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
Assort
Categorize

Related
Assign

Antonym
Declassify

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

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

POTENTIAL CONSUMPTION OF A GOOD OR SERVICE WHEN PEOPLE ARE WILLING AND ABLE TO BUY IT AT A SPECIFIED PRICE.

NOTE THAT PERCEIVED VALUE IS SUBJECTIVE!!

WHAT IS DEMAND?

WHAT CAN CAUSE A CHANGE IN DEMAND FOR A GOOD OR SERVICE??

THOUSANDS OF THINGS!!
MARKETS AND DEMAND

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

<table>
<thead>
<tr>
<th>Synonym</th>
<th>Related</th>
<th>Antonym</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thought</td>
<td>Vision</td>
<td>Tangible</td>
</tr>
<tr>
<td>Notion</td>
<td></td>
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</tr>
</tbody>
</table>

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

THIS WILL EFFECT QUANTITY DEMANDED NOT TOTAL DEMAND!!
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

CLASSIC SUPPLY & DEMAND GRAPH

MARKET = MARKERS IN GARY POPULATION OF 100

DEMAND CURVE

ALWAYS SLOPES DOWNWARD FROM LEFT TO RIGHT

THESE NEVER CHANGE

NetMBA.com
MARKETS AND DEMAND

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

<table>
<thead>
<tr>
<th>Synonym</th>
<th>Related</th>
<th>Antonym</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foretell</td>
<td>Conjecture</td>
<td>Reserved</td>
</tr>
<tr>
<td>Forecast</td>
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</table>

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.

<table>
<thead>
<tr>
<th>Synonym</th>
<th>Related</th>
<th>Antonym</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extreme</td>
<td>Radical</td>
<td>Calm</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Subtle</td>
</tr>
</tbody>
</table>

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 !!!!

% CHANGE ($\Delta$) IN QUANTITY DEMANDED ($d$)

% CHANGE ($\Delta$) 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??

GASOLINE

INELASTIC
DEMAND

FOOD FOR THOUGHT ..............

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

GOOD? \( p \)

\( p^1 \)
\( p^2 \)
\( p^3 \)

PERFECTLY INELASTIC

INSULIN

\( Q \)
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
WHAT HAPPENS WHEN THINGS ARE NOT "HELD EQUAL" AND SOME OTHER FACTORS EFFECT THE MARKET?? FOR EXAMPLE > 

CLASSIC SUPPLY & DEMAND GRAPH
MARKET = MARKERS IN GARY
POPULATION OF 200

YOU HAVE A CHANGE IN TOTAL DEMAND IN THIS CASE AN INCREASE
AN INCREASE IN TOTAL DEMAND MOVES IT TO THE RIGHT

A DECREASE MOVES IT TO THE LEFT
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 COMBINATION OF GOODS AND SERVICES BECAUSE OF A PRICE CHANGE > THIS ALSO WORKS IN REVERSE!

ї NORMAL GOODS – GOODS THAT CONSUMERS DEMAND MORE OF .....

MARKETS AND DEMAND

The 6 most common things that will affect a change in demand:

1. Consumer income effect > cont.
   - When incomes increase
     - Inferior goods - goods that demand for falls when there is an increase in income

2. Consumer expectations
3. Population size
4. Advertising
5. Preferences

The 6 most common things that will affect a change in demand:
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

P

IN ENGLISH PUBS, ALE IS ORDERED BY PINTS AND QUARTS

Q

WHEN CUSTOMERS 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:

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

YOUR MARKET IS: CEREAL
THE PRICE OF AIRLINE TICKETS DOUBLES, WHAT HAPPENS TO THE MARKET FOR BUS TICKETS?

YOUR MARKET IS: BUS TICKETS

INCREASE IN THE PRICE OF A RELATED PRODUCT SUBSTITUTE

D1
MARKETS AND DEMAND

SUMMARY:

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

SUMMARY:

Å WHAT ARE THE SUBSTITUTION AND INCOME EFFECTS?
Å WHAT CAUSES SHIFTS IN THE DEMAND CURVE?
Å DEFINE ELASTICITY OF DEMAND
Å WHAT ARE EXAMPLES OF INELASTIC AND ELASTIC GOODS?
Å WHAT FACTORS AFFECT ELASTICITY?
Å HOW DO YOU CALCULATE ELASTICITY?
HOW THE MARKETS WORK AND DYNAMICS OF “DEMAND”

SEEKING A DEEPER UNDERSTANDING OF DEMAND
DEMAND

PROPER LABELING OF GRAPHS:

GRAPH TITLE
DEMAND

FOOD FOR THOUGHT ..............

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

**GOOD?**

\[ p^1 \]

\[ p^2 \]

\[ p^3 \]

\[ d \]

**PERFECTLY INELASTIC**

**INSULIN**

**Q**
DEMAND

FOOD FOR THOUGHT ............... 

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

INELASTIC
DEMAND

ELASTIC GOOD

P

$300

$200

$100

Q

d

BICYCLES

100 200 500
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):

<table>
<thead>
<tr>
<th>INELASTIC</th>
<th>ELASTIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>↑ P</td>
<td>↑ TR</td>
</tr>
<tr>
<td>↓ P</td>
<td>↓ TR</td>
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</table>
DEMAND

THE FIVE TESTS FOR ELASTICITY

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

\[
Ed = \frac{\Delta \text{ IN } Qd}{Qd} \times \frac{\Delta \text{ IN } P}{P}
\]

REMEMBER !
INELASTIC < 1
ELASTIC > 1
## DEMAND

### WIDGETS ELASTICITY EXAMPLE

<table>
<thead>
<tr>
<th>PRICE OF WIDGETS</th>
<th>QUANTITY DEMANDED</th>
<th>ELASTICITY</th>
<th>REVENUE TEST</th>
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<tbody>
<tr>
<td>10</td>
<td>0</td>
<td>3.85</td>
<td>360</td>
</tr>
<tr>
<td>9</td>
<td>40</td>
<td>3.85</td>
<td>360</td>
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<tr>
<td>8</td>
<td>80</td>
<td>1.00</td>
<td>960</td>
</tr>
<tr>
<td>7</td>
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<td>960</td>
</tr>
<tr>
<td>6</td>
<td>160</td>
<td>.26</td>
<td>840</td>
</tr>
<tr>
<td>5</td>
<td>200</td>
<td>.26</td>
<td>840</td>
</tr>
<tr>
<td>4</td>
<td>240</td>
<td>.26</td>
<td>840</td>
</tr>
<tr>
<td>3</td>
<td>280</td>
<td>.26</td>
<td>840</td>
</tr>
<tr>
<td>2</td>
<td>320</td>
<td>.26</td>
<td>840</td>
</tr>
<tr>
<td>1</td>
<td>380</td>
<td>.26</td>
<td>840</td>
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</table>
DEMAND

WIDGETS ELASTICITY EXAMPLE

ELASTIC

UNITARY ELASTIC

INELASTIC
<table>
<thead>
<tr>
<th>Factors Affecting Demand</th>
<th>Effect on D</th>
<th>Shift In D</th>
<th>P</th>
<th>Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>↑ # of consumers</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
</tr>
<tr>
<td>↑ Y Normal goods</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
</tr>
<tr>
<td>↑ Y Inferior goods</td>
<td>↓</td>
<td>L</td>
<td>↓</td>
<td>↓</td>
</tr>
<tr>
<td>↑ Preferences</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
</tr>
<tr>
<td>↑ P of a Substitute</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
</tr>
<tr>
<td>↑ P of a Complement</td>
<td>↓</td>
<td>L</td>
<td>↓</td>
<td>↓</td>
</tr>
<tr>
<td>↑ EFP by C</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
</tr>
<tr>
<td>↑ EFY by C</td>
<td>↑</td>
<td>R</td>
<td>↑</td>
<td>↑</td>
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</tbody>
</table>