

Subject: Microeconomic Theory I

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Lecture Notes: 2nd

Demand and Supply

Supply and demand, in [economics](#), relationship between the quantity of a commodity that producers wish to sell at various [prices](#) and the quantity that consumers wish to buy. It is the main model of [price](#) determination used in economic theory. The price of a commodity is determined by the interaction of supply and demand in a [market](#). The resulting price is referred to as the equilibrium price and represents an agreement between producers and consumers of the good. In equilibrium the quantity of a good supplied by producers equals the quantity demanded by consumers.

Equilibrium

Equilibrium is a situation in which there is no tendency for change. A market will be in equilibrium when there is no reason for the market price of the product to rise or to fall. This occurs at the price where quantity demanded equals quantity supplied. At this price, the amount that consumers wish to buy is exactly the same as the amount that producers wish to sell.

Quantity Demanded	Price	Quantity Supplied
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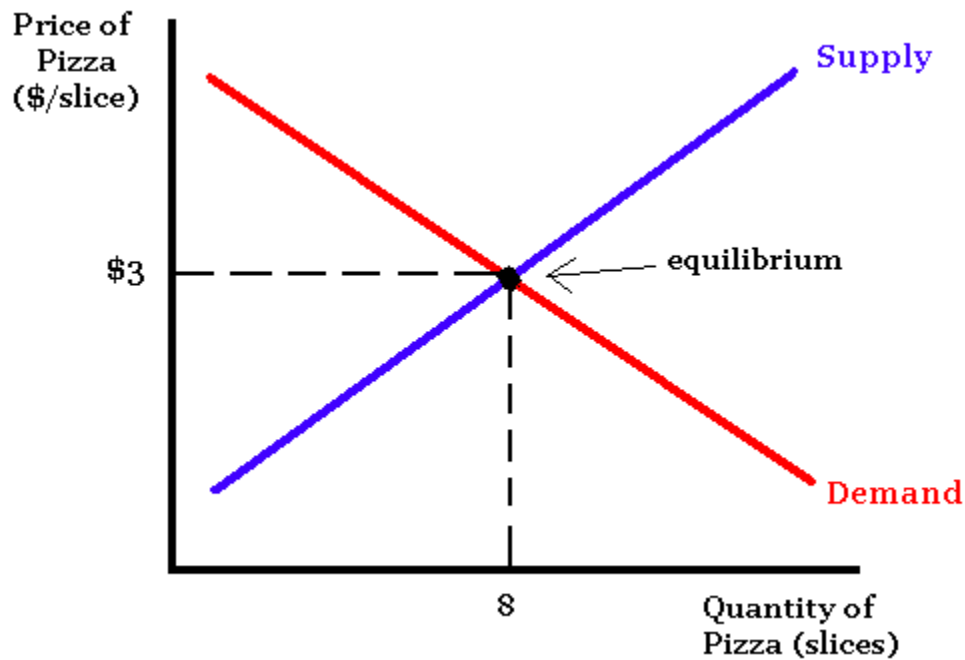
2	\$5	18
5	4	15
8	3	8
12	2	2
17	1	1



Equilibrium occurs at a price of \$3. The equilibrium quantity is 8 slices of pizza. When the price is above the equilibrium of \$3, quantity supplied is greater than quantity demanded. Firms are unable to sell all they want to at that price. There is an excess supply and this surplus creates pressure for the price to fall. If the price is below equilibrium, there is excess

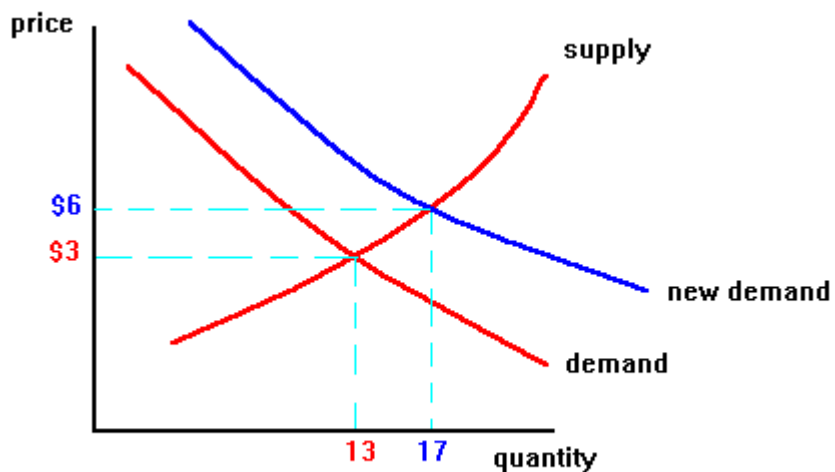
demand and the shortage creates pressure for the price to rise. Only at the equilibrium price is there no pressure for price to rise or fall.

Supply and Demand Curves



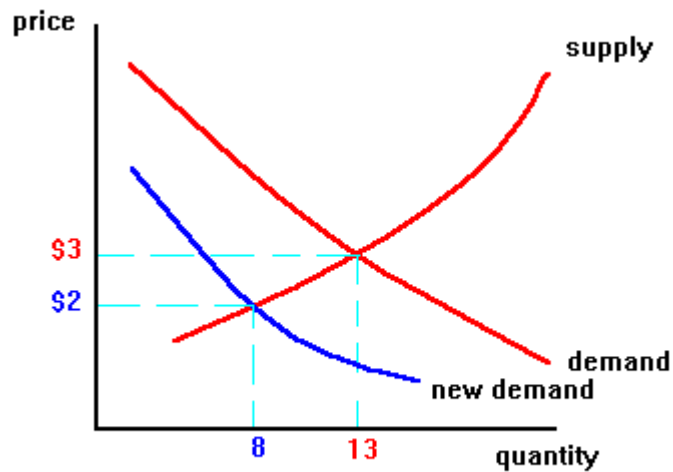
Demand and supply curves are simply graphs of demand and supply schedules. Equilibrium occurs where the supply and demand curves intersect at an equilibrium price of \$3 and an equilibrium quantity bought and sold of 8. Excess supply or excess demand at any price is simply the horizontal distance between the supply and demand curves.

Shifts of the Demand Curve



An **increase in demand** means that consumers wish to purchase more of the good at every price than before.

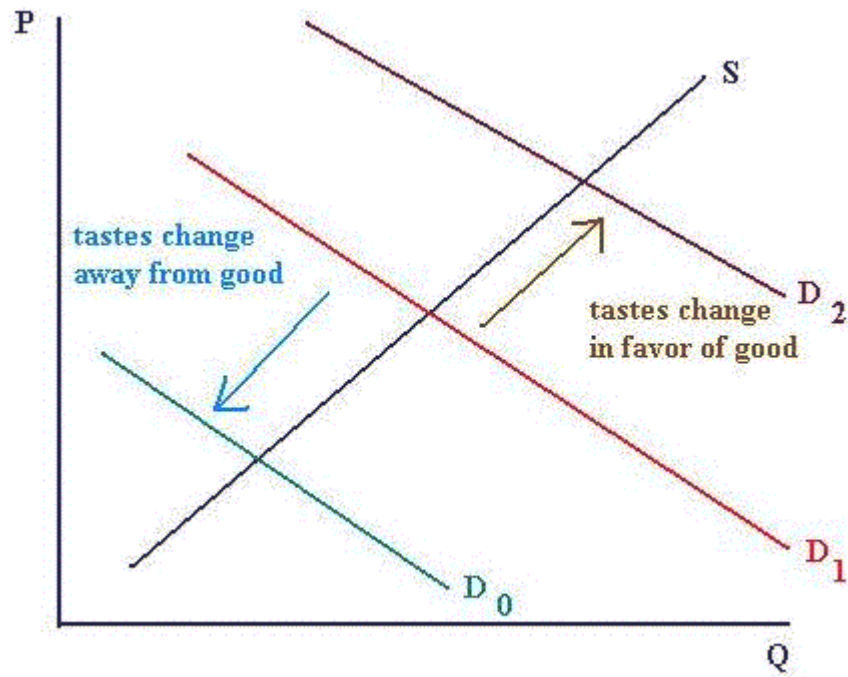
Graphically, the demand curve shifts up to the right. As a result of an increase in demand, the equilibrium price rises as does the equilibrium quantity bought and sold. Notice that an increase in demand has no effect on the supply curve. Firms do increase production, but only in response to the higher market price.



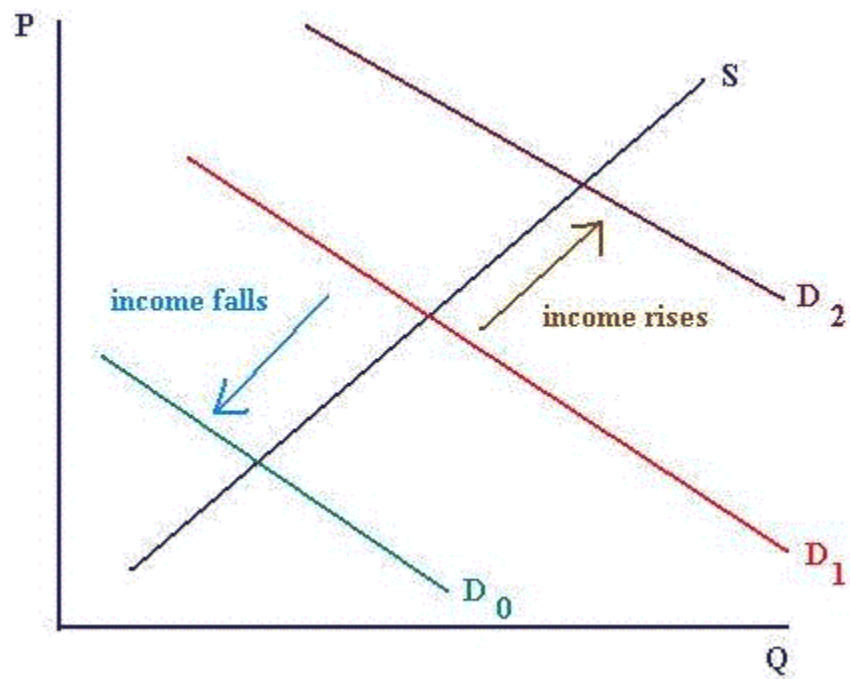
A **decrease in demand**, on the other hand, means that people wish to purchase less of this good at every price than before. The demand curve shifts down to the left. The equilibrium price and quantity both decrease. Again, the shift of the demand curve has no effect on the supply curve. From the point of view of producers, all that has happened is that the market price has fallen. So, firms decrease the quantity supplied. The supply curve itself does not shift. A movement along the supply curve occurs.

Things that Shift the Demand Curve

- changes in tastes/preferences

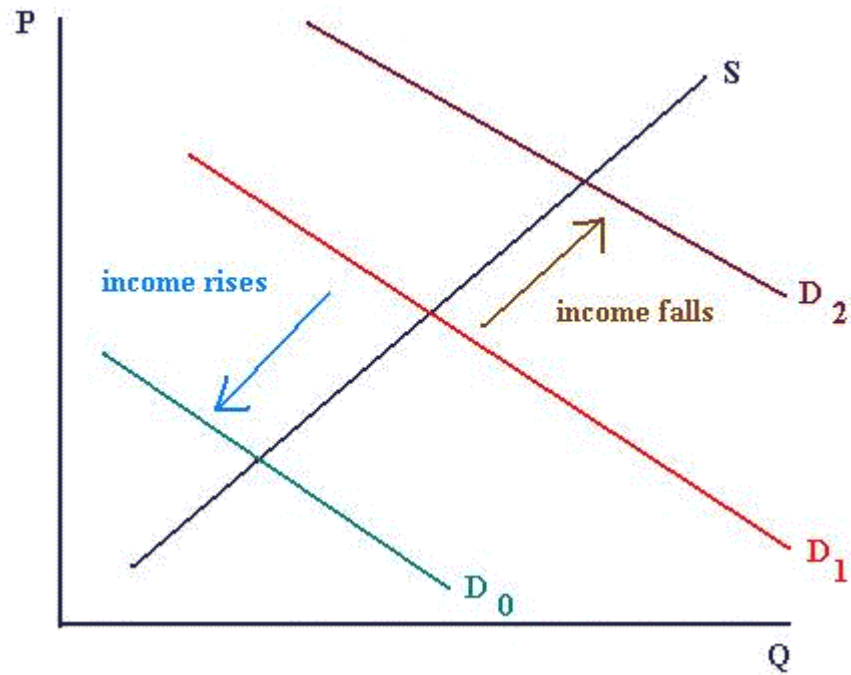


- changes in income
 - normal goods



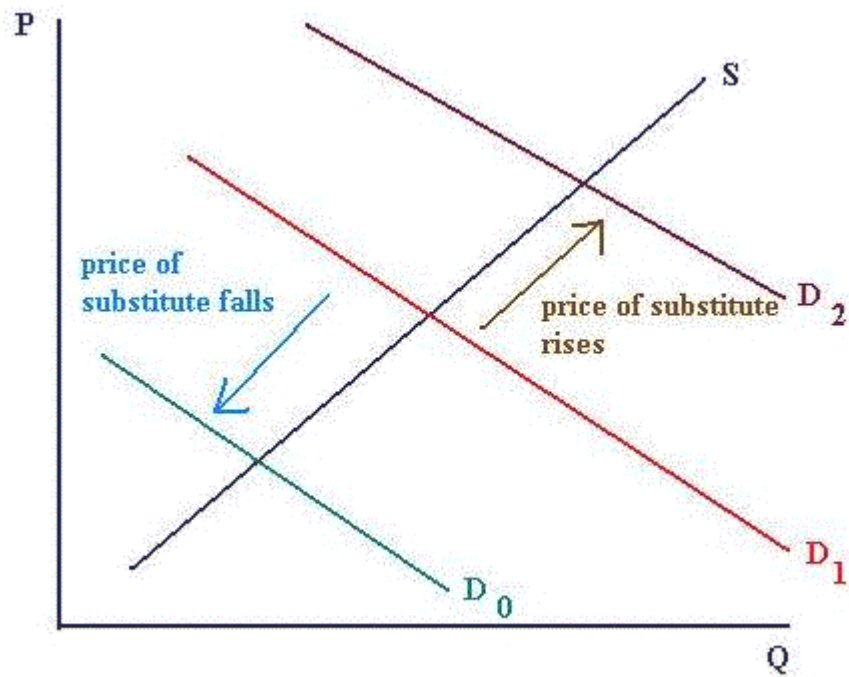
2. inferior

goods

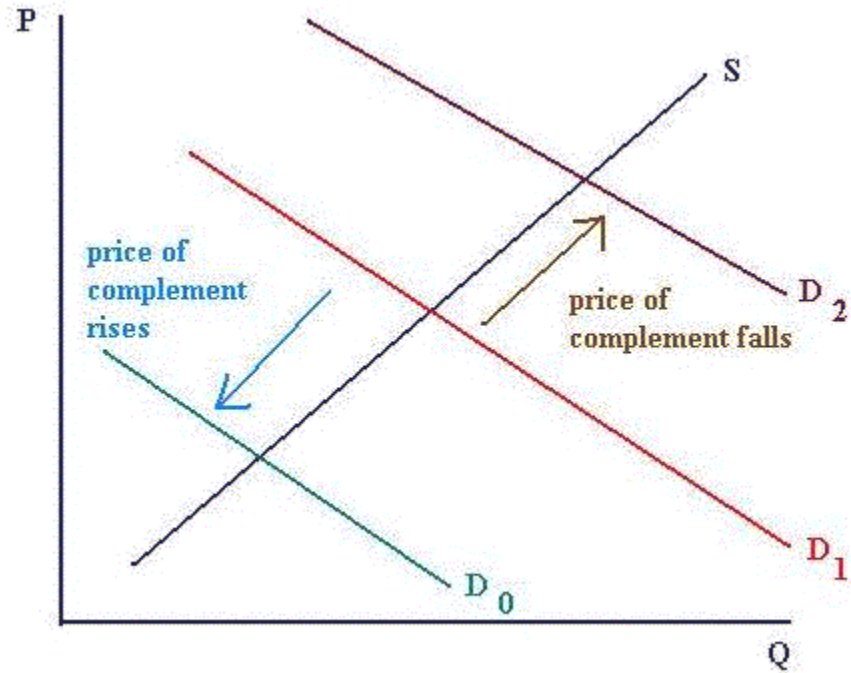


- changes in the prices of related goods

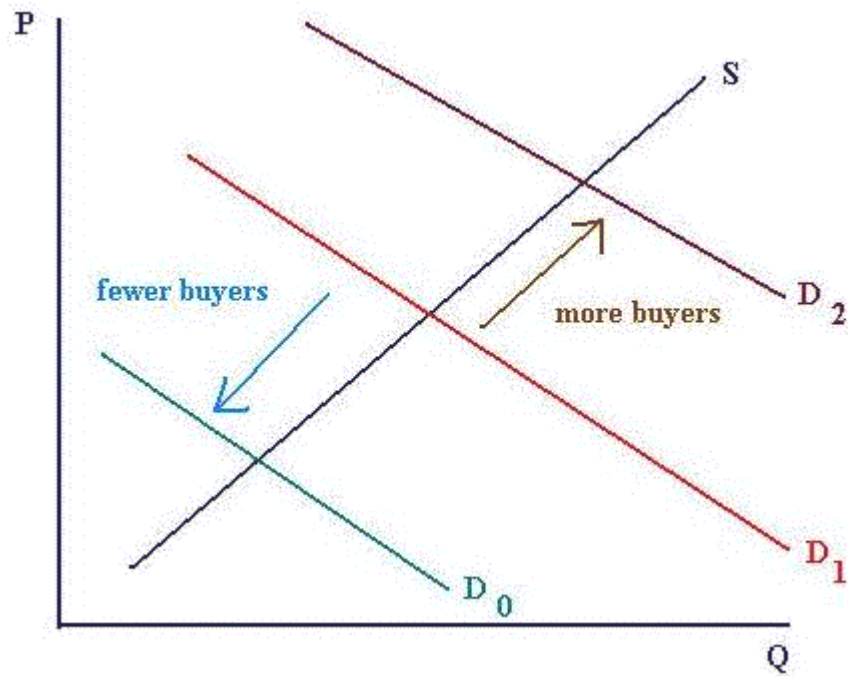
1. substitutes



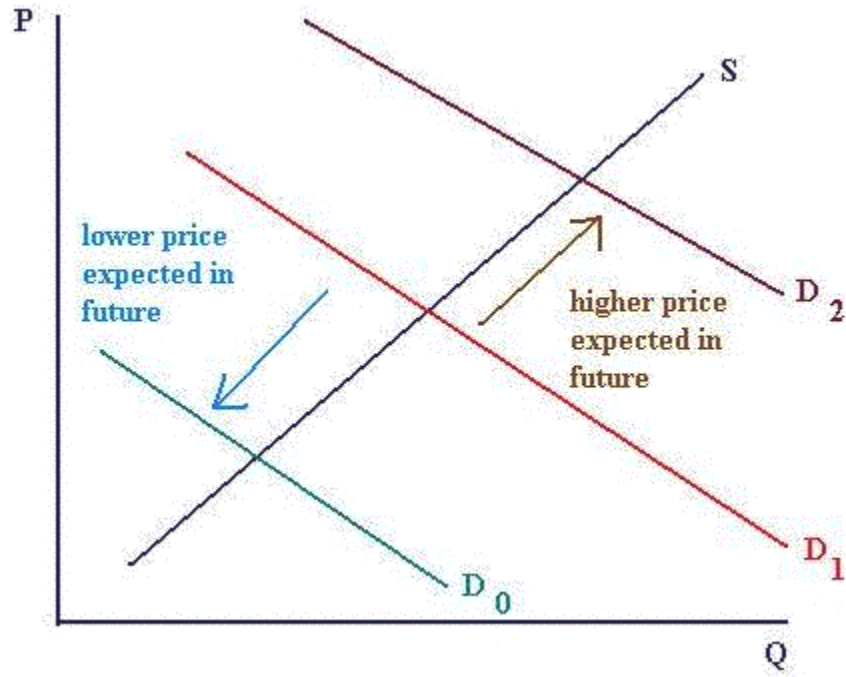
2. complements



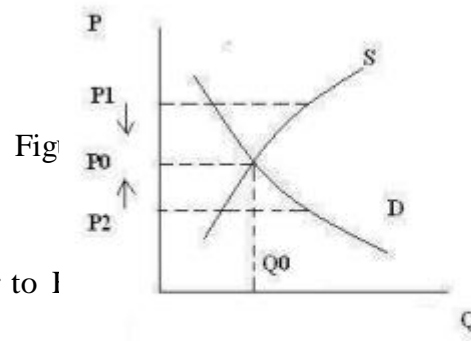
- changes in the population of potential buyers



- changes in expected future prices



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m state.

is the intersection

point of the
curves.

Supply Price
0
Change in \Rightarrow Change in equilibrium
Demand Quantity

Surplus and Shortage

Surplus. Price P_1 is higher than P_0 and will fall down.

Shortage. Price P_2 is lower than P_0 and will raise
P P

Books

1. Chapter 2 from Pindyck and Rubinfeld with Mehta (2005), Microeconomics- latest available Edition in market.
2. Chapter 3 from D.N Dwivedi (2016), Microeconomics Theory and Application-- latest available Edition in market.