

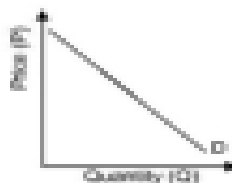


Microeconomics: Supply & Demand

"Micro" means small. Microeconomics is about economics on a small scale of individual households and firms and their exchanges of buying and/or selling.

There are two sides of the market system: demand (from buyers) and supply (from sellers). An example of a retail market is the demand for donuts by consumers and the supply of donuts by businesses. Another example is the labour market, e.g. the demand for construction workers (here businesses do the demanding) and the supply of construction workers (from the population).

Demand is the consumer side of the equation. It is described by a linear equation that shows the quantity of a good that consumers will demand over a range of prices. It has a negative slope (slopes downward to the right), meaning that price (P) and quantity demanded (Q_D) are negatively related. When one goes up, the other goes down and vice versa. This should make sense: when things go on sale ($P \downarrow$), we buy more of them ($Q_D \uparrow$).



There are three reasons why P and Q_D have a negative relationship: (1) **income effect**: as the price goes down, we can buy more of the same good with the same amount of money; (2) **law of diminishing marginal utility**: since the satisfaction of consumption decreases with each extra good, a business has to make the next good cheaper in order for it to be worth purchasing (think buy one, get one 50% off sales); and (3) **substitution effect**: people will substitute a cheaper equivalent good (choosing to buy the cheaper tortilla chips rather than a particular name brand).

There are seven determinants of demand (things that affect the demand curve or where exactly on the demand curve we are): (1) Product price (2) Price of substitutes or complements (3) income (4) Consumer taste and preference (5) Number of buyers (6) Expectation of future prices (7) Expectation of future income.

Product price is the only determinant that results in moving along (from one point to another) the same demand curve. We call this a **change in quantity demanded**. Moving from point **a** to point **b** on the following graph shows an increase in quantity demanded as price decreases. If you compare the x -coordinates for each point, you can see that the quantity demanded at **b** is larger than the quantity demanded at **a**. If you compare the y -coordinates for each point, you can see that the price at **b** is lower than the price at point **a**.