HOW THE MARKETS WORK AND DYNAMICS OF " DEMAND "

MARKETS & DEMAND

CHAPTER CONTENTS

- *WHAT IS A MARKET ?*
- *TYPES OF MARKETS*
- *WHAT IS DEMAND ?*
- *THE LAW OF DEMAND*
- *ILLUSTRATING DEMAND WITH THE "DEMAND CURVE"*
- *CAUSES AND EFFECTS OF DEMAND CHANGES*

MARKETS AND DEMAND

WHAT IS A MARKET ??

MARKETS AND DEMAND

WHAT IS A " MARKET " ?

AN ARRANGEMENT THAT ALLOWS BUYERS AND SELLERS TO EXCHANGE THINGS

THEY EXIST BECAUSE NO ONE ENTITY IS , OR SHOULD BE , SELF – SUFFICIENT

MARKETS AND DEMAND

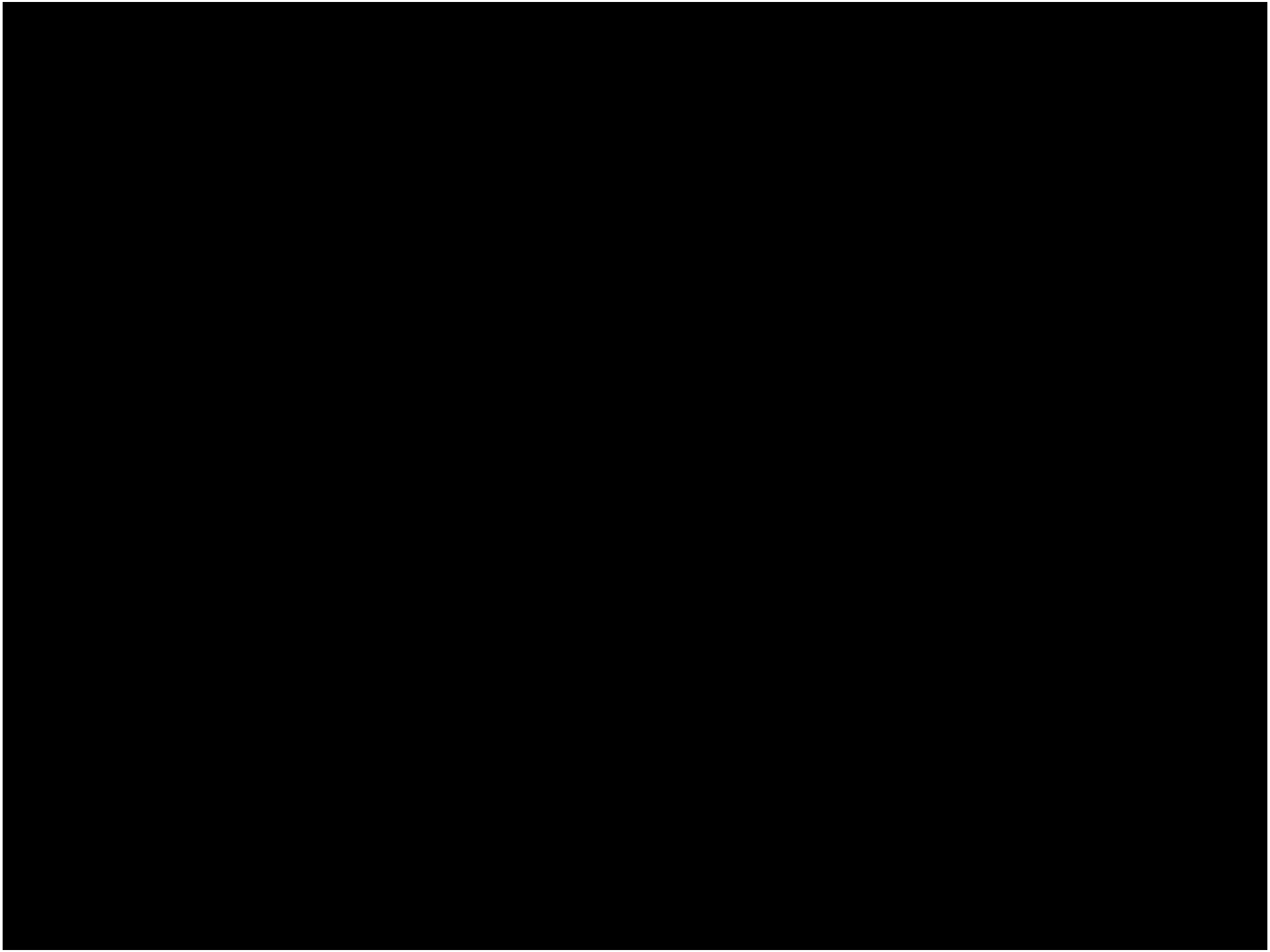
Classified / Classification > Noun . A way of grouping based on shared characteristics .

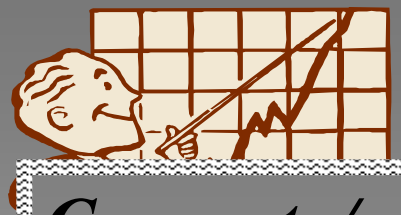
Synonym	***Related***	***Antonym***
Assort	***Assign***	***Declassify***
Categorize		

The classified advertising section of the newspaper has a section for selling used cars .

Å ***GARY***

THEY EXIST IN ALL SHAPES AND SIZES TRADING ALL TYPES OF GOODS AND SERVICES !!!!





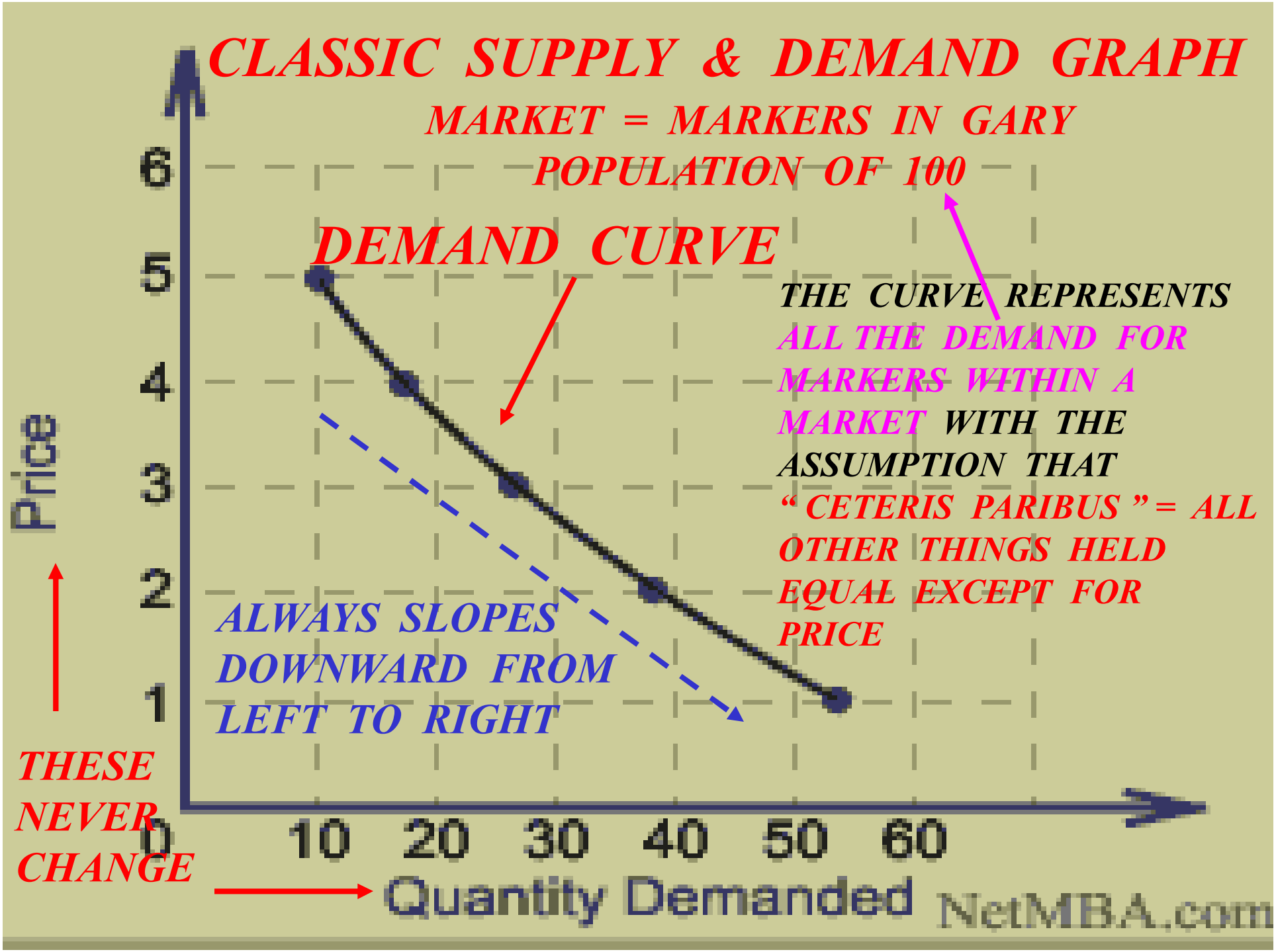
MARKETS AND DEMAND

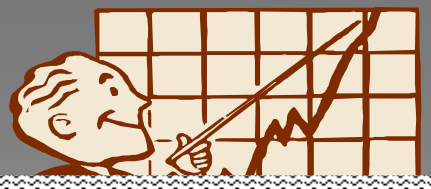
Concept / Conceptual > Noun . A general idea or understanding . Dealing with what only exists in the mind .

Synonym	***Related***	***Antonym***
Thought	***Vision***	***Tangible***
Notion		

He was very good at explaining concepts through the use of diagrams .

THIS WILL EFFECT QUANTITY DEMANDED NOT TOTAL DEMAND !!


CLASSIC SUPPLY & DEMAND GRAPH
MARKET = MARKERS IN GARY
POPULATION OF 100
DEMAND CURVE
THE CURVE REPRESENTS ALL THE DEMAND FOR MARKERS WITHIN A MARKET WITH THE ASSUMPTION THAT " CETERIS PARIBUS " = ALL OTHER THINGS HELD EQUAL EXCEPT FOR PRICE
ALWAYS SLOPES DOWNWARD FROM LEFT TO RIGHT
THESE NEVER CHANGE
Price
Quantity Demanded
0
1
2
3
4
5
6
10
20
30
40
50
60
NetMBA.com

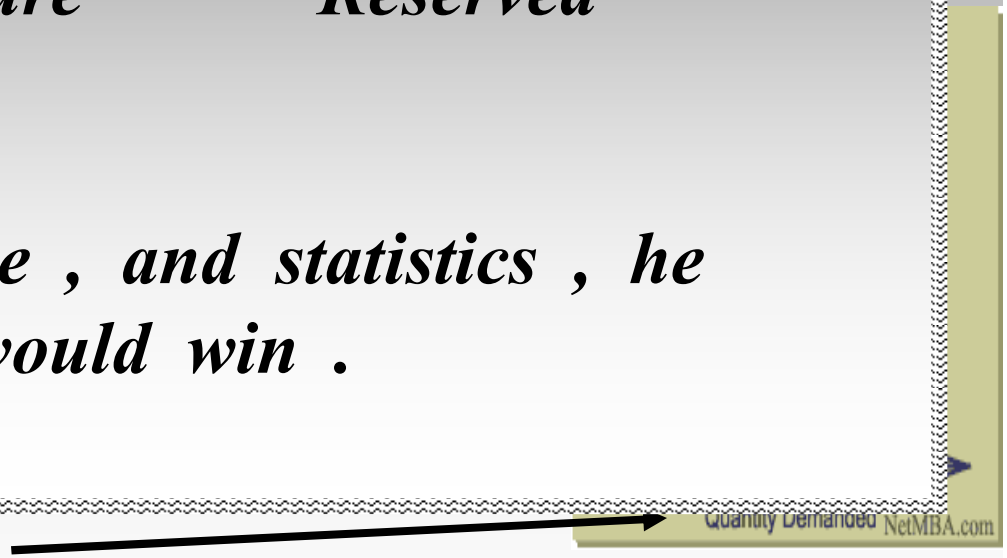


MARKETS AND DEMAND

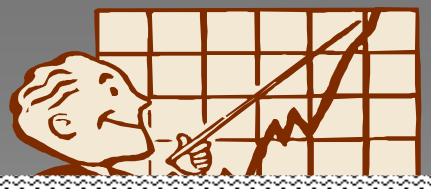
Predict / Predictability > Verb . To state or make known in advance .

Synonym	***Related***	***Antonym***
Foretell	***Conjecture***	***Reserved***
Forecast		

Based on prior experience , and statistics , he predicted that the team would win .



!! IMPORTANT NOTE : ECONOMISTS MEASURE CONSUMPTION (DEMAND) ON THE AMOUNT OF GOODS PURCHASED, NOT THE AMOUNT SPENT TO BUY THEM



MARKETS AND DEMAND

Drastic / Drastically > Adjective . Taking effect violently or rapidly .

Synonym	***Related***	***Antonym***
Extreme	***Radical***	***Calm***
		Subtle

The change in weather conditions had a drastic effect on traffic safety .

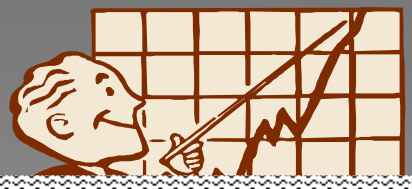
DEMAND FOR A GOOD OR SERVICE VARIES AT EVERY PRICE LEVEL

MARKETS AND DEMAND

CAN ELASTICITY BE CALCULATED ?

YES !!!!

$$\frac{\%\ \text{CHANGE}\ (\Delta)\ \text{IN QUANTITY DEMANDED}\ (d)}{\%\ \text{CHANGE}\ (\Delta)\ \text{IN PRICE}\ (p)}$$



MARKETS AND DEMAND

Proportional > Adjective . Forming a relationship with other parts or quantities . Math - having constant ratio .

Synonym	***Related***	***Antonym***
Commensurate	***Relative***	***Disproportionate***

The improvement in business conditions had a proportional effect in the unemployment rate .

UNITARY ELASTIC - WHEN DEMAND FOR A GOOD OR SERVICE IS PROPORTIONALLY EQUAL TO THE CHANGE IN PRICE > Ed = 1

MARKETS AND DEMAND

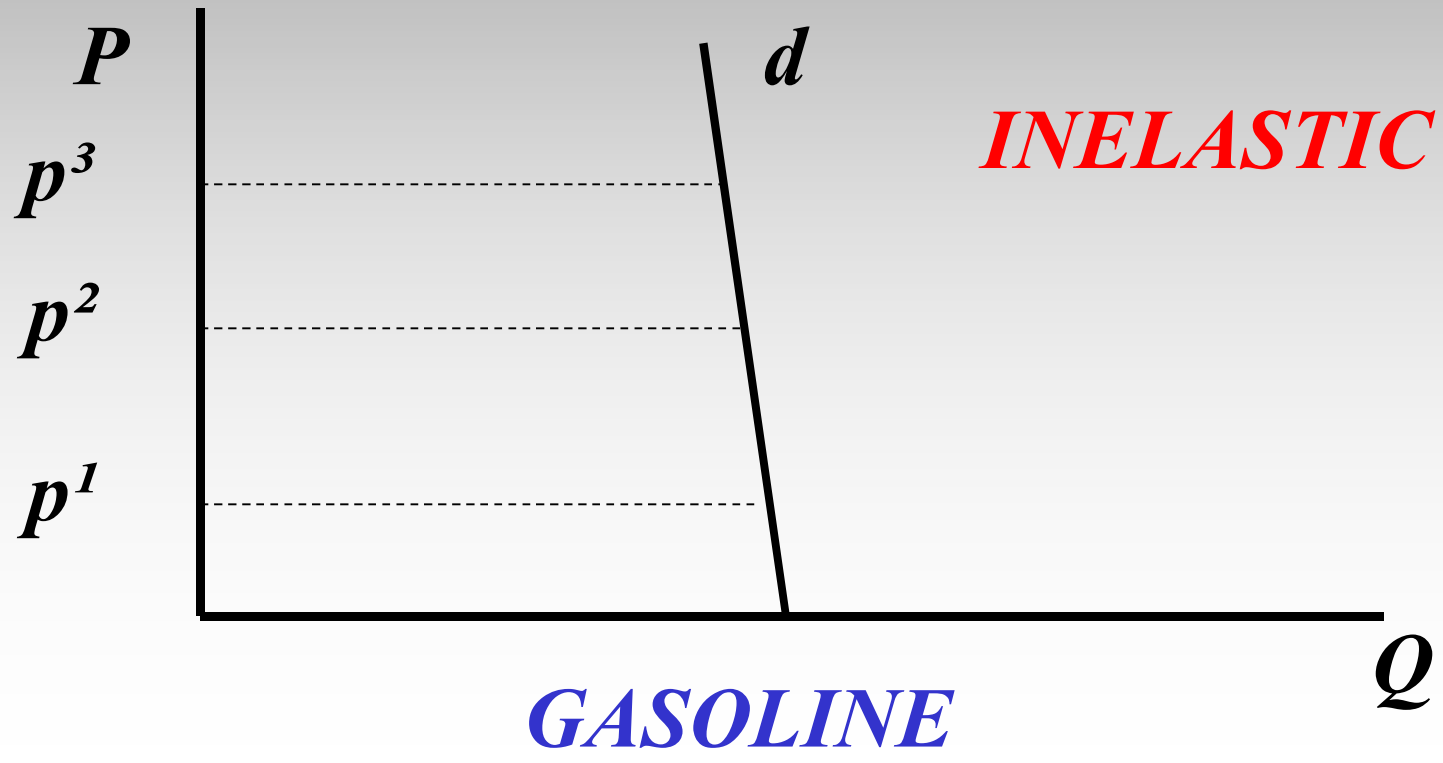
THE 3 TYPES OF DEMAND :

- ***INELASTIC*** *- DEMAND FOR A GOOD OR SERVICE THAT IS GENERALLY NOT SENSITIVE TO PRICE CHANGES >* ***Ed = < 1 AND STEEP CURVE***

DEMAND

FOOD FOR THOUGHT ……..

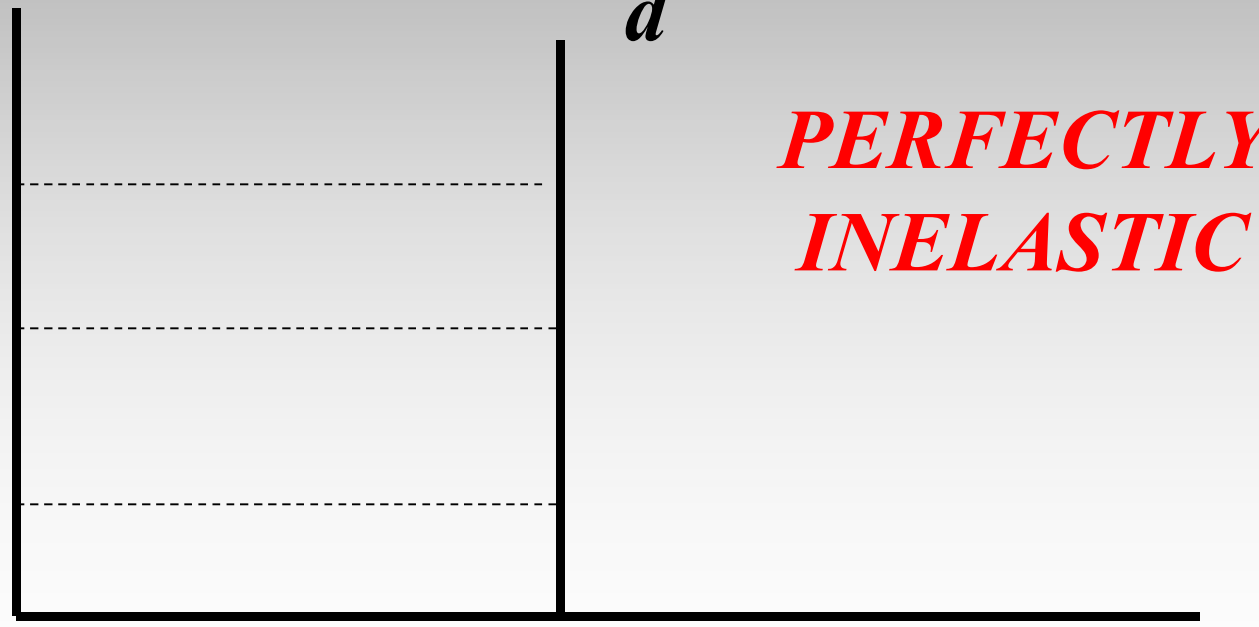
WHAT WOULD A DEMAND CURVE LOOK LIKE FOR AN " INELASTIC " GOOD ??



DEMAND

FOOD FOR THOUGHT ……..

WHAT WOULD A DEMAND CURVE LOOK LIKE FOR A " PERFECTLY INELASTIC " GOOD ?



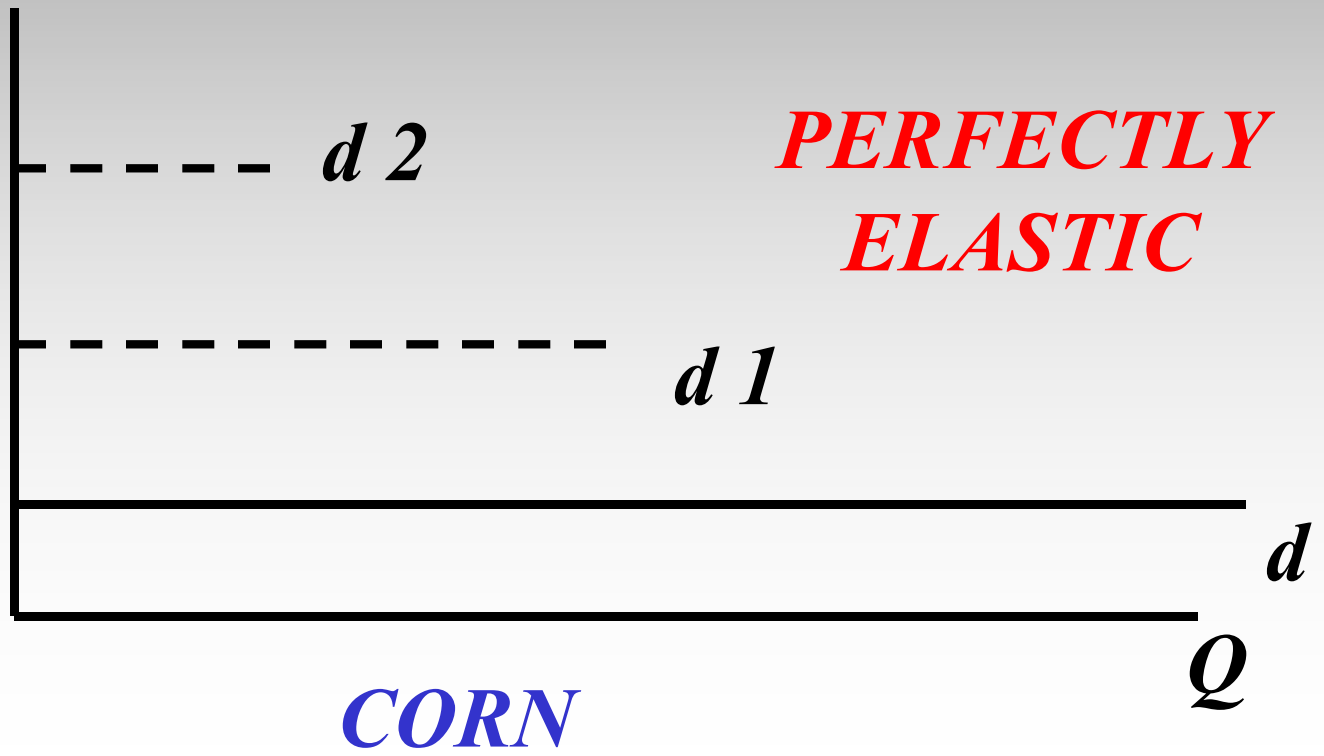
PERFECTLY INELASTIC

INSULIN

DEMAND

FOOD FOR THOUGHT ……..

WHAT WOULD A DEMAND CURVE LOOK LIKE FOR A " PERFECTLY ELASTIC " GOOD ?



MARKETS AND DEMAND

WHAT 3 FACTORS EFFECT ELASTICITY ?

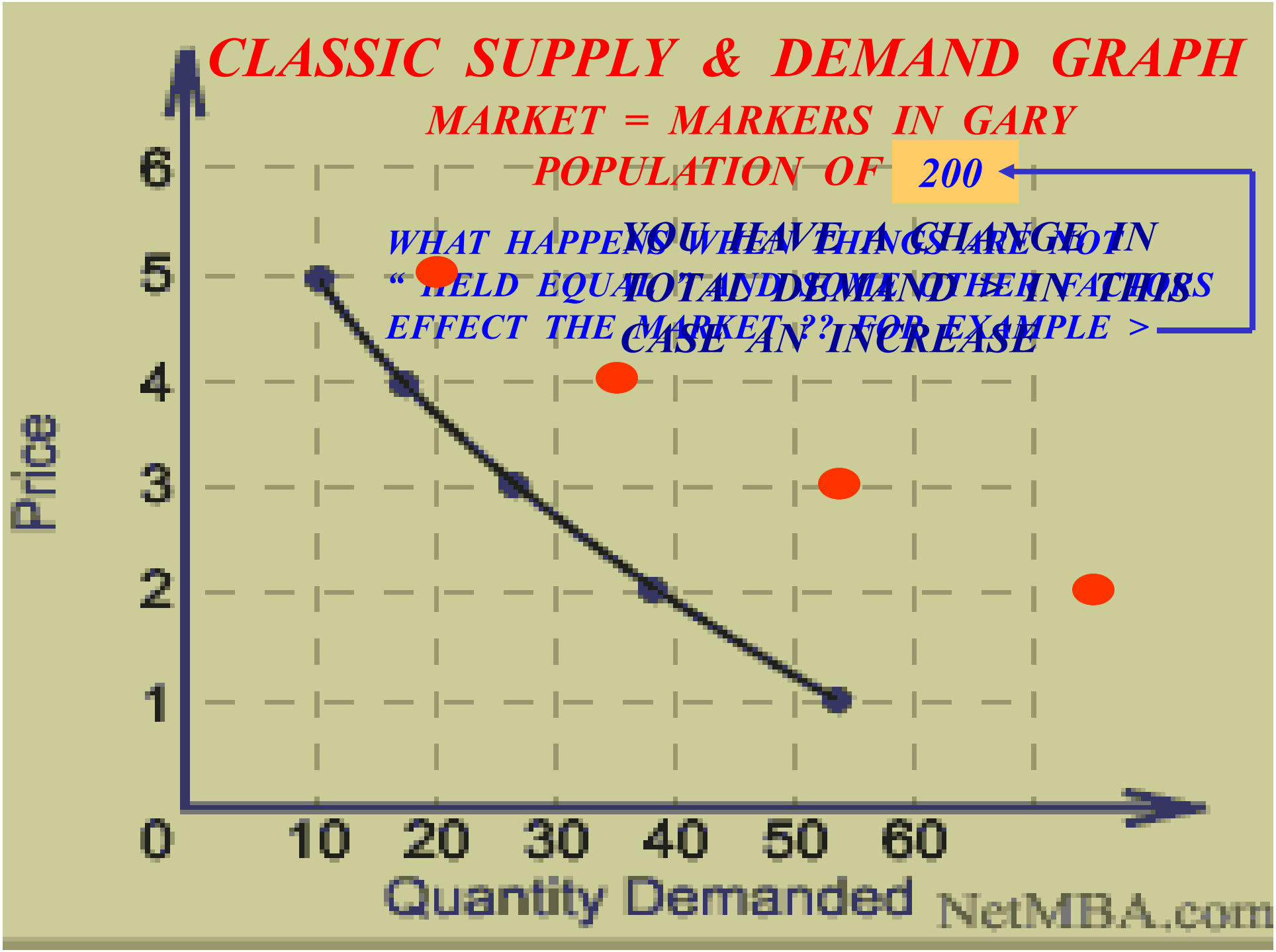
- *AVAILABILITY OF SUBSTITUTES*
- *NEEDS VERSUS WANTS*
- *PROPORTION OF INCOME SPENT*

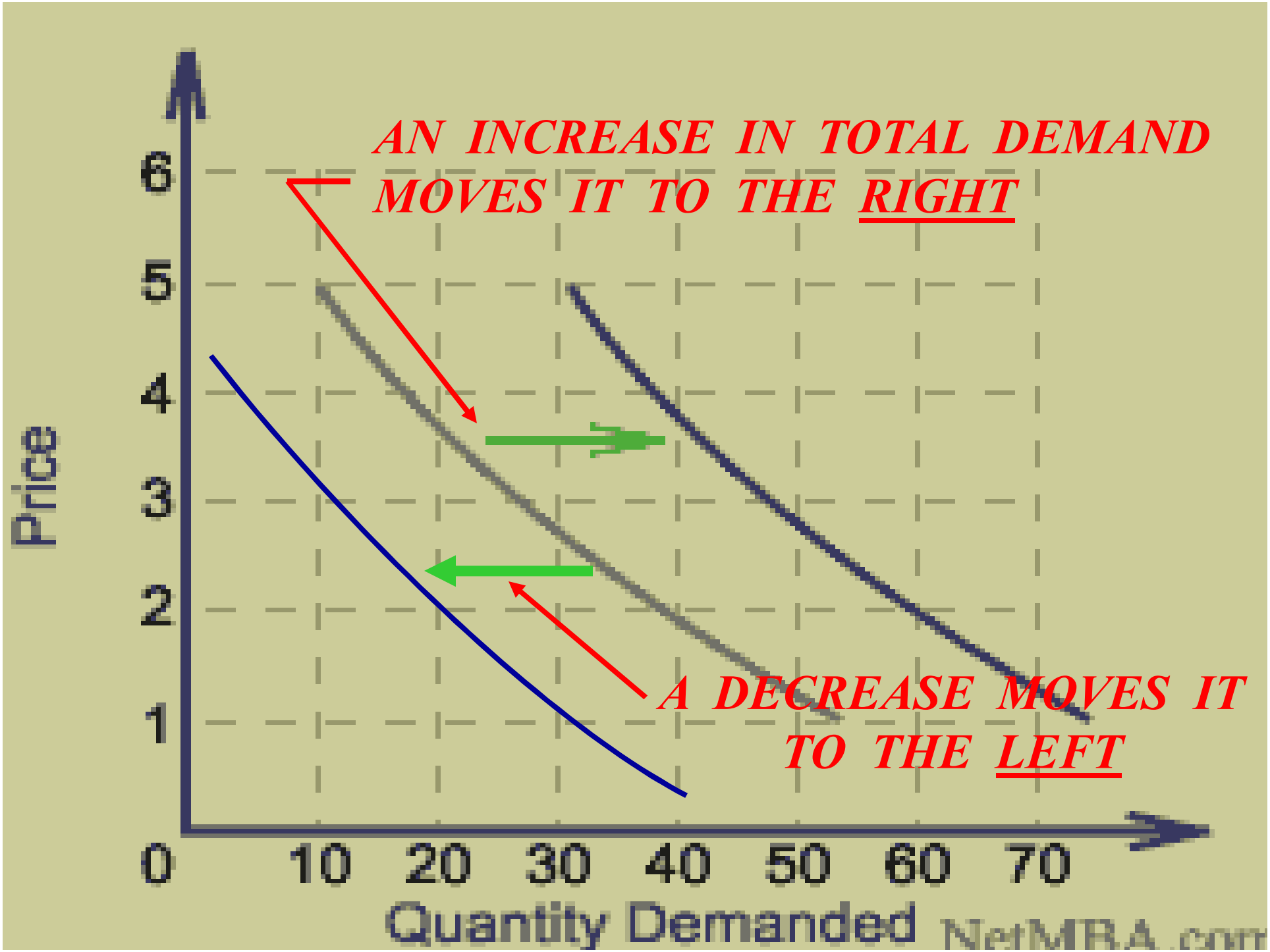
MARKETS AND DEMAND

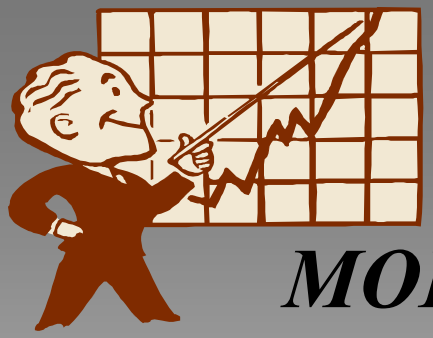
ELASTICITY EXAMPLES :

1. AN INCREASE IN THE PRICE OF GASOLINE FROM $ 2.20 TO $ 3.00 PER GALLON RESULTS IN A 1 % (.01) DECREASE IN SALES .027 INELASTIC

2. THE PRICE OF A HAIRCUT INCREASES TO $ 7.84 FROM $ 7.00 AND THIS RESULTS IN A DECREASE IN SALES FROM 40 TO 27 PER DAY 2.70 ELASTIC


CLASSIC SUPPLY & DEMAND GRAPH
MARKET = MARKERS IN GARY
POPULATION OF 200
WHAT HAPPENS WHEN THINGS ARE NOT " HELD EQUAL" AND SOMETHING EFFECT THE MARKET ?? FOR EXAMPLE > YOU HAVE A CHANGE IN TOTAL DEMAND IN THIS CASE AN INCREASE
Price
6
5
4
3
2
1
0
10
20
30
40
50
60
Quantity Demanded
NetMBA.com


AN INCREASE IN TOTAL DEMAND MOVES IT TO THE RIGHT
A DECREASE MOVES IT TO THE LEFT
Price
6
5
4
3
2
1
0
10
20
30
40
50
60
70
Quantity Demanded
NetMBA.com



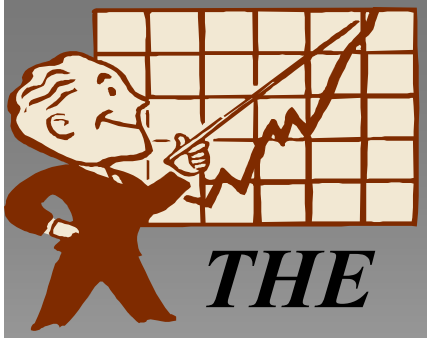
MARKETS AND DEMAND

MORE FOOD FOR THOUGHT ……..

WHAT IS THE DIFFERENCE BETWEEN A CHANGE IN QUANTITY DEMANDED AND A CHANGE IN TOTAL DEMAND ?

- *A CHANGE IN QUANTITY DEMANDED RESULTS FROM A CHANGE IN PRICE*
- *A CHANGE IN TOTAL DEMAND RESULTS FROM THE OTHER FIVE FACTORS*

SO , WHAT IS THE DIFFERENCE BETWEEN A SHIFT ALONG A DEMAND CURVE AND A SHIFT OF THE CURVE ??



MARKETS AND DEMAND

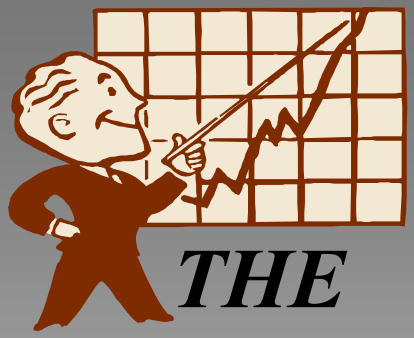
THE 6 MOST COMMON THINGS THAT WILL EFFECT A CHANGE IN DEMAND :

 # 2 > THE " SUBSTITUTION EFFECT " -

WHEN THE PRICE OF A GOOD OR SERVICE INCREASES CONSUMERS ARE MORE LIKELY TO BUY AN ALTERNATIVE AS A SUBSTITUTE IF AVAILABLE >

SHIFTS THE CURVE OF THE SUBSTITUTE

THIS LAW CAN ALSO BE APPLIED WHEN A DROP IN PRICE OCCURS

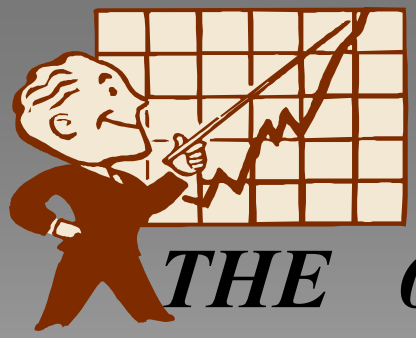


MARKETS AND DEMAND

THE 6 MOST COMMON THINGS THAT WILL EFFECT A CHANGE IN DEMAND :

Å# *3 > CONSUMER INCOME EFFECT* - ***WHEN A CONSUMER CAN NO LONGER AFFORD TO BUY THE SAME COMBIN-ATION OF GOODS AND SERVICES BECAUSE OF A PRICE CHANGE > THIS ALSO WORKS IN REVERSE !***

ï *NORMAL GOODS* – ***GOODS THAT CONSUMERS DEMAND MORE OF …..***



MARKETS AND DEMAND

THE 6 MOST COMMON THINGS THAT WILL EFFECT A CHANGE IN DEMAND :

- ***CONSUMER INCOME EFFECT > CONT.***
  - ***…. WHEN INCOMES INCREASE***
  - ***INFERIOR GOODS - GOODS THAT DEMAND FOR FALLS WHEN THERE IS AN INCREASE IN INCOME***
- ***# 4 > CONSUMER EXPECTATIONS***
- ***# 5 > POPULATION SIZE***
- ***# 6 > ADVERTISING > PREFERENCES***

MARKETS AND DEMAND

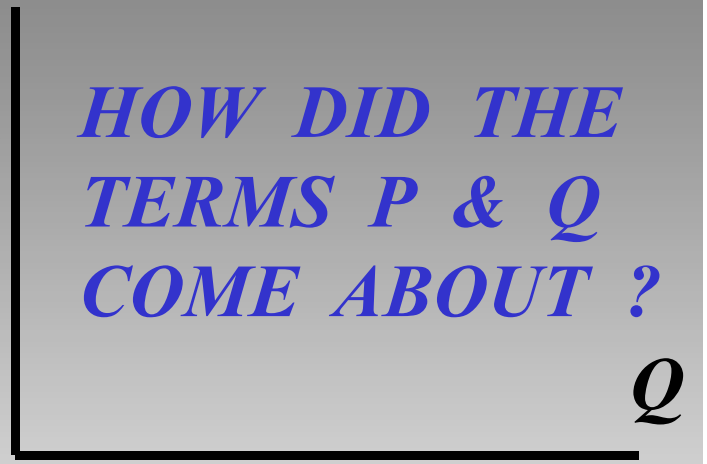
THE 2 MAJOR EFFECTS OF DEMAND SHIFTS :

- ***CONSUMPTION OF COMPLEMENTARY AND SUBSTITUTE GOODS AND SERVICES CAN BE DRAMATICALLY AFFECTED***
- ***SHORTAGES MAY OCCUR***

MARKETS & DEMAND

GRAPH HISTORY

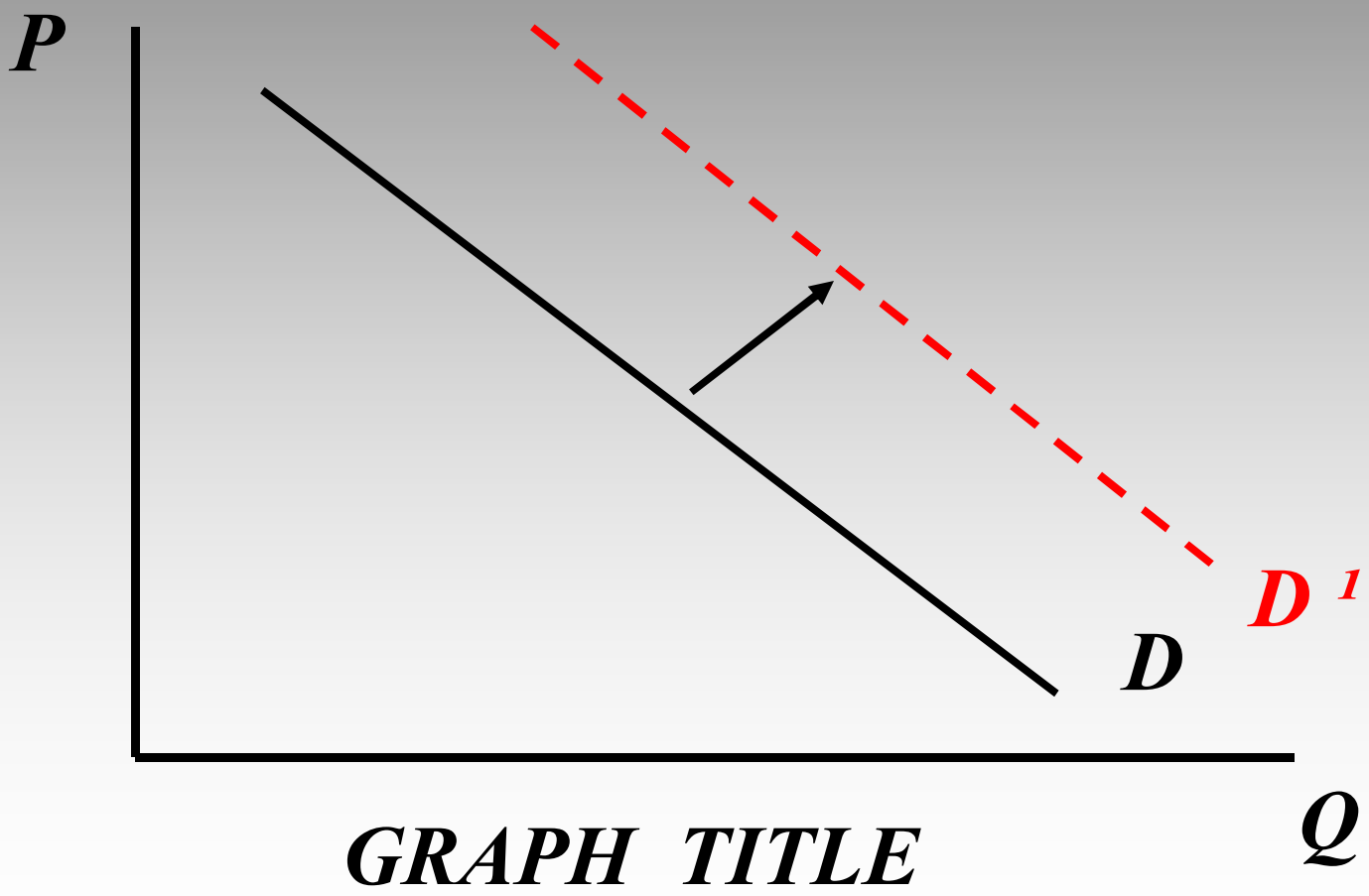
- *IN ENGLISH PUBS, ALE IS ORDERED BY PINTS AND QUARTS*
- *WHEN CUTOMERS GOT UNRULY, THE BARTENDER WOULD YELL AT THEM TO "MIND" THEIR OWN PINTS AND QUARTS AND SETTLE DOWN > SO THAT'S WHERE WE GOT THE PHRASE "MIND YOUR Ps AND Qs" !!*



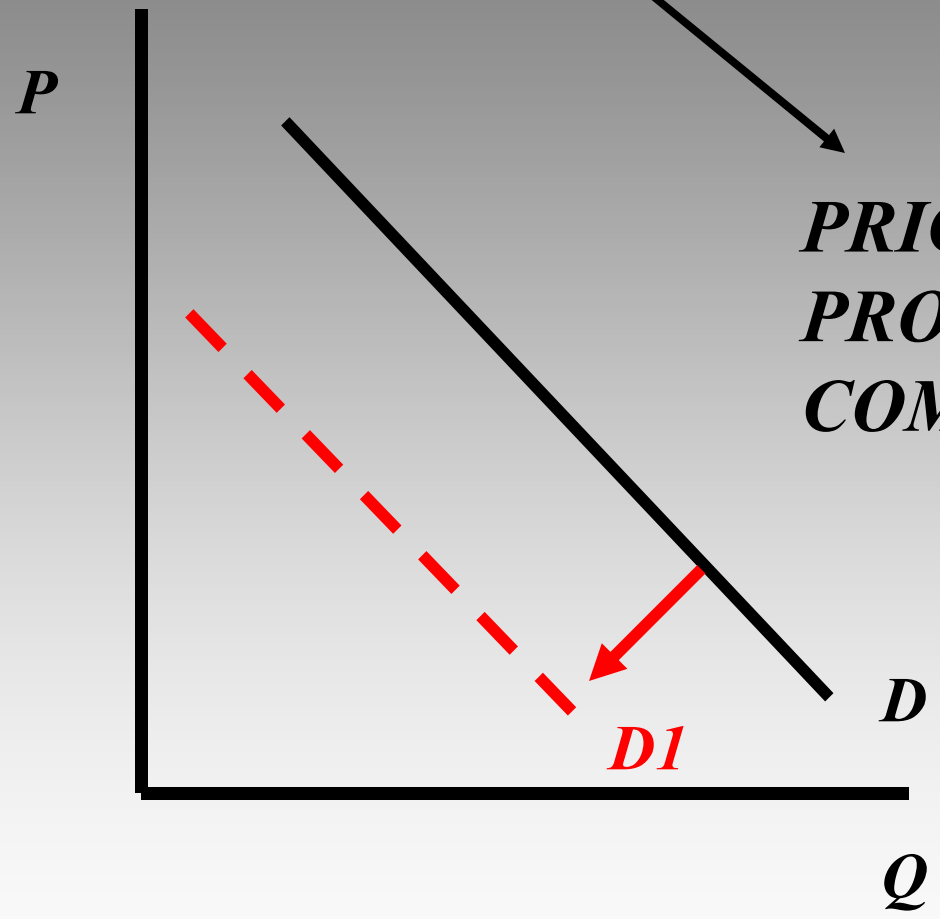
HOW DID THE TERMS P & Q COME ABOUT ?

DEMAND

PROPER LABELING OF GRAPHS :



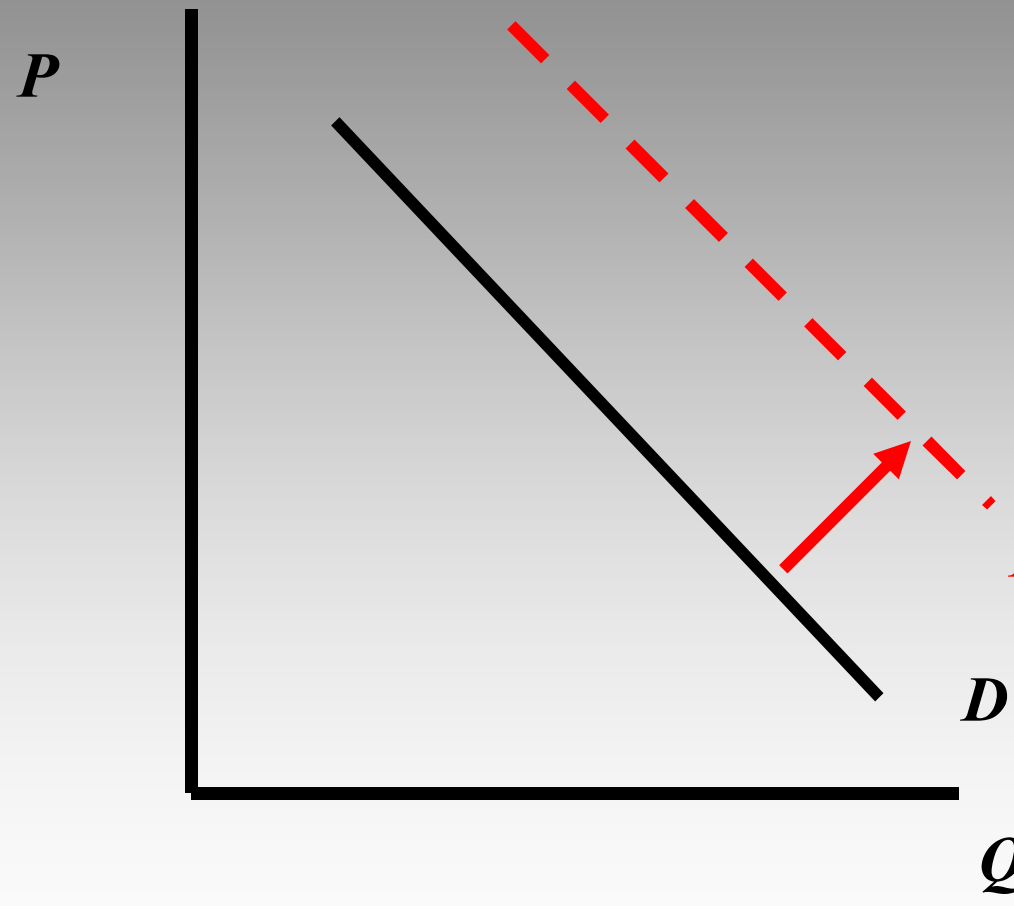
THE PRICE OF MILK DOUBLES ; WHAT HAPPENS TO THE MARKET FOR CEREAL ?



PRICE OF RELATED PRODUCT COMPLEMENT

YOUR MARKET IS : ***CEREAL***

THE PRICE OF AIRLINE TICKETS DOUBLES , WHAT HAPPENS TO THE MARKET FOR BUS TICKETS ?



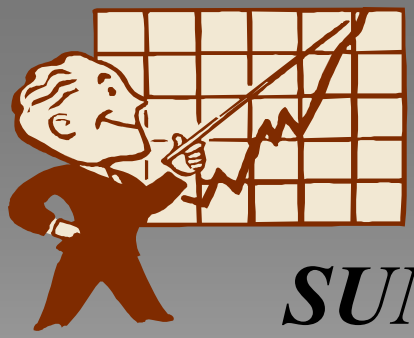
INCREASE IN THE PRICE OF A RELATED PRODUCT SUBSTITUTE

YOUR MARKET IS : BUS TICKETS

MARKETS AND DEMAND

SUMMARY :

- ***WHAT IS A MARKET ?***
- ***WHAT IS AN EXAMPLE OF A MARKET ?***
- ***WHAT IS DEMAND AND THE LAW OF DEMAND ?***
- ***EXPLAIN WHAT THE DIFFERENCE IS BETWEEN A NORMAL AND INFERIOR GOODS***



MARKETS AND DEMAND

SUMMARY :

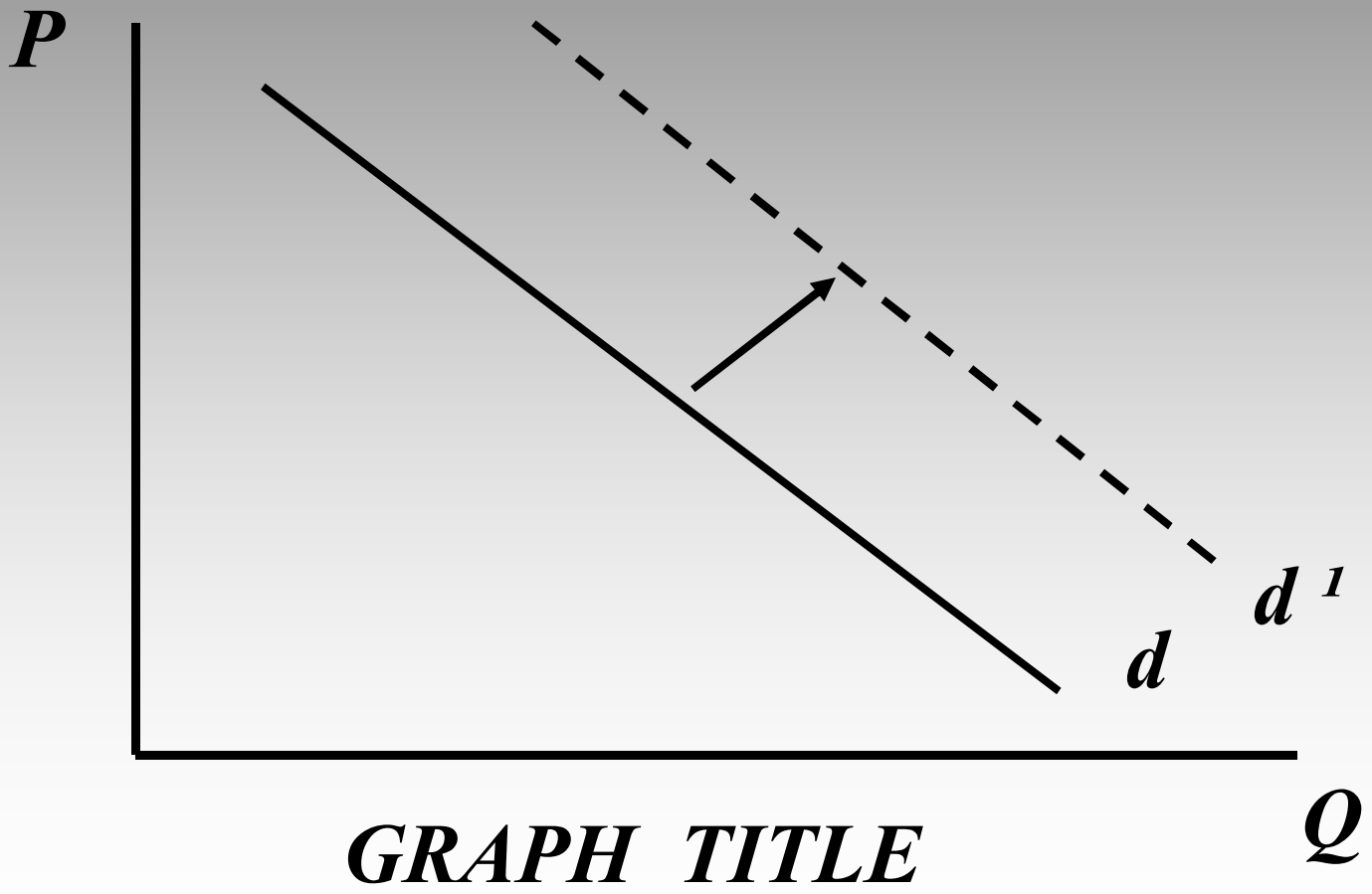
- *WHAT ARE THE SUBSTITUTION AND INCOME EFFECTS ?*
- *WHAT CAUSES SHIFTS IN THE DEMAND CURVE ?*
- *DEFINE ELASTICITY OF DEMAND*
- *WHAT ARE EXAMPLES OF INELASTIC AND ELASTIC GOODS ?*
- *WHAT FACTORS AFFECT ELASTICITY ?*
- *HOW DO YOU CALCULATE ELASTICITY ?*

HOW THE MARKETS WORK AND DYNAMICS OF "DEMAND"

SEEKING A DEEPER UNDERSTANDING OF DEMAND

DEMAND

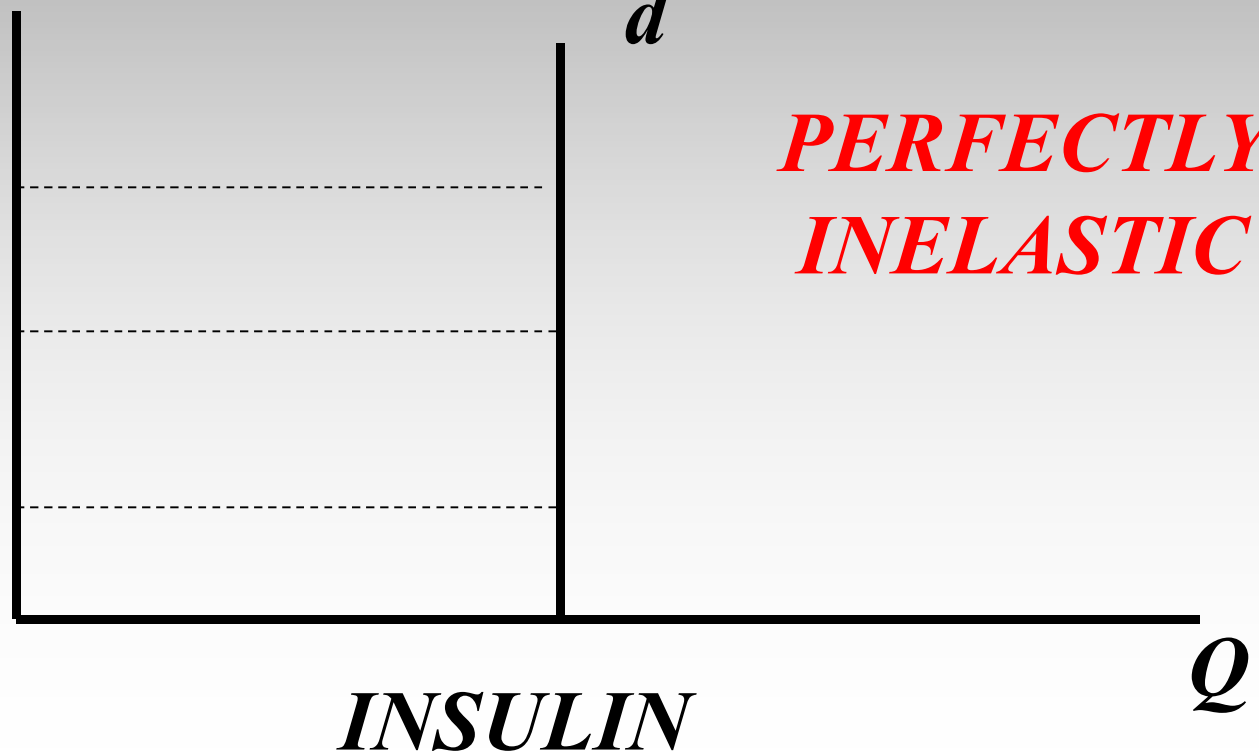
PROPER LABELING OF GRAPHS :



DEMAND

FOOD FOR THOUGHT ……..

WHAT WOULD A DEMAND CURVE LOOK LIKE FOR A " PERFECTLY INELASTIC " GOOD ?



PERFECTLY INELASTIC

INSULIN

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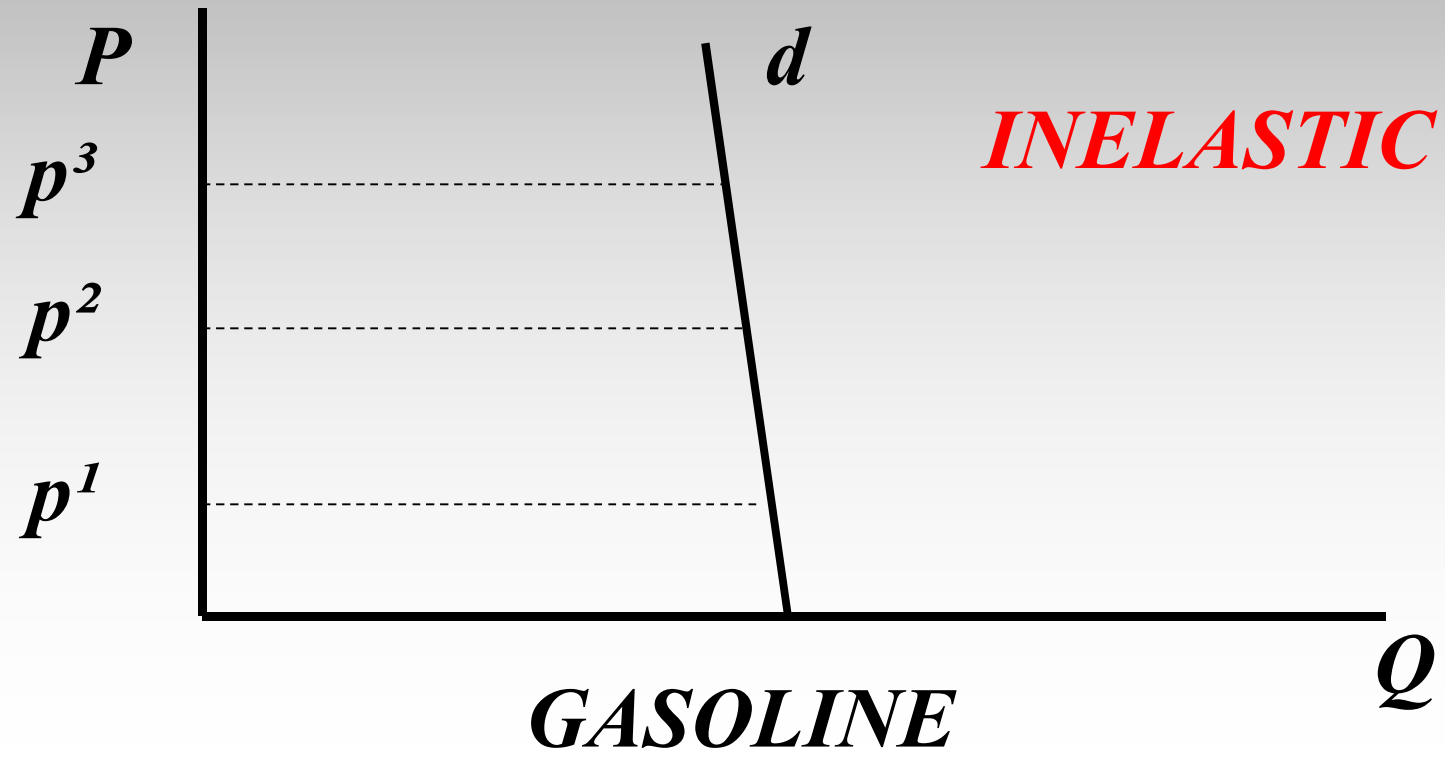
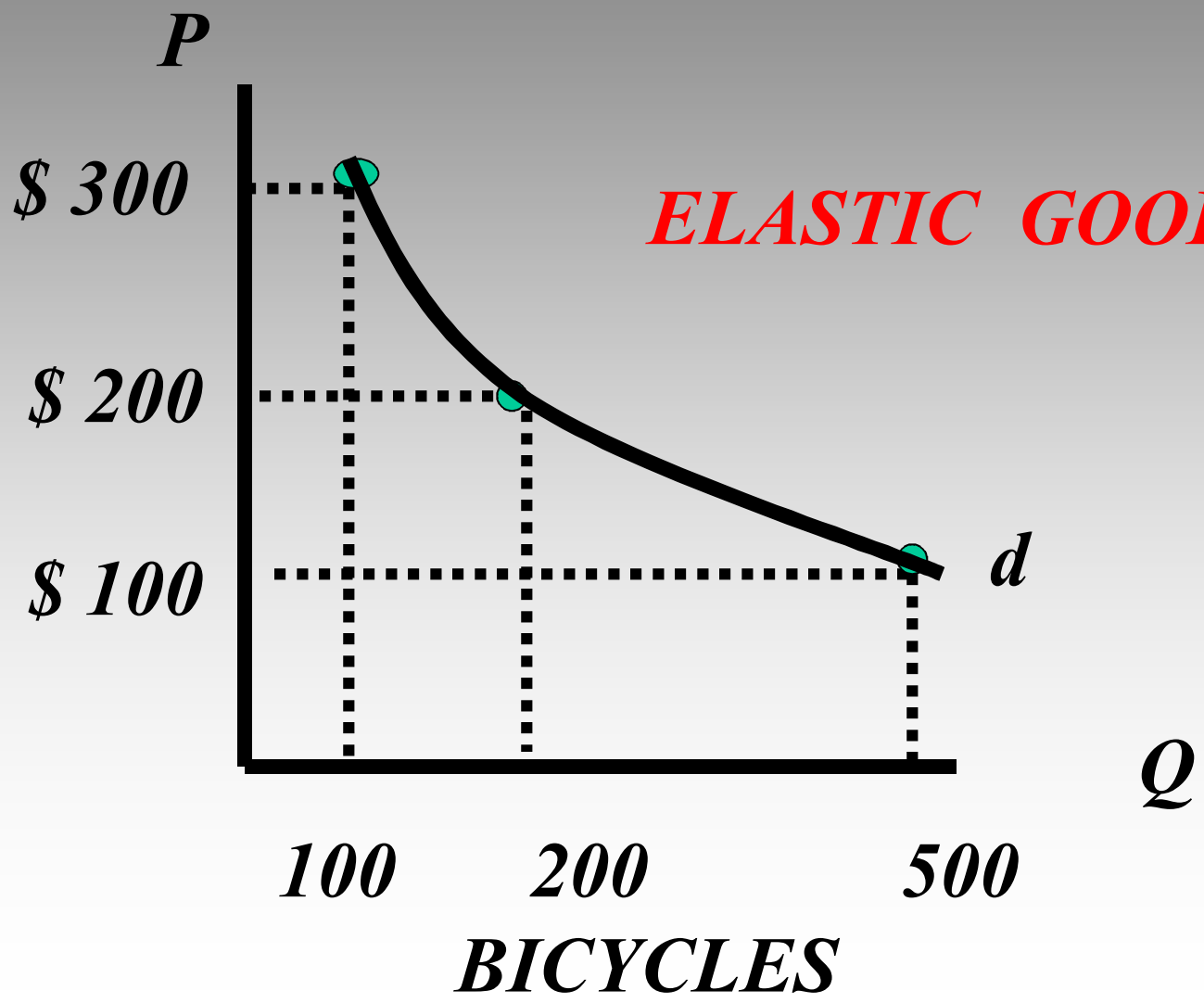


DEMAND



DEMAND

THE FIVE TESTS FOR ELASTICITY

- *ARE THERE ANY SUBSTITUTES ?*
- *NECESSITY OR LUXURY ?*
- *PRICE > EXPENSIVE OR INEXPENSIVE ?*
- *EFFECT OF Δ IN PRICE ON TOTAL REVENUE (TR) :*

INELASTIC	*ELASTIC*
↑ P ↑ TR	*↑ P ↓ TR*
↓ P ↓ TR	*↓ P ↑ TR*

DEMAND

THE FIVE TESTS FOR ELASTICITY

Å ELASTICITY FORMULA > BY THE WAY FOR YOU MATHLETES, HERE IS THE FORMULA SIMPLIFIED (COEFFICIENT):

$$Ed = \frac{\Delta \text{ IN } Qd}{Qd} \; X \; \frac{P}{\Delta \text{ IN } P}$$

REMEMBER !!

INELASTIC < 1 ELASTIC > 1

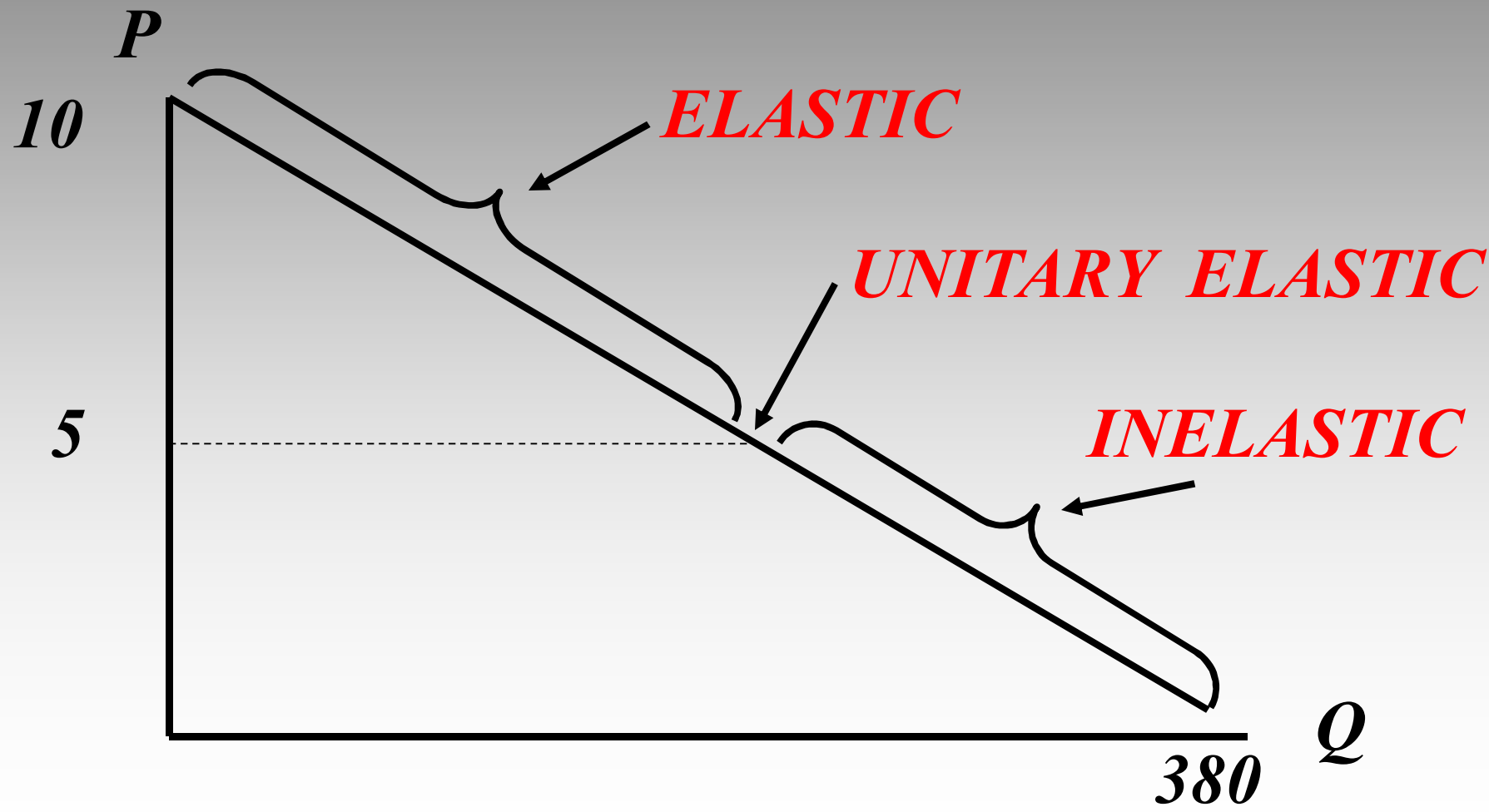
DEMAND

WIDGETS ELASTICITY EXAMPLE

PRICE OF WIDGETS	QUANTITY DEMANDED	ELASTICITY	REVENUE TEST	↑ ↓
10	0			
9	40	3.85	360	↓
8	80		640	
7	120			
6	160	1.00	960	→
5	200		1000	
4	240			
3	280	.26	840	↑
2	320		640	
1	380			

DEMAND

WIDGETS ELASTICITY EXAMPLE



Factors Affecting Demand	Effect on D	Shift In D	P	Q
↑ # of consumers	↑	R	↑	↑
↑ Y Normal goods	↑	R	↑	↑
↑ Y Inferior goods	↓	L	↓	↓
↑ Preferences	↑	R	↑	↑
↑ P of a Substitute	↑	R	↑	↑
↑ P of a Complement	↓	L	↓	↓
↑ EFP by C	↑	R	↑	↑
↑ EFY by C	↑	R	↑	↑