

Supply and Demand

ECO 120: Global Macroeconomics

Goals

1 / 30

Unit Goals

Define demand and identify what influences demand

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Predict how prices and quantities are determined by supply and demand.

Use these skills to make predictions about changes in price and quantity.

Learning Objectives

LO 2: Use the supply and demand model to predict price and quantity outcomes for markets for products and services.

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Reading and Exercises

2 / 30

Textbook: Demand, Module 5

Textbook: Supply and Equilibrium, Module 6

Textbook: Changes and Equilibrium, Module 7

Canvas Quiz due Wed 11:59 PM.

Multiple-choice, 10 questions, unlimited attempts allowed,
only best score counts

Homework/In-class Exercise due Friday 11:59 PM. We
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Demand

3 / 30

The **quantity demanded** of a good or service is the amount consumers are willing and able to buy in a given time period at a particular price.

Law of demand: All other things remaining equal, the higher (lower) the price of the good, the smaller (higher) is the quantity demanded.

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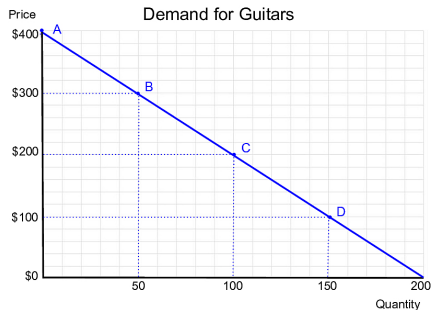
Law of demand: All other things remaining equal, the higher (lower) the price of the good, the smaller (higher) is the quantity demanded.

Demand

Demand Schedule For Guitars

Point	Price	Q_D
A	\$400	0
B	\$300	50
C	\$200	100
D	\$100	150

Demand Curve for Guitars



Law of demand makes the demand curve **downward sloping**.

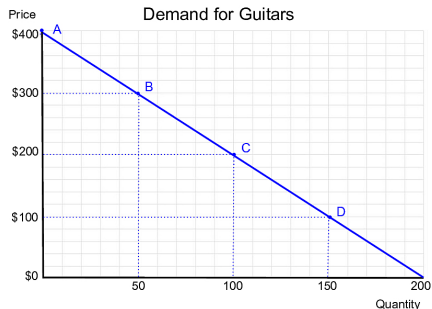
Change in quantity demanded: when there is a **change in price** causing a **movement** from one point on the demand curve to another point.

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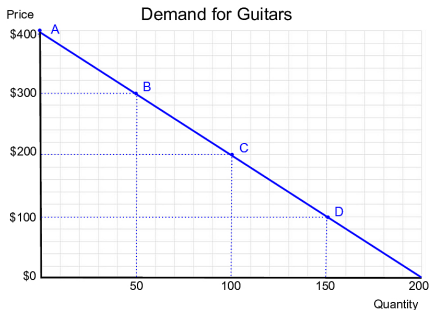
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Income and Substitution effects

The demand curve is downward sloping because of the income and substitution effect.

Substitution effect: when the price of a good rises, people may buy substitute goods instead.

Income effect: When the price of a good rises, the real purchasing power of your income decreases. When the real value of your income decreases, you buy less of everything.

Close to correct. More on the income effect later.

Income and Substitution effects

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Supply

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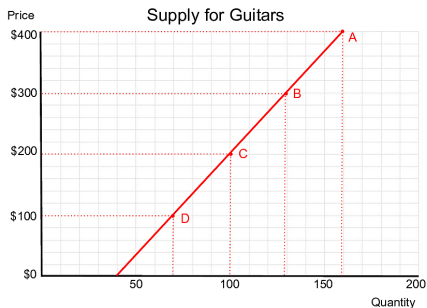
Supply

7 / 30

Supply Schedule For Guitars

Point	Price	Q_S
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Supply Curve for Guitars



Law of supply makes the supply curve **upward sloping**.

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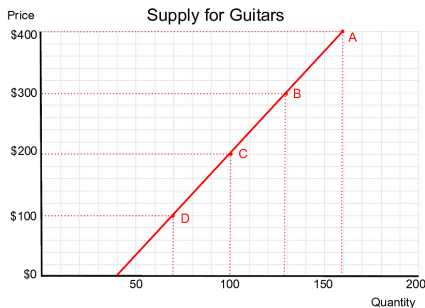
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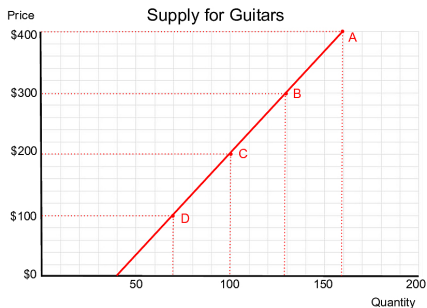
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Equilibrium

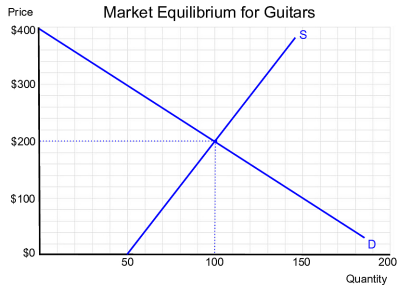
Equilibrium Definition

The **equilibrium price** is the price where the quantity supplied is equal to the quantity demanded.

The **equilibrium quantity** is the corresponding quantity.

This is the price and quantity that will prevail in an unregulated market.

Graphical Equilibrium



Equilibrium

8 / 30

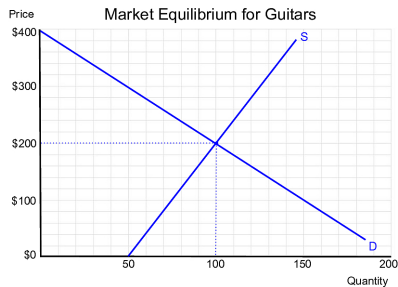
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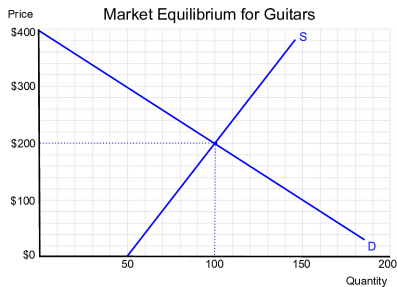
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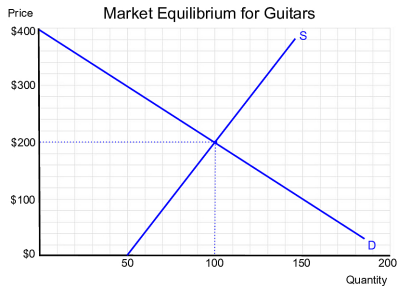
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Surplus

9 / 30

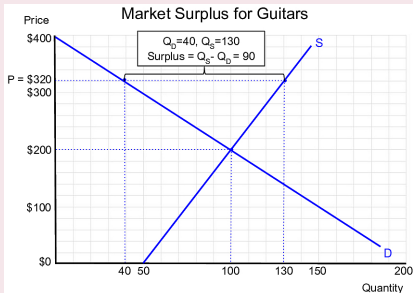
Surplus Definition

When the prevailing price is **above** equilibrium price, quantity supplied exceeds quantity demanded

Difference is the surplus

In an unregulated market, market forces will push price lower toward equilibrium

Graphical Surplus



Surplus

9 / 30

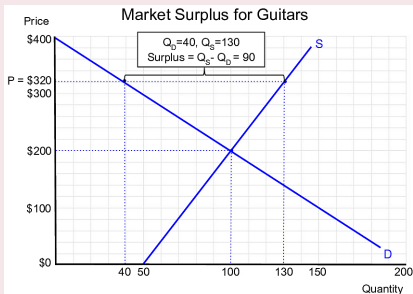
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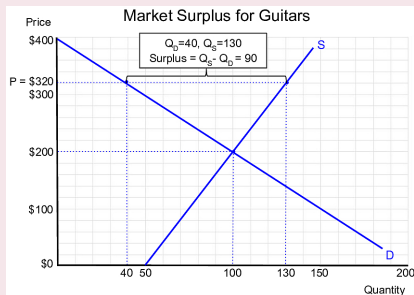
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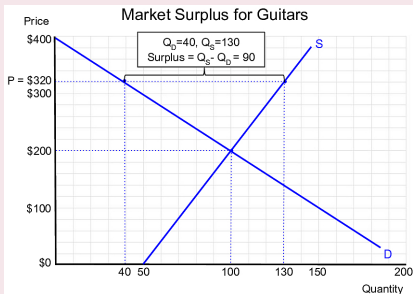
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Shortage

10 / 30

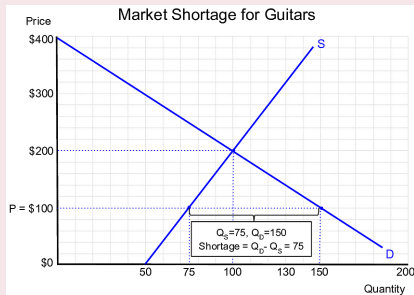
Shortage Definition

When the prevailing price is **below** equilibrium price, quantity demanded exceeds quantity supplied

Difference is the shortage

In an unregulated market, market forces will push equilibrium price higher

Graphical Shortage



Shortage

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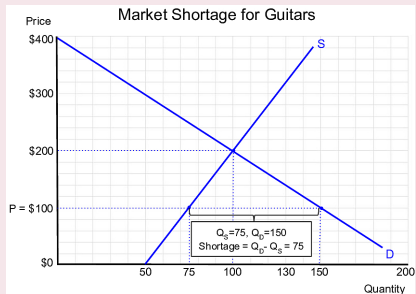
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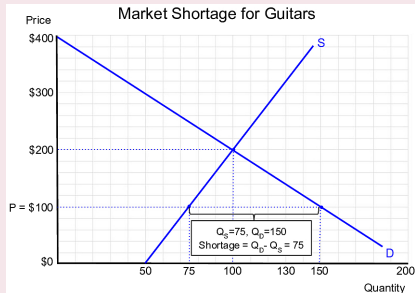
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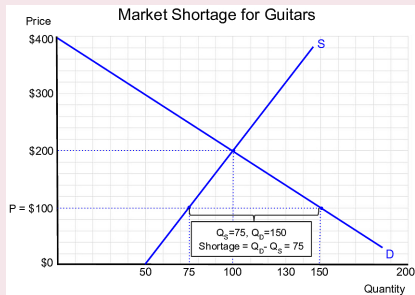
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Demand Curve Shifts

11 / 30

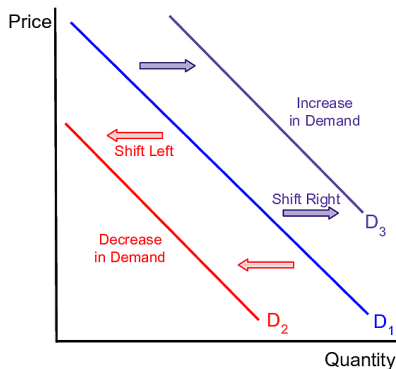
Shifts in Whole Demand Curve

When something *besides the price of the good* effects demand, we say there is a *change or shift in demand*.

Something that **increases** demand shifts the demand curve to the **right**

Something that **decreases** demand shifts the demand curve to the **left**

Shifts in Demand



Demand Curve Shifts

11 / 30

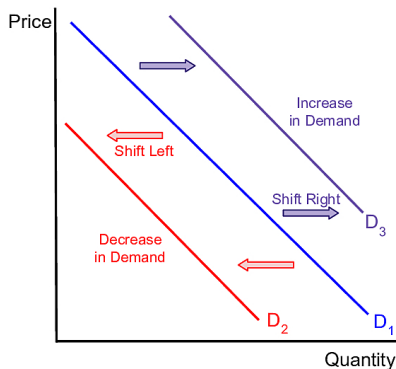
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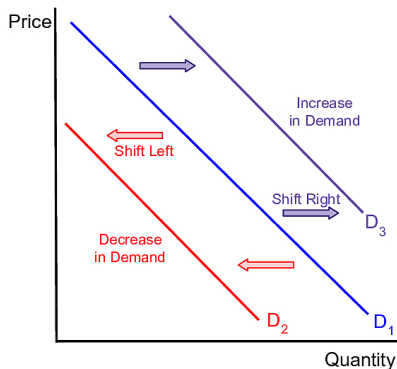
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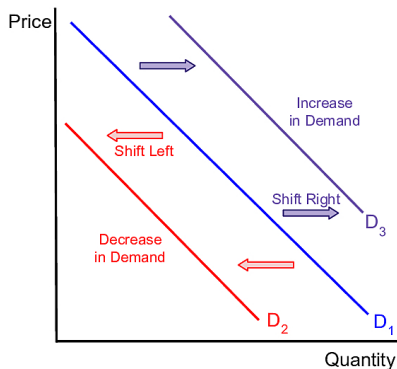
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Shifts in Demand



Substitute Goods

12/ 30

Price of Substitute Goods

Substitutes: a substitute good is a good that can be consumed instead of another good.

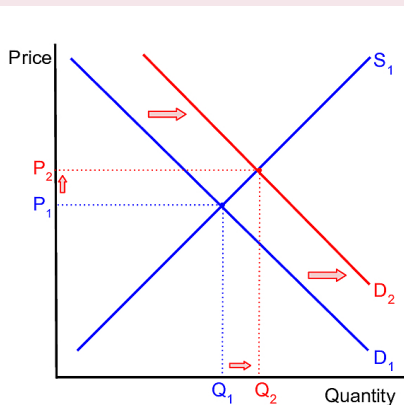
Examples: hamburgers and hot dogs, iPhones and Samsung smartphones, E-books and print books

If the price of a **substitute increases**, this will **increase demand** for a good

Eqm price increases, quantity increases

Price of Samsung phones increase

Market for iPhones



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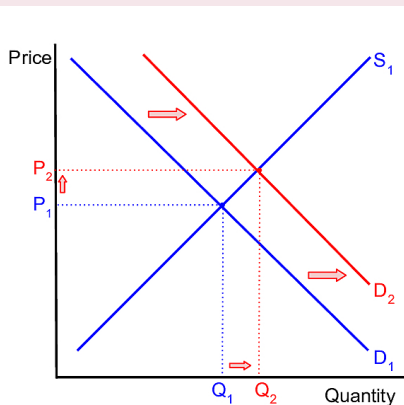
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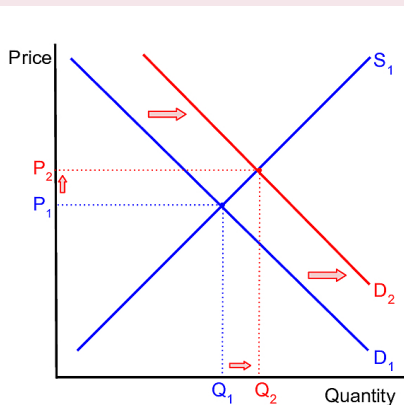
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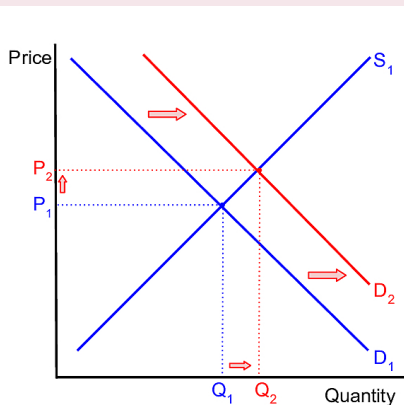
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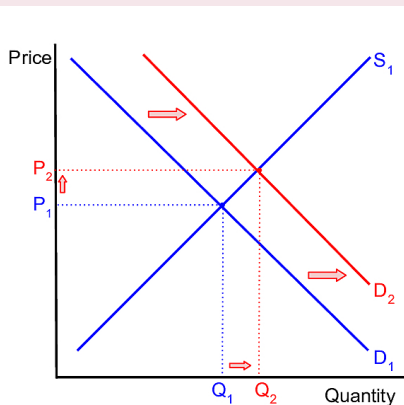
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Complement Goods

13 / 30

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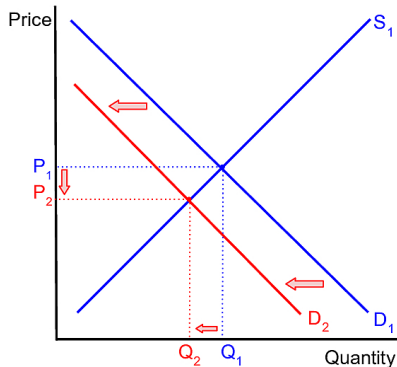
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Market for Andriod Apps



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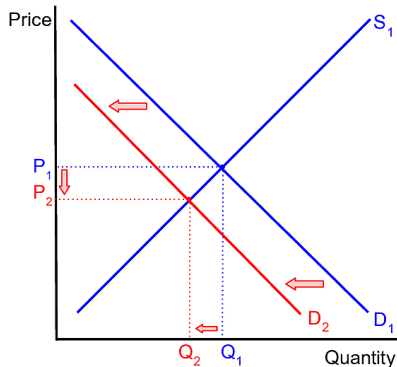
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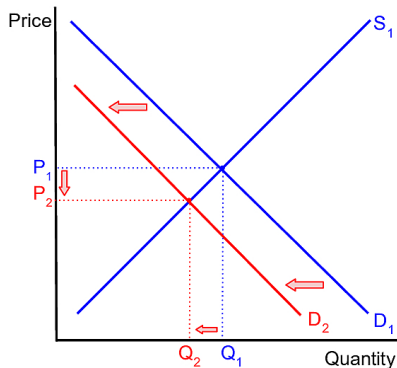
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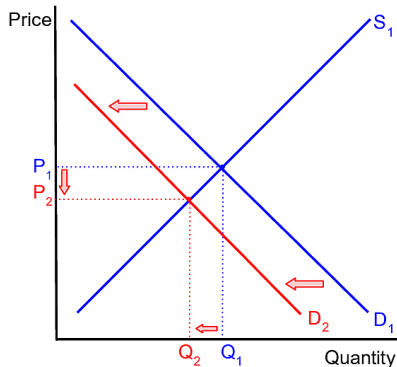
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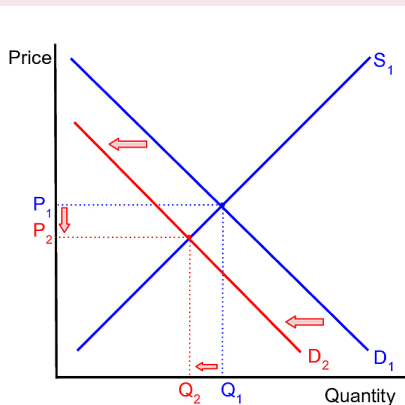
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Changes in Income

14 / 30

Normal good: a good whose demand increases when consumers' incomes increase.

Inferior good: a good whose demand decreases when consumers' incomes increase.

Can you think of examples of an inferior good?

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Changes in Income: Normal Goods

15 / 30

Income Effect on Normal Goods

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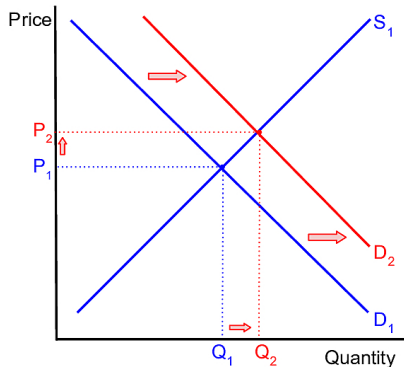
Examples: Most things, computers, automobiles, restaurant meals

If **income increases**, this will **increase demand** for a normal good

Eqm price increases, quantity increases

Increase in Income

Market for Automobiles



Changes in Income: Normal Goods

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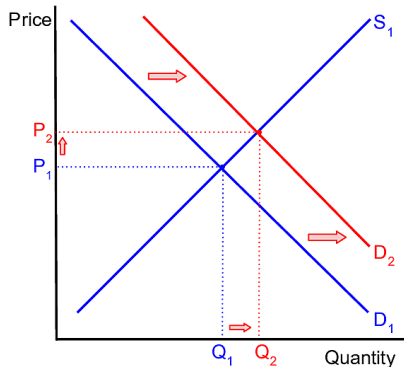
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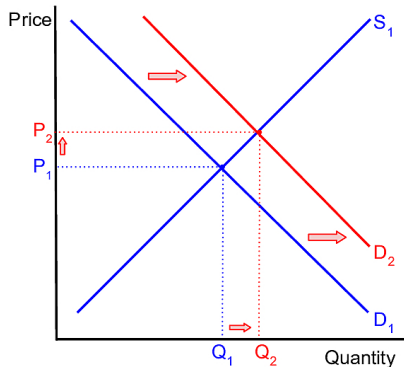
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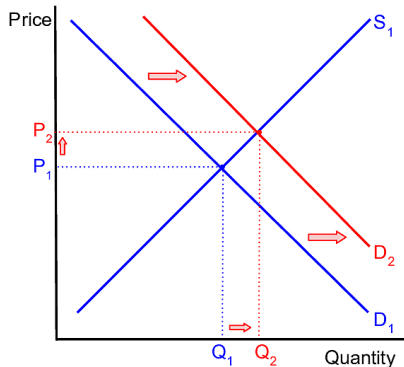
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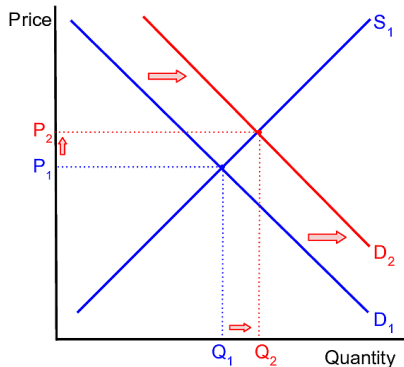
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Changes in Income: Inferior Goods

16 / 30

Income Effect on Inferior Goods

Inferior good: a good whose demand **decreases** when consumers' incomes increase.

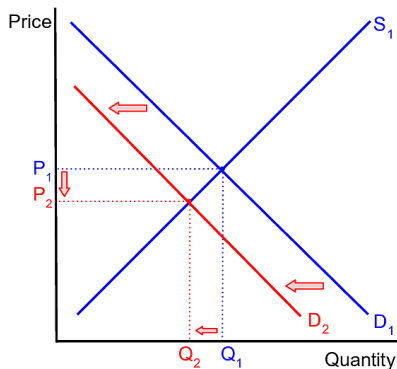
Examples: Used clothing,
Ramen noodles

If **income increases**, this will **decrease demand** for an inferior good

Eqm price decreases, quantity decreases

Increase in Income

Market for Used Clothing



Changes in Income: Inferior Goods

16 / 30

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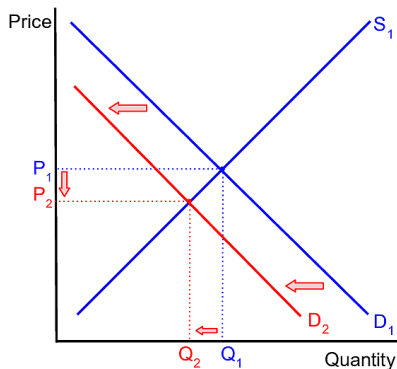
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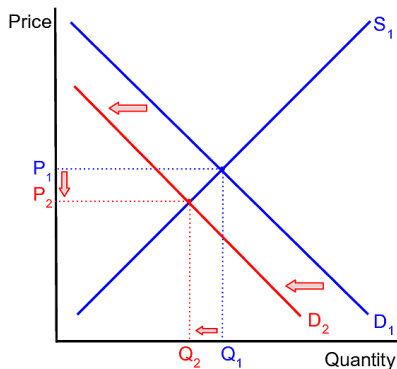
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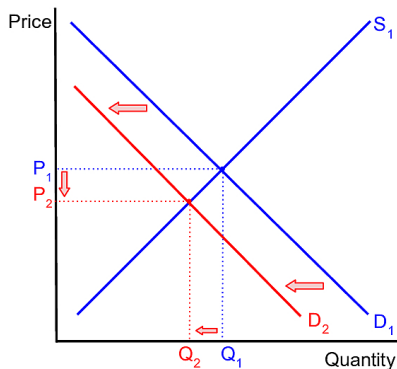
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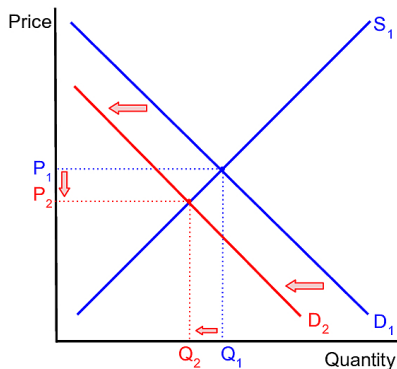
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Consumers Expect Price Increase

17 / 30

Expectation of Price Increase

If consumers expect a price will increase in the future, demand will increase in the present

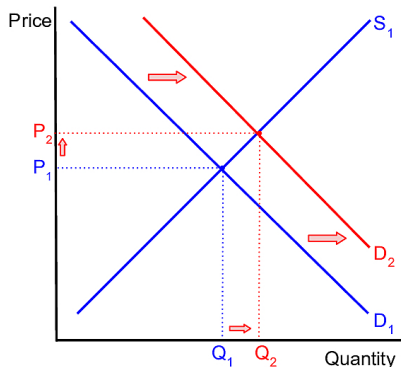
The expectation can be well-informed or even unfounded speculation

Results in higher price, higher quantity

Self-fulfilling expectations are possible!

Expectation of a Price Increase

Market for Gasoline on 9/11/2001



Consumers Expect Price Increase

17 / 30

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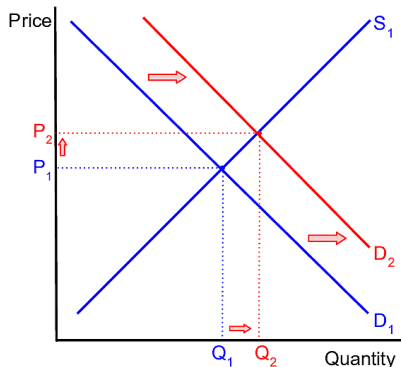
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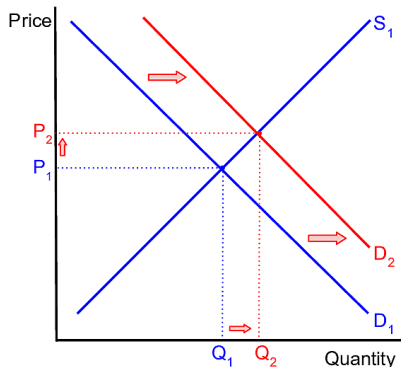
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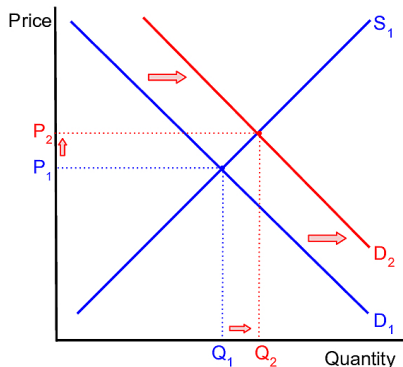
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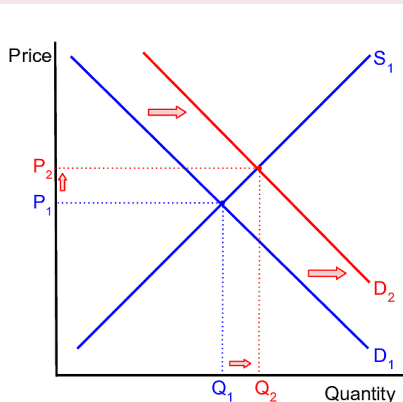
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Consumers Expect Increase in Income

18 / 30

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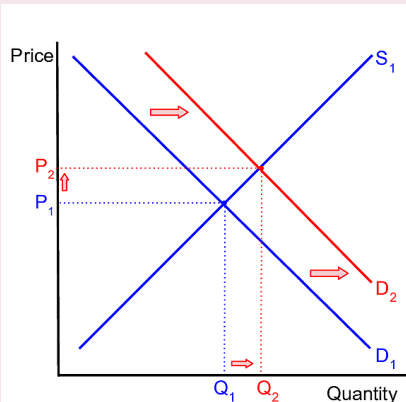
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Why consumer confidence is so important for macroeconomy

Expectation of Higher Income

Market for Automobiles (Normal Good)



Consumers Expect Increase in Income

18 / 30

Expectation of Increase in Income

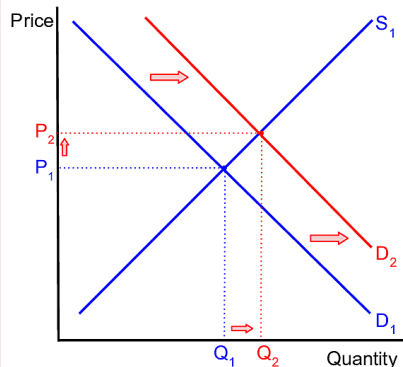
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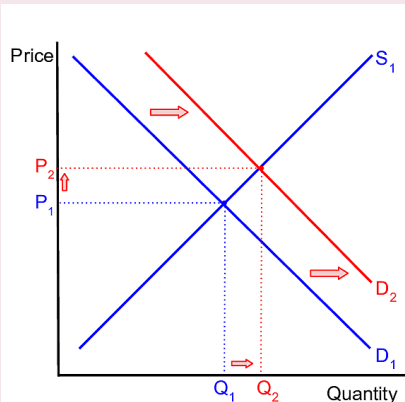
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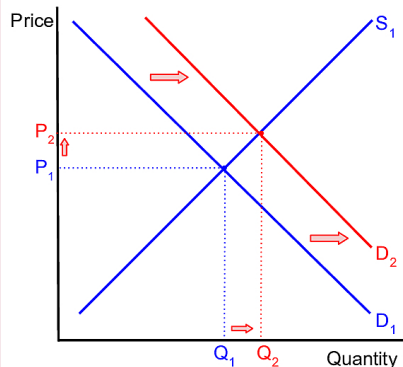
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Supply Curve Shifts

19/ 30

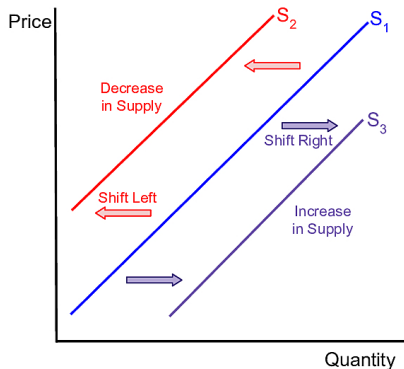
Shifts in Whole Supply Curve

When something *besides the price of the good* effects supply, we say there is a *change or shift in supply*.

Something that **increases** supply shifts the demand curve to the **right**

Something that **decreases** supply shifts the demand curve to the **left**

Shifts in Supply



Supply Curve Shifts

19 / 30

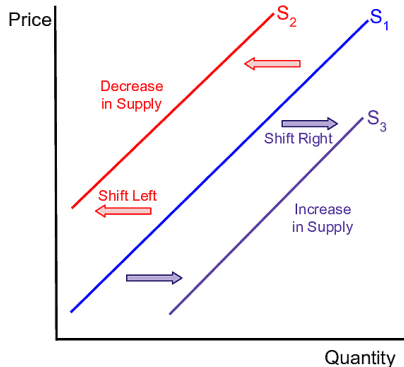
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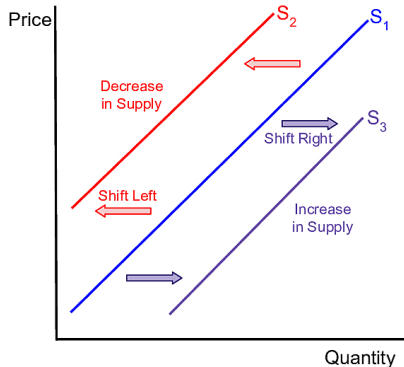
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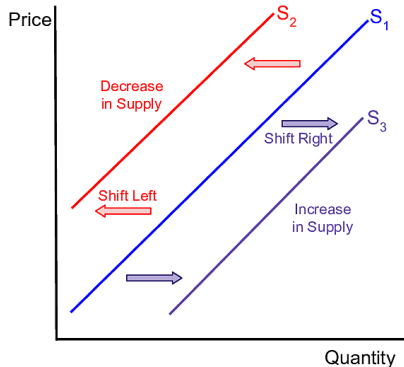
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Improvements in Technology

20 / 30

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Improvements in technology can make it possible to produce more

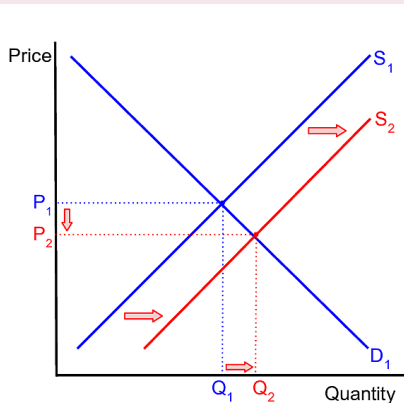
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Shift supply to the right

Eqm quantity increases, price decreases

Improvement in Technology

Market for Computers



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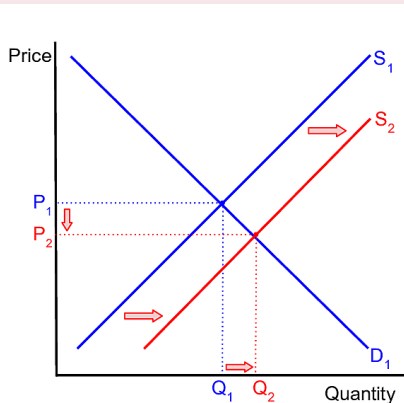
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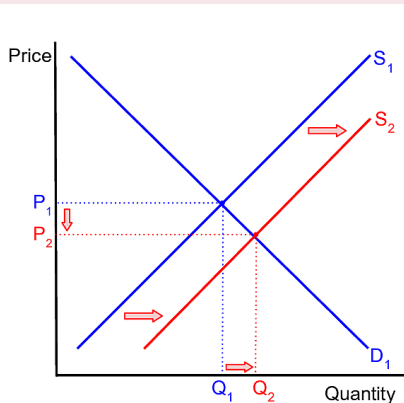
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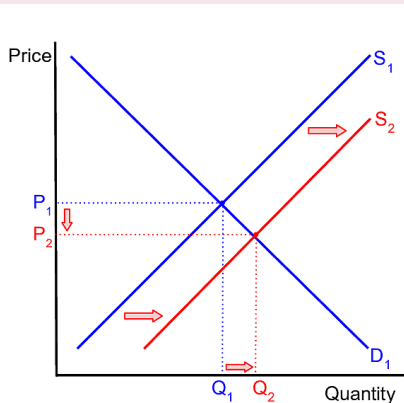
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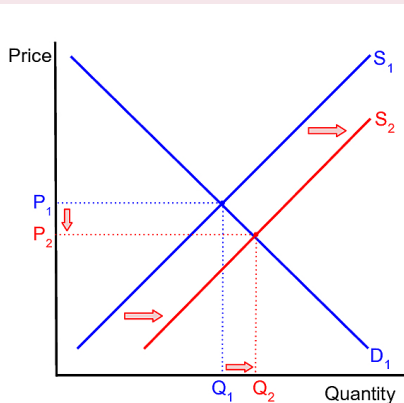
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Increase in Production Costs

21 / 30

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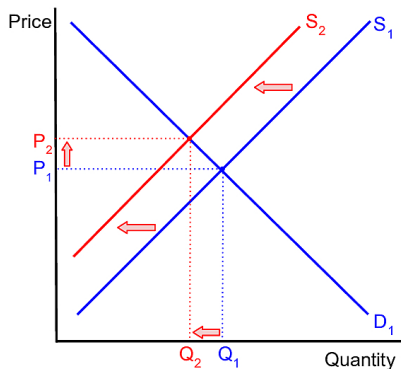
Any increase in production costs causes supply to shift to the left

For example: Increase in price of lumber for construction of new housing

Eqm quantity decreases, price increases

Increase in Production Costs: Lumber Used in Construction

Market for New Housing



Increase in Production Costs

21 / 30

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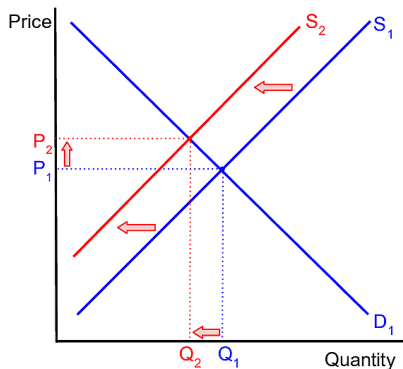
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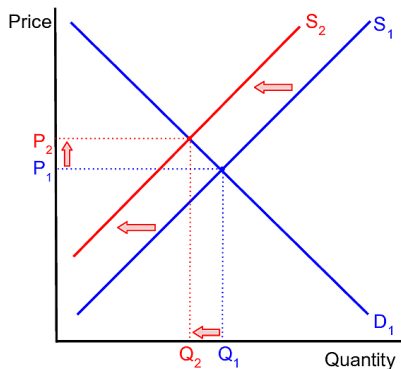
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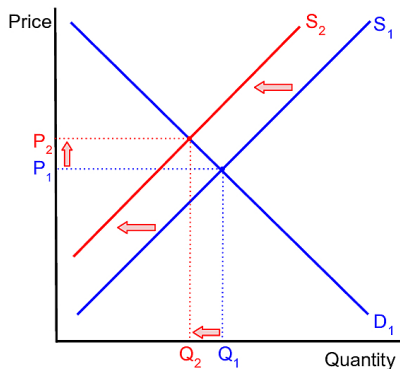
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Producers Expect Higher Prices in Future

22 / 30

Producer Expectations

If producers expect an increase in prices, may hold back production or sales until prices are higher

Easier for goods than can be stored or warehoused

For example: Agriculture producers expects an increase in price of grain

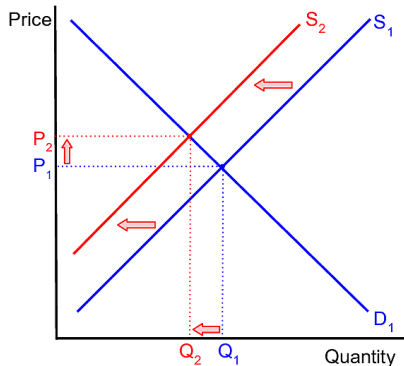
Store grain to sell later, supplying less today, supply shifts left

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Can lead to self-fulfilling expectations

Expectation of Higher Price

Market for Grain



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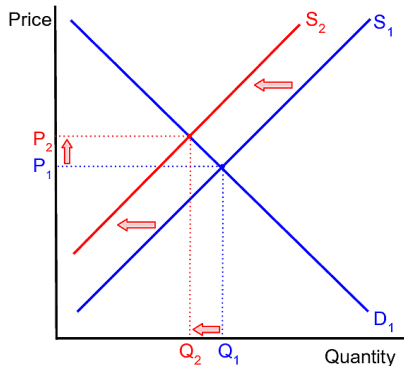
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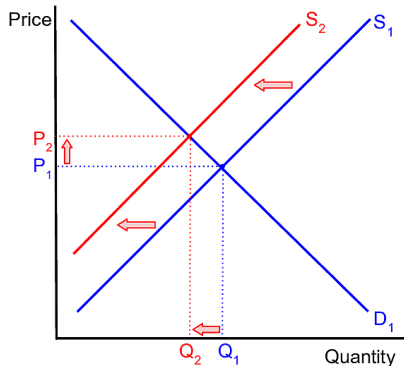
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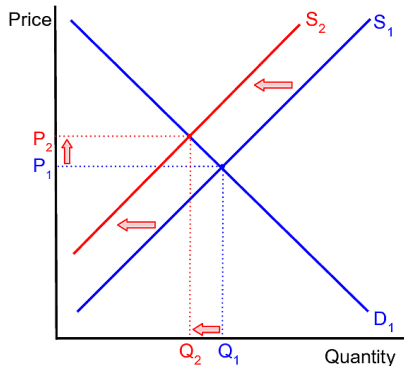
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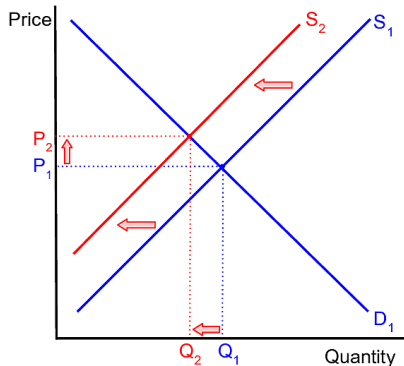
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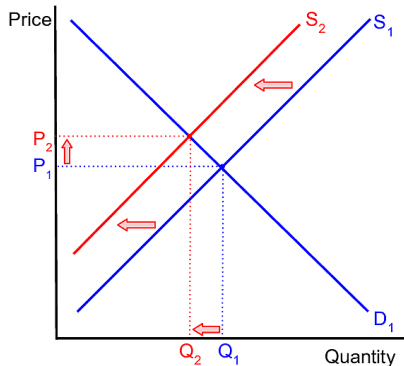
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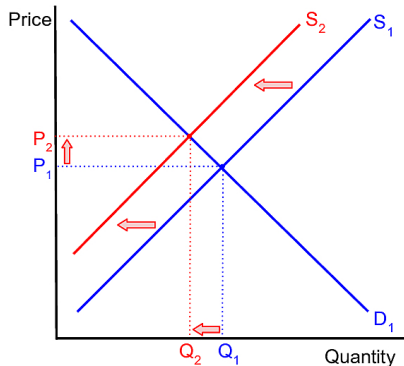
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Subsidy on Ethanol Production

23 / 30

Scenario

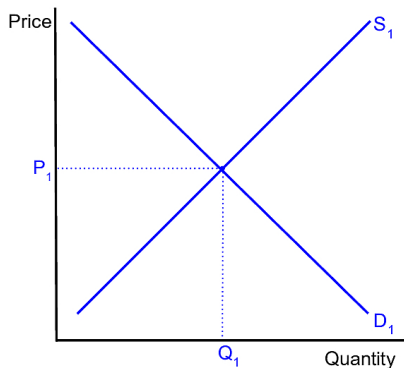
Suppose the government increases the subsidy to gasoline producers for blending ethanol into gasoline.

Impact

Supply for gasoline with ethanol increases
Eqm quantity increases, price decreases

Supply and Demand

Market for Gasoline with Ethanol



Subsidy on Ethanol Production

23 / 30

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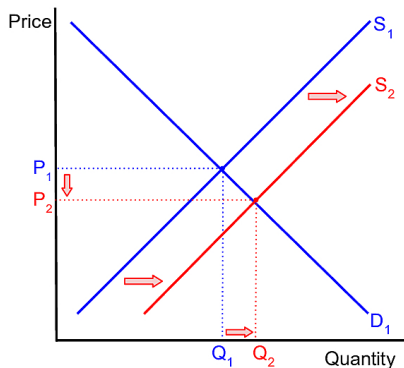
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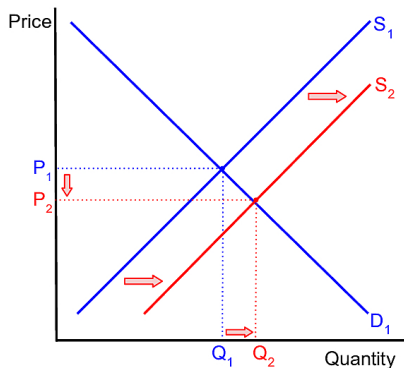
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Supply and Demand

Market for Gasoline with Ethanol



Taxes on Goods and Services

24 / 30

Scenario

Suppose the government increases the taxes on cigarettes.

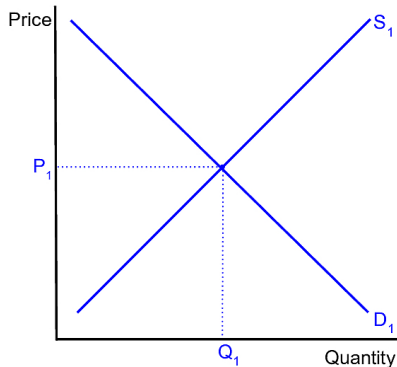
Impact

Demand for cigarettes decreases

Eqm quantity decreases, price decreases

Supply and Demand

Market for Cigarettes



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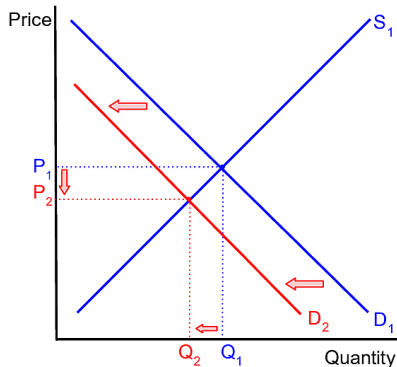
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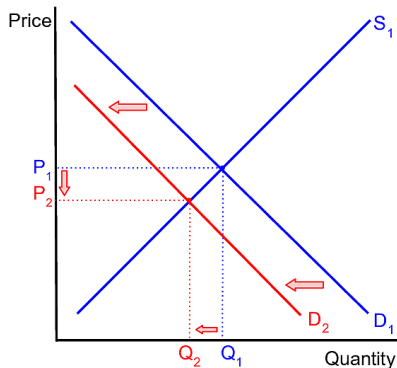
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Supply and Demand

Market for Cigarettes



Changes in Opinions and Preferences: Peloton

25 / 30

Scenario

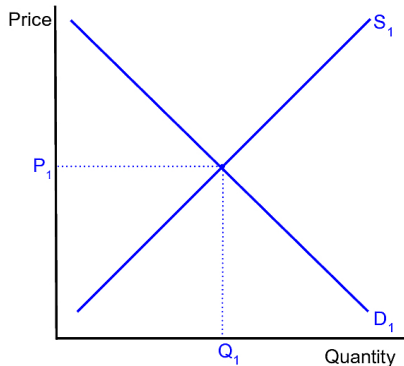
Suppose the Mr. Big dies while working out on his Peloton bike, and this leads people to think that Peloton bikes are dangerous.

Impact

Demand for Peloton bikes decreases
Eqm quantity decreases, price decreases

Supply and Demand

Market for Peloton Bikes



Changes in Opinions and Preferences: Peloton

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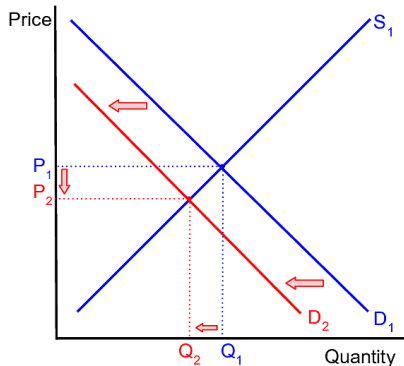
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Supply and Demand

Market for Peloton Bikes



Changes in Opinions and Preferences: Peloton

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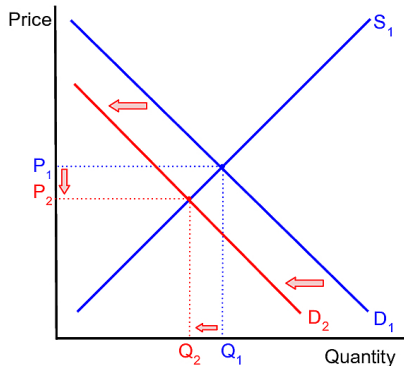
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Supply and Demand

Market for Peloton Bikes



Changes in Preferences: Christmas Trees

26 / 30

Scenario

After a difficult year in 2020, more people decided to celebrate the holiday season with real Christmas trees.

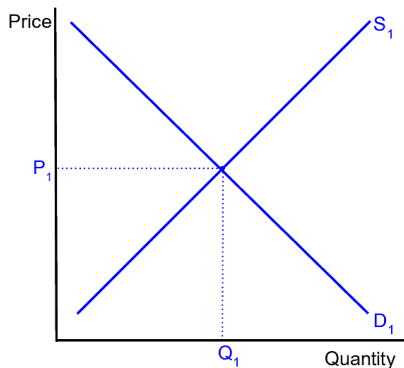
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Demand for Christmas trees increases

Eqm quantity increases,
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Supply and Demand

Market for Christmas Trees



Changes in Preferences: Christmas Trees

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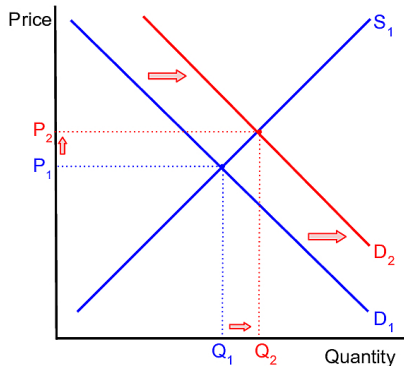
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Supply and Demand

Market for Christmas Trees



Changes in Preferences: Christmas Trees

26 / 30

Scenario

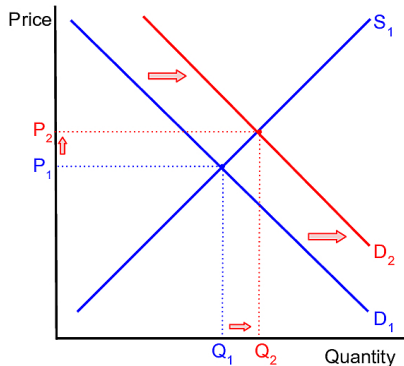
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Impact

Demand for Christmas trees increases
Eqm quantity increases,
price increases

Supply and Demand

Market for Christmas Trees



Changes in Supply and Demand: Christmas Trees

27 / 30

Scenario

During a very difficult recession in 2009-2010, many Christmas tree farmers did not invest in planting new trees. It takes about 10-11 years for trees to grow to typical room height.

Also, after a difficult year in 2020, more people decided to celebrate the holiday season with real Christmas trees.

Impact

Demand increases

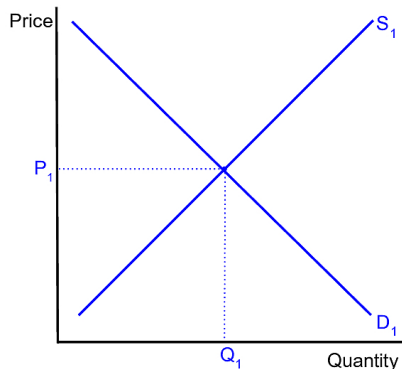
Supply decreases

Equilibrium price increases

Change in equilibrium quantity is indeterminate

Supply and Demand

Market for Christmas Trees



Changes in Supply and Demand: Christmas Trees

27 / 30

Scenario

During a very difficult recession in 2009-2010, many Christmas tree farmers did not invest in planting new trees. It takes about 10-11 years for trees to grow to typical room height.

Also, after a difficult year in 2020, more people decided to celebrate the holiday season with real Christmas trees.

Impact

Demand increases

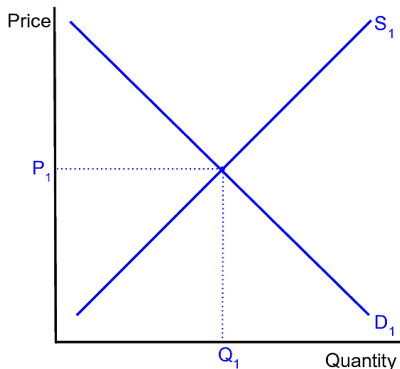
Supply decreases

Equilibrium price increases

Change in equilibrium quantity is indeterminate

Supply and Demand

Market for Christmas Trees



Changes in Supply and Demand: Christmas Trees

27 / 30

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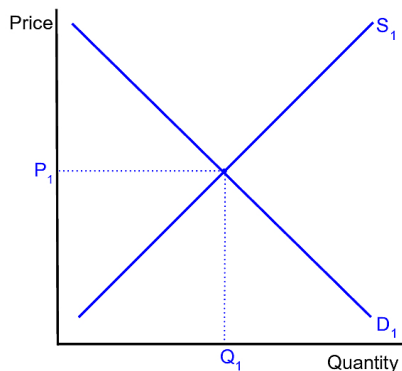
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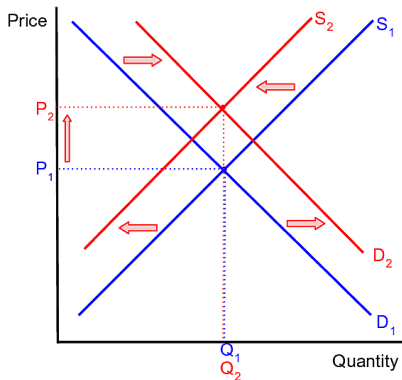
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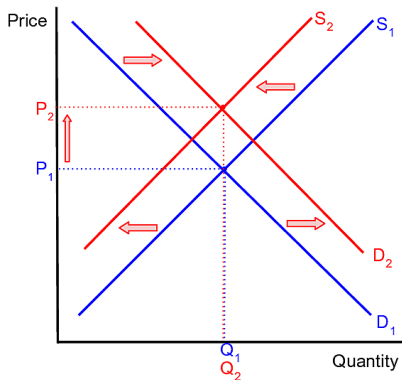
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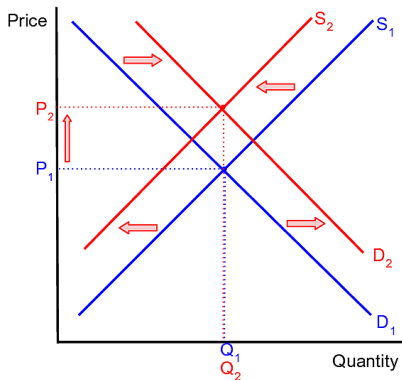
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Market for Christmas Trees



Changes in Supply and Demand: New Homes

28 / 30

Scenario

Suppose that global supply chain problems cause a decrease in availability for construction materials

Suppose also that the country is in a recession and people have lower incomes

Impact on Market for Homes

Demand for new homes decreases

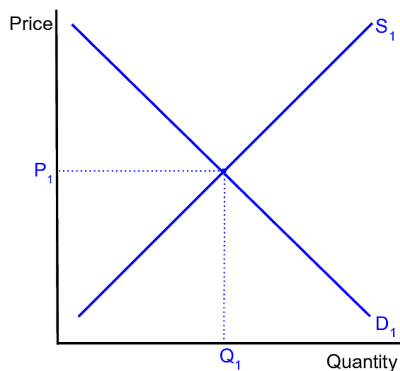
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Equilibrium quantity decreases

Change in equilibrium price is indeterminate

Supply and Demand

Market for New Homes



Changes in Supply and Demand: New Homes

28 / 30

Scenario

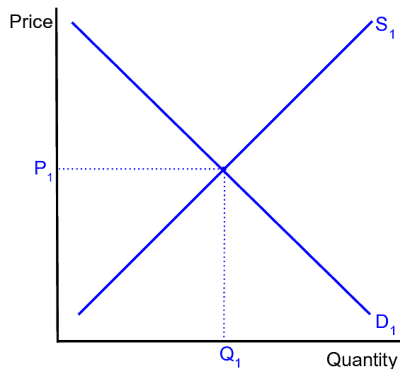
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Impact on Market for Homes

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Change in equilibrium price is indeterminate

Supply and Demand

Market for New Homes



Changes in Supply and Demand: New Homes

28 / 30

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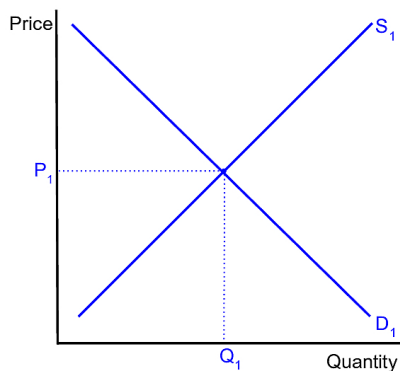
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Supply and Demand

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Changes in Supply and Demand: New Homes

28 / 30

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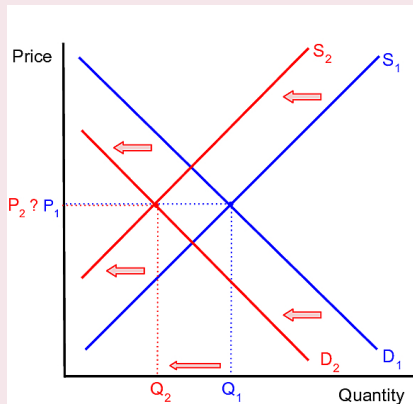
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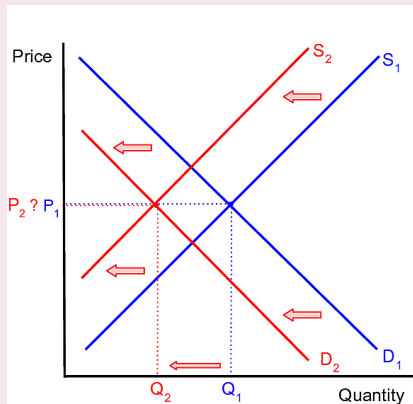
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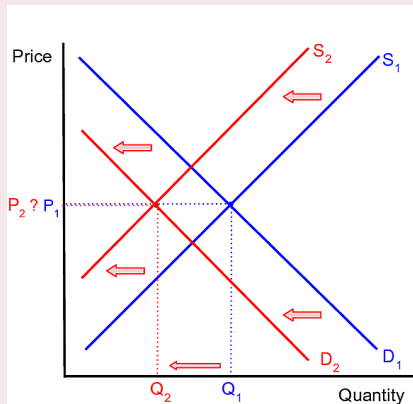
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Scholar Spotlight: Dr. Zsuzsanna Csereklyei

The effect of wind and solar power generation on wholesale electricity prices in Australia, *Energy Policy* August 2019.

Wind, Solar, and Electricity Markets

Clean energy production and electricity prices have been rising together in Australia.

Estimated the impact: Increases in wind and solar energy lead to decreases in electricity prices.

Impact has grown over time with more solar and energy production capacity.

Increasing natural gas prices has led to increases in electricity prices.



Dr. Zsuzsanna Csereklyei

Senior Lecturer
School of Economics, Finance and Marketing
RMIT University, Melbourne, Australia

Reading and Exercises

30 / 30

Textbook: Demand, Module 5

Textbook: Supply and Equilibrium, Module 6

Textbook: Changes and Equilibrium, Module 7

Canvas Quiz due Wed 11:59 PM.

Multiple-choice, 10 questions, unlimited attempts allowed, only best score counts

Homework/In-class Exercise due Friday 11:59 PM. We will work together in class on Thursday.

Next week! Apply our knowledge of supply and demand to currencies: looking at behavior of exchange rates, imports, and exports (Module 47)

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