THE FEDERAL RESERVE BANK OF ATLANTA

Supply & Demand

How do markets determine prices?

MICROECONOMICS

Law of Supply

There is a direct, or positive, relationship between the price of a good or service and the quantity supplied of that good or service.

Price = P Qs = Quantity supplied

↑P → ↑Qs

↓P → ↓Qs

Law of Demand

There is an inverse or negative relationship between the price of a good or service and the quantity demanded of that good or service.

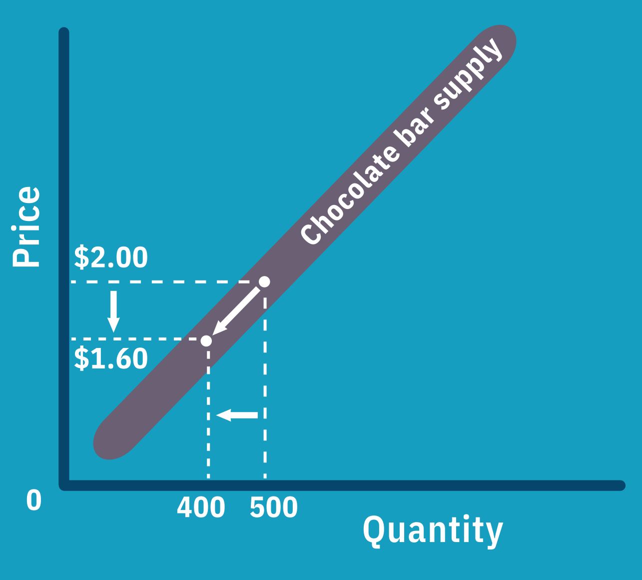
Price = P Qd = Quantity demanded

↑P → ↓Qd

↓P → ↑Qd

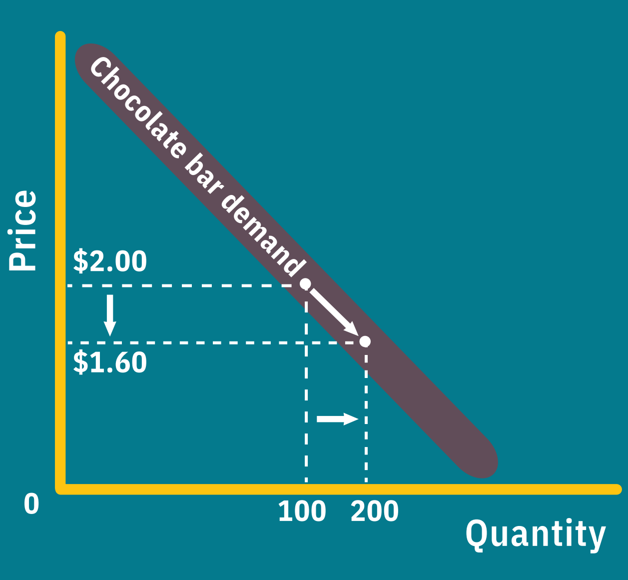
Chocolate Bar Supply Curve

If P↓ from $2.00 to $1.60
Then Qs↓ from 500 to 400 bars



Chocolate Bar Demand Curve

If P↓ from $2.00 to $1.60
Then Qd↑ from 100 to 200 bars.



Determinants of Supply

- Δ Input prices
- Δ Technology
- Δ Number of sellers
- Δ Producer expectations

Δ=Change

Determinants of Demand

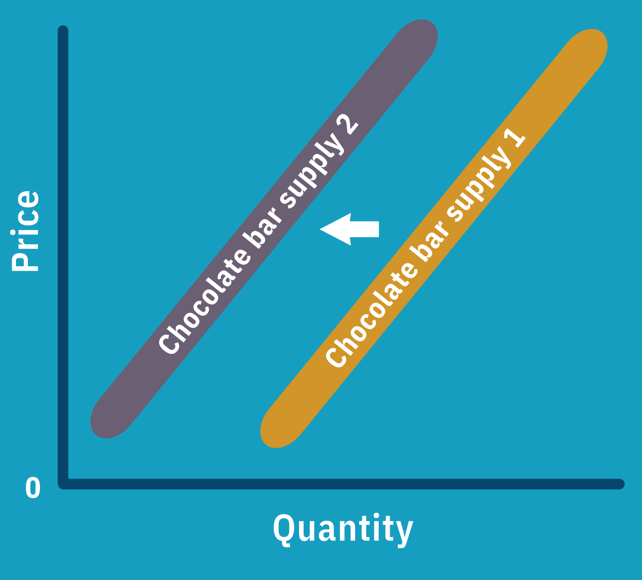
- Δ Income
- Δ Prices of related goods
- Δ Number of buyers
- Δ Consumer expectations

Δ=Change

Shifting the Supply Curve

Δ Cost for factors of production
↑P of cocoa and sugar

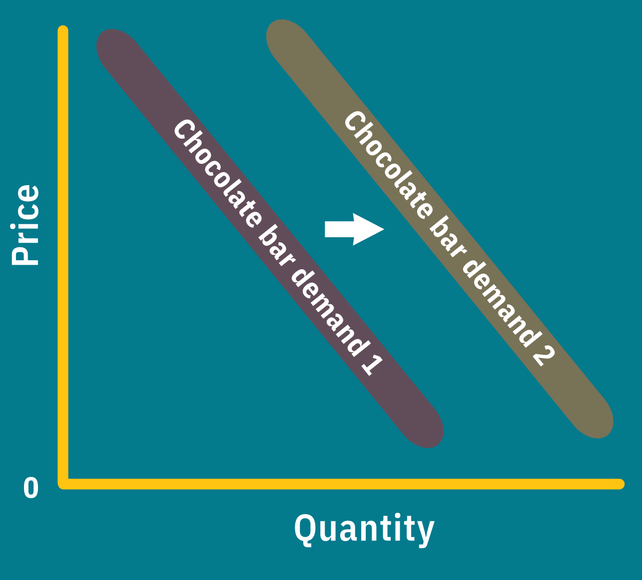
Supply↓ and shifts left from S1 to S2



Shifting the Demand Curve

Δ Price of complementary goods
↓P for graham crackers and marshmallows

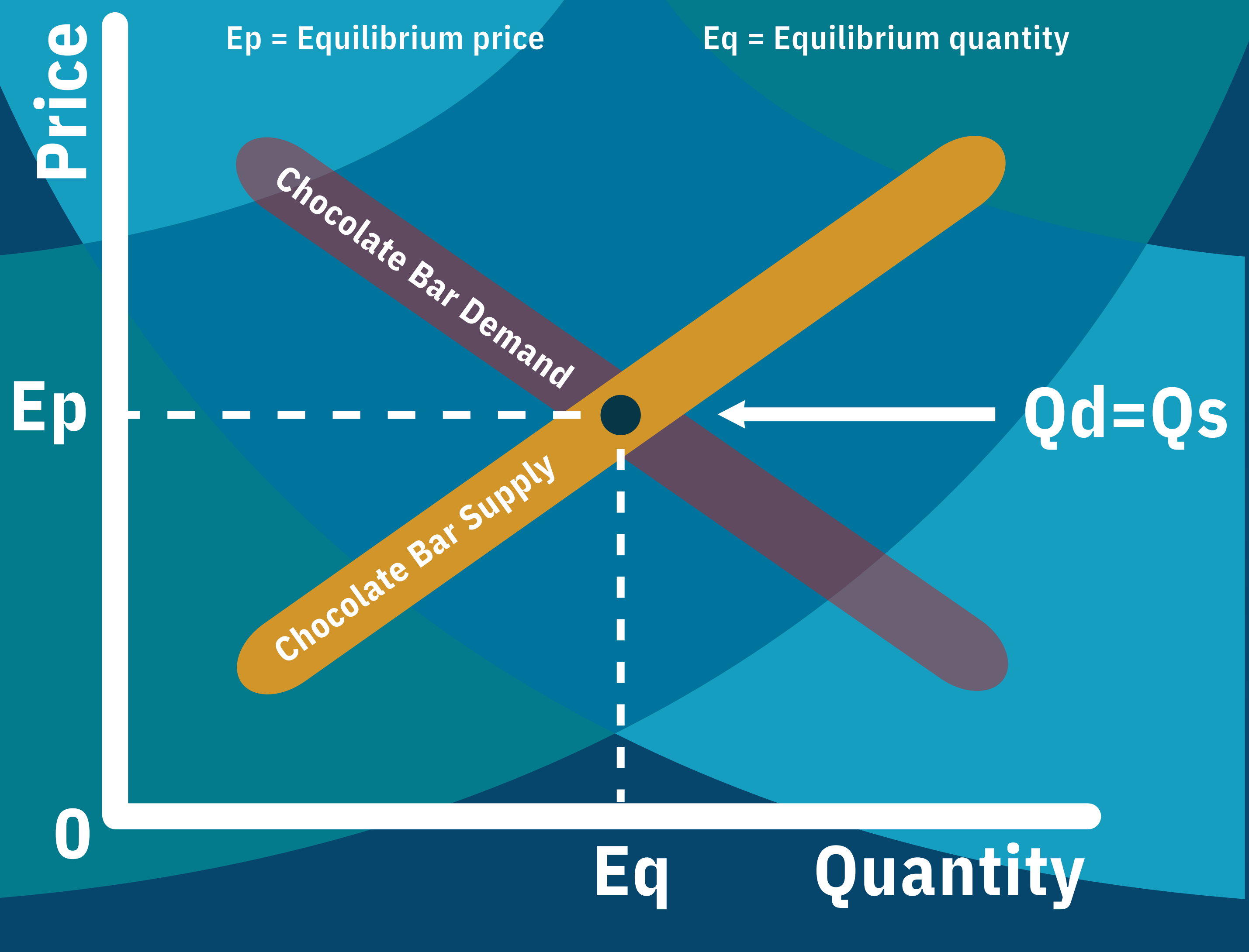
Demand↑ and shifts right from D1 to D2



Market Equilibrium

When a market is in equilibrium, the quantity demanded equals the quantity supplied at the price that clears the market. This is the equilibrium price.

Ep = Equilibrium price Eq = Equilibrium quantity



Federal Reserve Bank of Atlanta

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