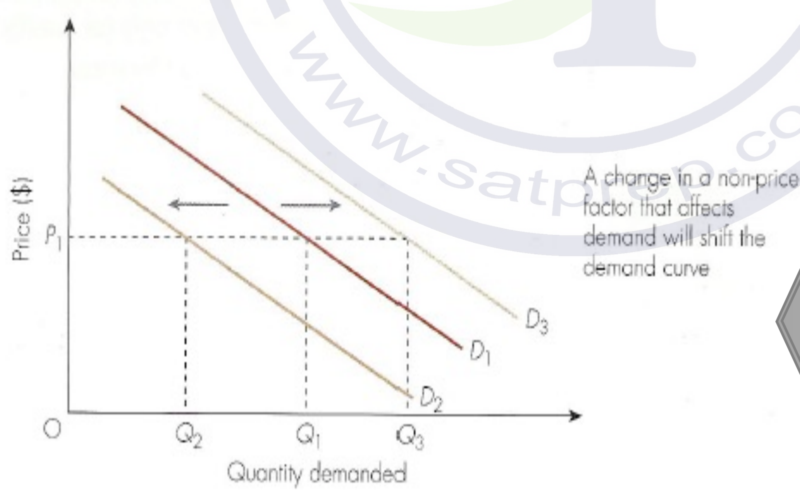

Figure 3.4 Shifts in the demand curve

Tips!!

1. A shift in demand is caused by changes in non-price factors that affect demand.
2. A movement along the demand curve is caused by changes in the price of the product.

Supply: Supply is the ability and willingness of firms to provide goods and services at given price levels. Firms will have more incentives to supply their products at higher prices – the higher the price, the greater supply tends to be. There are two reasons for this relationship:

1. Existing firms can earn higher profits if they supply more.

2. New firms are able to join the market if the higher price allows them to cover their production costs.

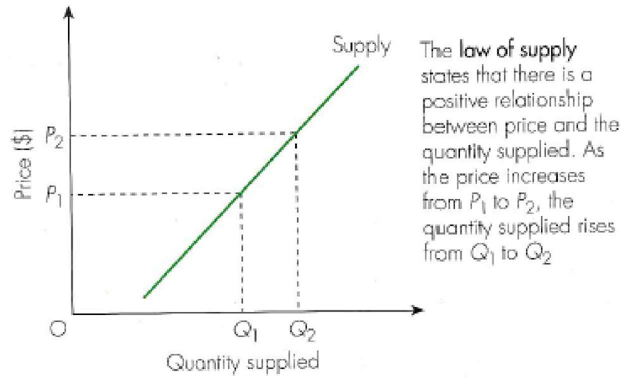

Figure 3.5 The supply curve

3. The **market supply curve** is the sum of all supply at each price level.

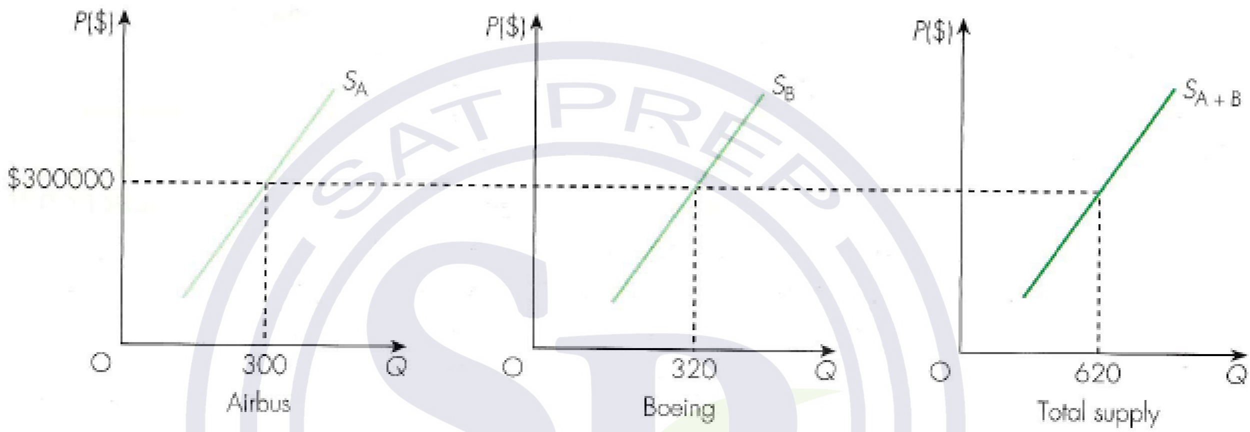

Figure 3.6 The market supply curve