Today’s Objectives

• Check Chapter 5 Homework
• Review Chapter 5 Homework
• Begin Chapter 6 Notes – Markets and Equilibrium

• You will...
  – Understand how to graph supply, demand, and find equilibrium prices and quantities
  – Understand what a market is and how buyers and sellers interact
  – How surpluses and shortages come about
  – The influence the government can have on prices
Markets, Equilibrium and Prices
Chapter 6
When Supply and Demand Meet

- **Equilibrium** – when demand and supply meet
  - Sets price that goods will be bought and sold
  - Referred to as *market equilibrium*

- Price set is known as the **equilibrium price**
  - Also known as the “**market-clearing price**”
    - There would be no extra product or wants
  - **Equilibrium quantity** – qty. marked at equilibrium
Prices Bring Markets to Balance

• What is a market?
  – Any place where buyers and sellers come together for a product

• Prices always move dependent on buyers and sellers
  – Buyers only willing to pay a certain price
  – Sellers want to sell at a high price

• Sets the “market price” – willing to pay price
  – If people price things low...
    • They sell out, need to make more, but can raise prices
  – If people price things high...
    • They don’t sell, lower the price, and clear inventory
“What Happens When the Price is Wrong?

• When the prices are wrong – considered to be in *disequilibrium*
  – Leads to either excess supply or excess demand
  – *Excess Supply* – Price is too HIGH
  – *Excess Demand* – Quantity was too LOW

• Prices eventually shift, but takes time
Price Too Low – Shortages Created

- Excess demand – not enough of a product
  - Shortage created
  - Price is too low

- To get to equilibrium price would need to rise

4000 still demanded at this price
Price Too High – Surplus Created

- Excess supply – too much of a product
  - Creates surplus
  - Price is too high

- To reach equilibrium the price will need to be reduced
Shifts in Supply and Demand

• Factors cause shifts in entire lines
  • Supply and demand shifters
    – Creates changes in prices

• 3 questions to ask when equilibrium changes
  – Does it affect supply? demand? or both?
  – Does it shift the line to the right or to the left?
  – What is the new price and quantity w/ the change?
How Price is Affected by Demand Shift

- Demand shifts for many reasons
  - Increase in demand -> higher price
  - Decrease in demand -> lower price

- New line is created; changes the price

Report on smoothies being good for you increases demand (shifts right) – leads to higher equilibrium price
How Price is Affected by a Supply Shift

• Supply shifts for many reasons

• New line is created; affects the price
  – Decrease in supply -> higher price
  – Increase in supply -> lower price

Poor harvest leads to a shift in supplies for smoothies—leads to higher equilibrium price
What If Both Shift?

• When both shift, a new equilibrium is found – Can mean numerous outcomes

Now both supply and demand increase – leads to more quantity and higher price
What Do The Shifts Tell Us?

• Changes in prices tell us many things
  – Sellers how much to produce (more/less)
  – Sellers how much to charge
  – Shows buyers interest (demand) for a product

• Prices give us incentives
  – Encourages us to produce more to make profit

• Allows markets to adjust to changing conditions
  – Helps to respond to global issues
  – Helps to use resources efficiently
What Happens When the Government is Involved?

- Government gets involved “for the common good”
  - Believe prices are too high or low
- Affect prices in two ways
  - Price ceilings – setting a MAX PRICE
  - Price floors – setting a MIN PRICE
- Creates shortages which can lead to “black markets”
- Difficult to stop gov’t control due to political pressures from those it benefits