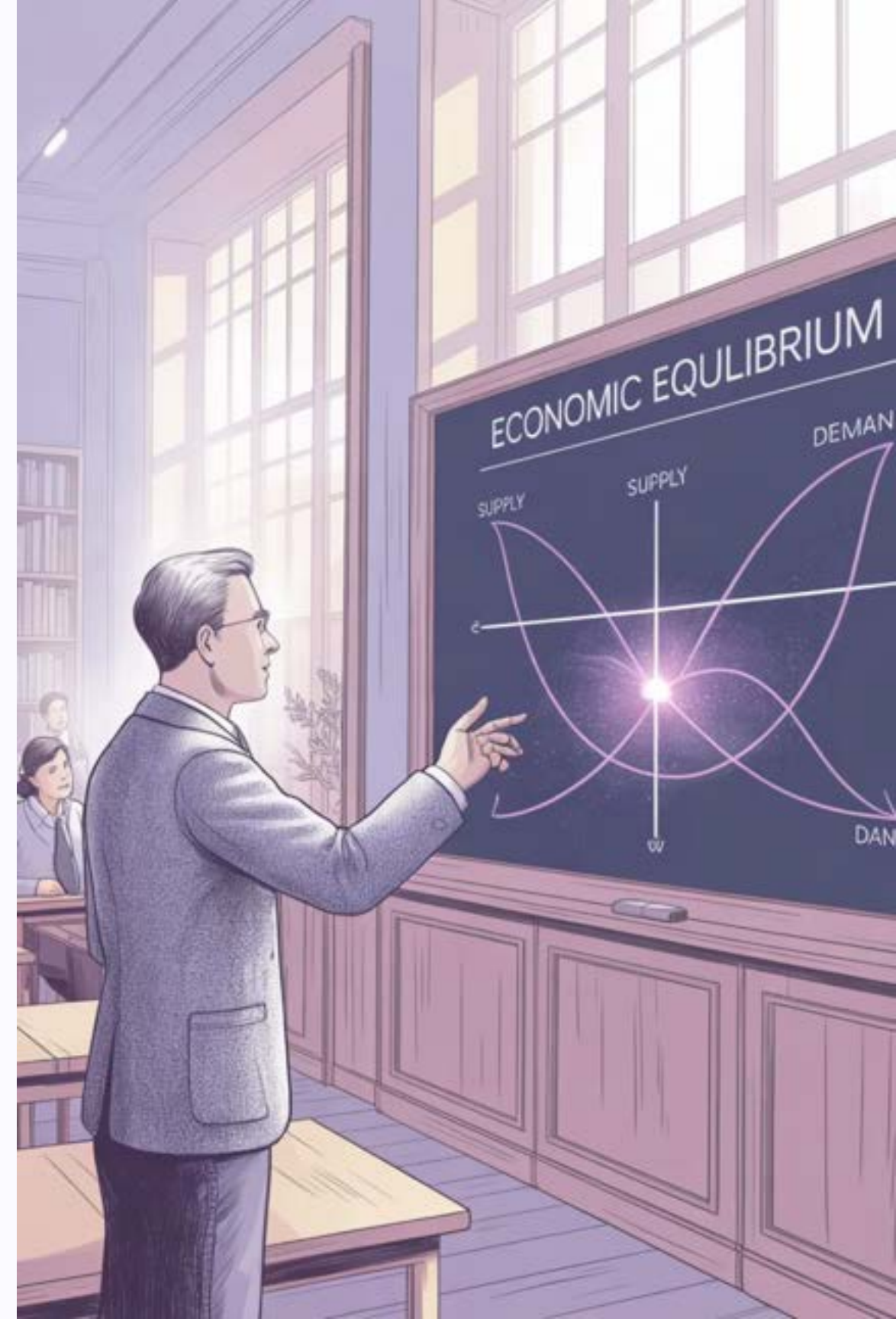


Supply and Demand Fundamentals

Welcome to Week 2 of our Economics course, where we'll explore the fundamental principles of supply and demand. These concepts form the backbone of economic theory and help explain how markets function, prices are determined, and resources are allocated in our economy.

Throughout this presentation, we'll examine the mechanics of supply and demand curves, market equilibrium, and how these principles apply to real-world business scenarios and consumer behavior.



Law of Supply and Demand

The Law of Supply and Demand is the fundamental principle governing market economies:

- As price increases, quantity demanded decreases (Law of Demand)
- As price increases, quantity supplied increases (Law of Supply)
- Markets naturally move toward equilibrium where supply equals demand

These relationships explain how prices act as signals that coordinate the decisions of buyers and sellers, leading to efficient resource allocation in competitive markets.





Demand Curves: Shifts vs Movements



Movement Along Demand Curve

Occurs when the price of the good changes, causing consumers to adjust quantity demanded. This is represented by moving along the existing demand curve.

- Price increases → Quantity demanded decreases
- Price decreases → Quantity demanded increases



Shift of Demand Curve

Occurs when factors other than price change, causing the entire demand curve to shift.

- Income changes
- Consumer preferences
- Prices of related goods
- Population changes
- Future price expectations

Supply Curves and Production Choices

Supply Curve Fundamentals

The supply curve shows the relationship between price and quantity supplied. As prices rise, producers are willing to supply more goods to the market.

Factors Affecting Supply

- Production costs
- Technology advancements
- Number of sellers
- Producer expectations
- Government regulations



Producers constantly evaluate market conditions to determine optimal production levels, adjusting output based on price signals and production costs.

Market Equilibrium: Graphical Illustration

Identifying Equilibrium

Market equilibrium occurs at the intersection of supply and demand curves, where quantity supplied equals quantity demanded.

Equilibrium Price

The price at which the market clears - no excess supply or demand exists. This is the market's natural resting point.

Equilibrium Quantity

The amount of goods exchanged at the equilibrium price, representing the optimal quantity for both buyers and sellers.



Surplus, Shortage, and Market Adjustment

Surplus

When price is above equilibrium:

- Quantity supplied exceeds quantity demanded
- Unsold inventory accumulates
- Sellers reduce prices to clear excess
- Market moves back toward equilibrium



Shortage

When price is below equilibrium:

- Quantity demanded exceeds quantity supplied
- Consumers cannot find enough product
- Prices rise as buyers compete
- Market moves back toward equilibrium

Market Adjustment

The natural process by which:

- Price signals coordinate activity
- Surpluses and shortages are temporary
- Markets self-correct without intervention

Real-World Applications: Consumer Behaviour

1 Price Elasticity of Demand

Measures how responsive consumers are to price changes. Essential goods (like medication) tend to be inelastic, while luxury items (like vacation packages) are typically elastic.

2 Substitution Effect

When prices rise, consumers often switch to lower-priced alternatives. This behavior reinforces the law of demand and explains why competing products often have similar pricing.

3 Income Effect

As consumer income changes, their purchasing power and demand for various goods shift. Higher incomes typically increase demand for normal goods while decreasing demand for inferior goods.



Factors Influencing Supply and Demand in Business



Key Business Applications

Understanding supply and demand helps businesses with:

- Pricing strategy development
- Production planning and inventory management
- Market expansion decisions
- Competitive analysis and positioning
- Forecasting future market conditions

Successful businesses continuously monitor market signals and adjust their strategies to align with changing supply and demand conditions.