

Demand Theory

Types of Demand

- Demand for consumers' goods and producers' goods
- Demand for perishable and durable goods
- Autonomous (direct) and derived (indirect) demand
- Individual demand and Aggregate/market Demand
- Firm and Industry Demand
- Demand by market segments and by total Market

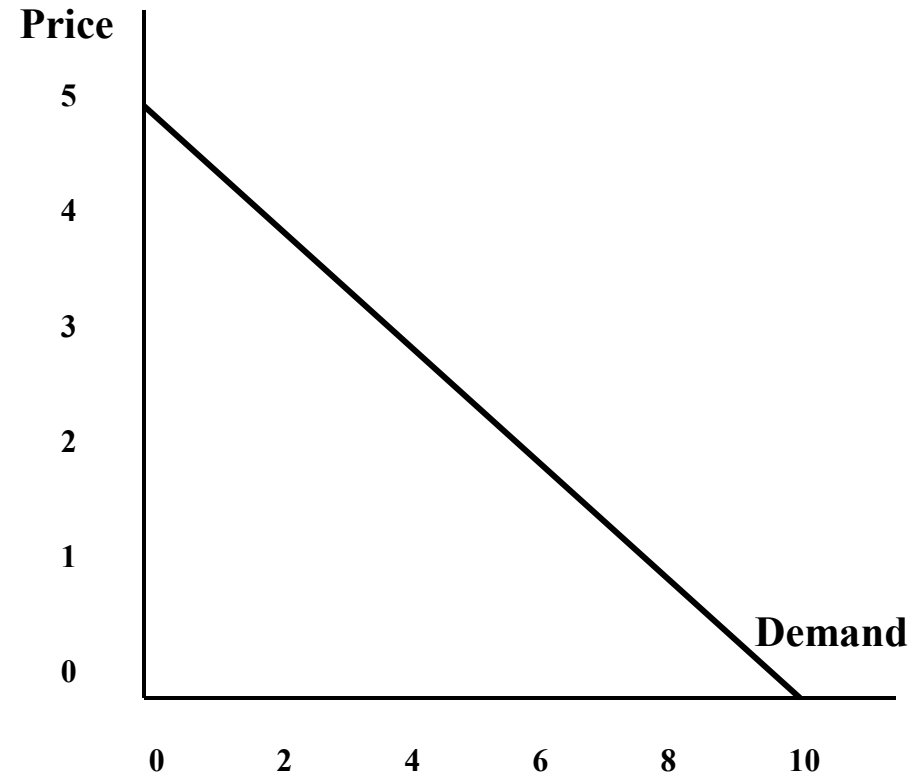
Law of Demand

- A decrease in the price of a good, all other things held constant, will cause an increase in the quantity demanded of the good.
- And Vice-versa

An Example

(the inverse relationship, i.e., The Law of Demand)

Price	Quantity
0	10
1	8
2	6
3	4
4	2
5	0



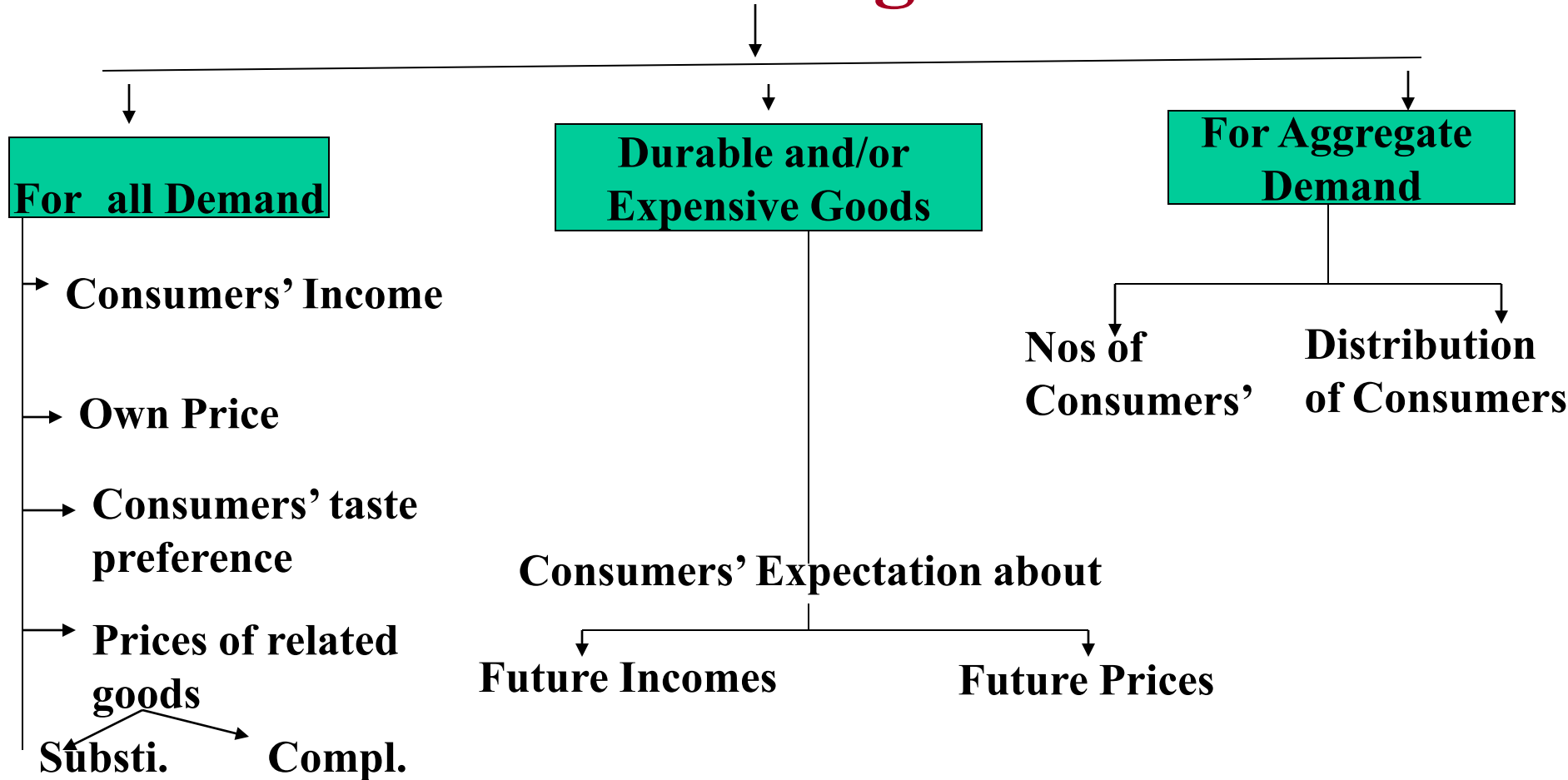
Determinants of Demand

- **Income**
- **Prices of substitutes**
- **Prices of complements**
- **Advertising**
- **Population**
- **Consumer expectations**

How Advertising?

- Advertising influences consumer choice and preferences.
- Advertising budgets of profit-seeking firms indicate that it influences consumer choices.
- Advertising can:
 - reduce the search time of consumers
 - help them make more informed choices
 - provide assurances with regard to quality (through brand names).

Factors affecting Demand



Demand Function

$$D_x = f (y, P_x, P_s, P_c, T; E_p, E_y; N, D, u)$$

Where,

D_x = Demand for good X

Y = Consumers' Income

P_x = Price of Good X

P_s = Prices of substitutes of X

P_c = Prices of complements of X

T = measures of consumers' tastes & preferences

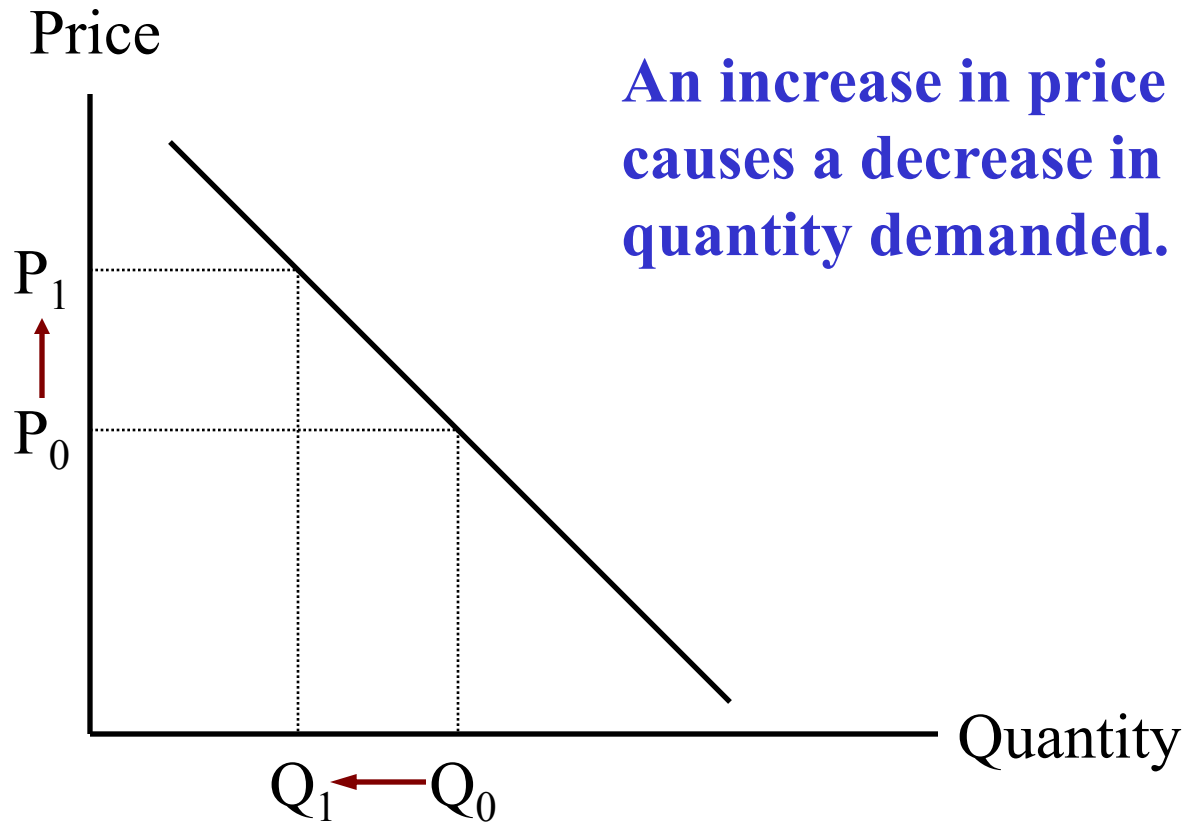
E_p & E_y = Consumers' expectation about future prices & incomes

N = Number of consumers

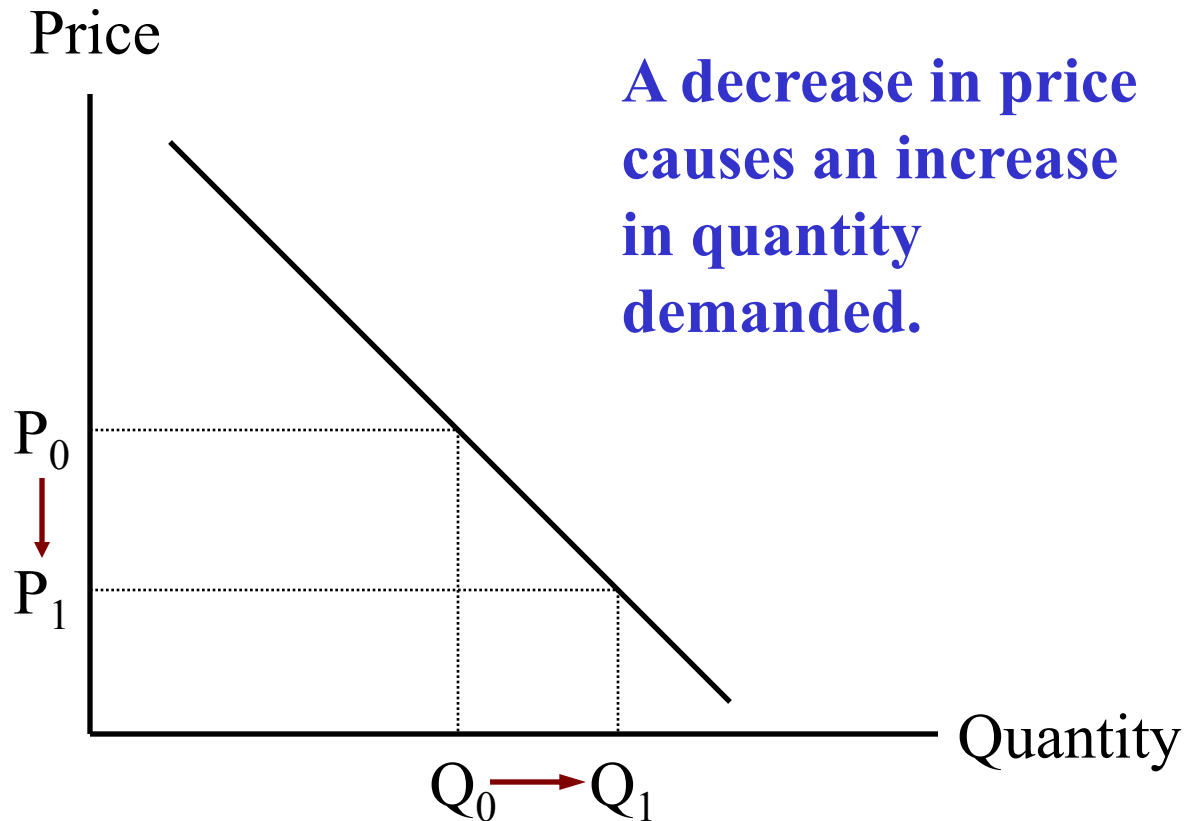
D = distribution of consumers

U = others

Change in Quantity Demanded



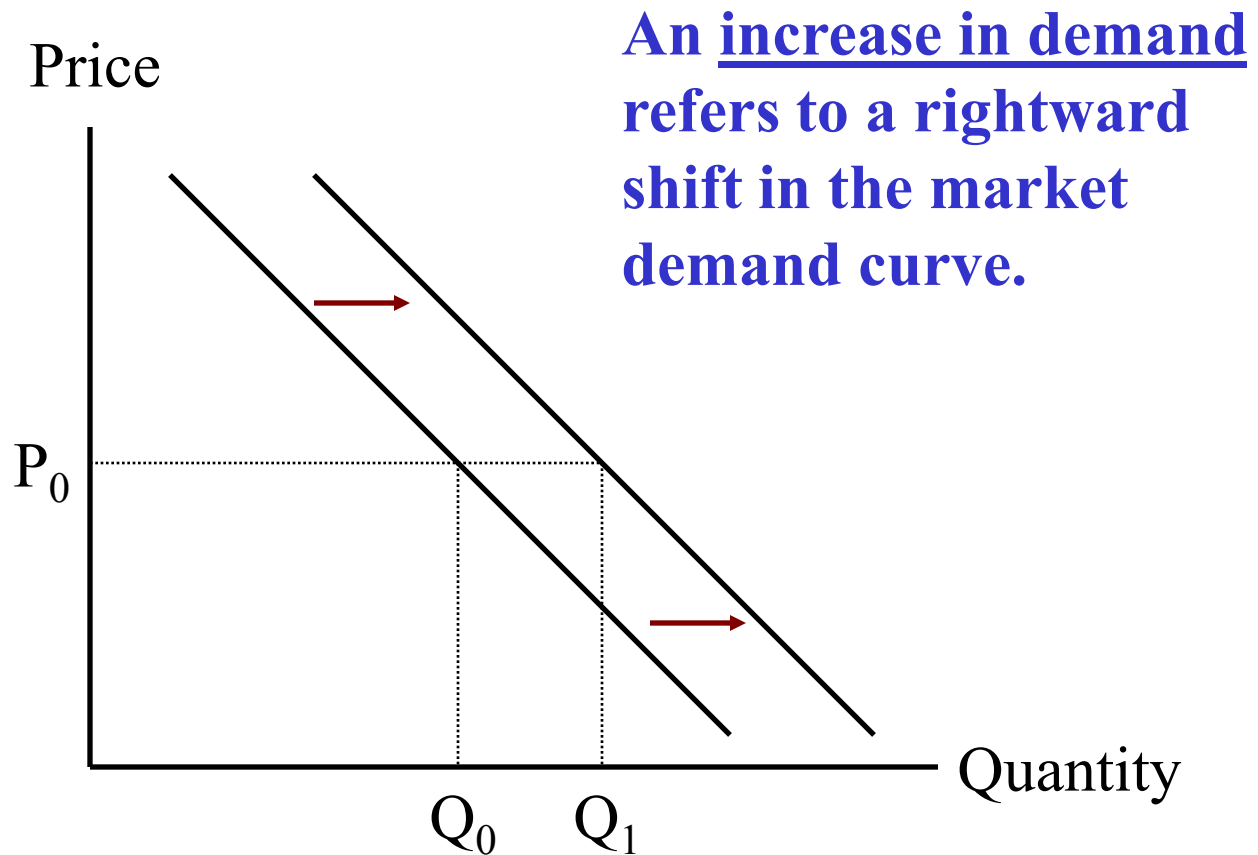
Change in Quantity Demanded



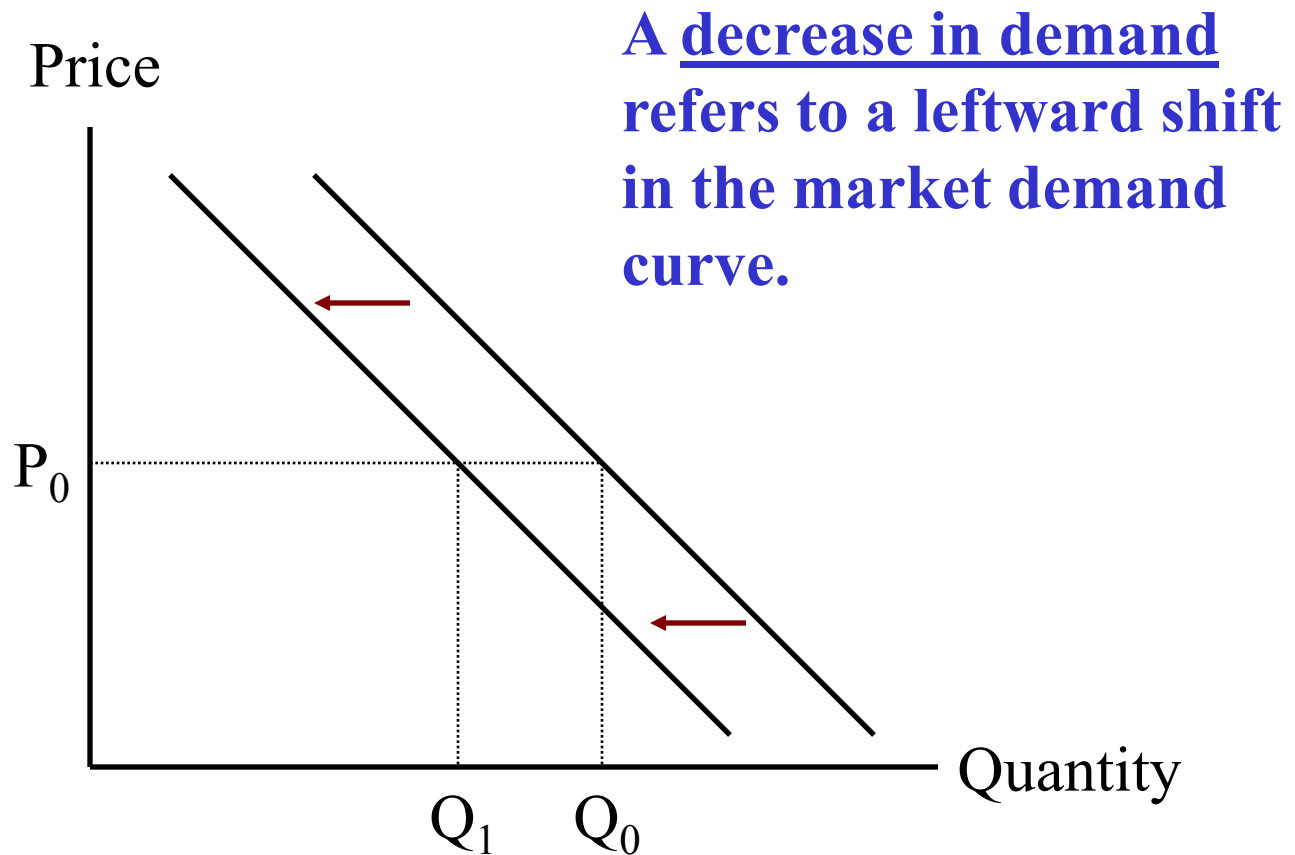
Changes in Demand

- Change in Buyers' Tastes
- Change in Buyers Incomes
 - Normal Goods
 - Inferior Goods
- Change in the Number of Buyers
- Change in the Price of Related Goods
 - Substitute Goods
 - Complementary Goods

Change in Demand

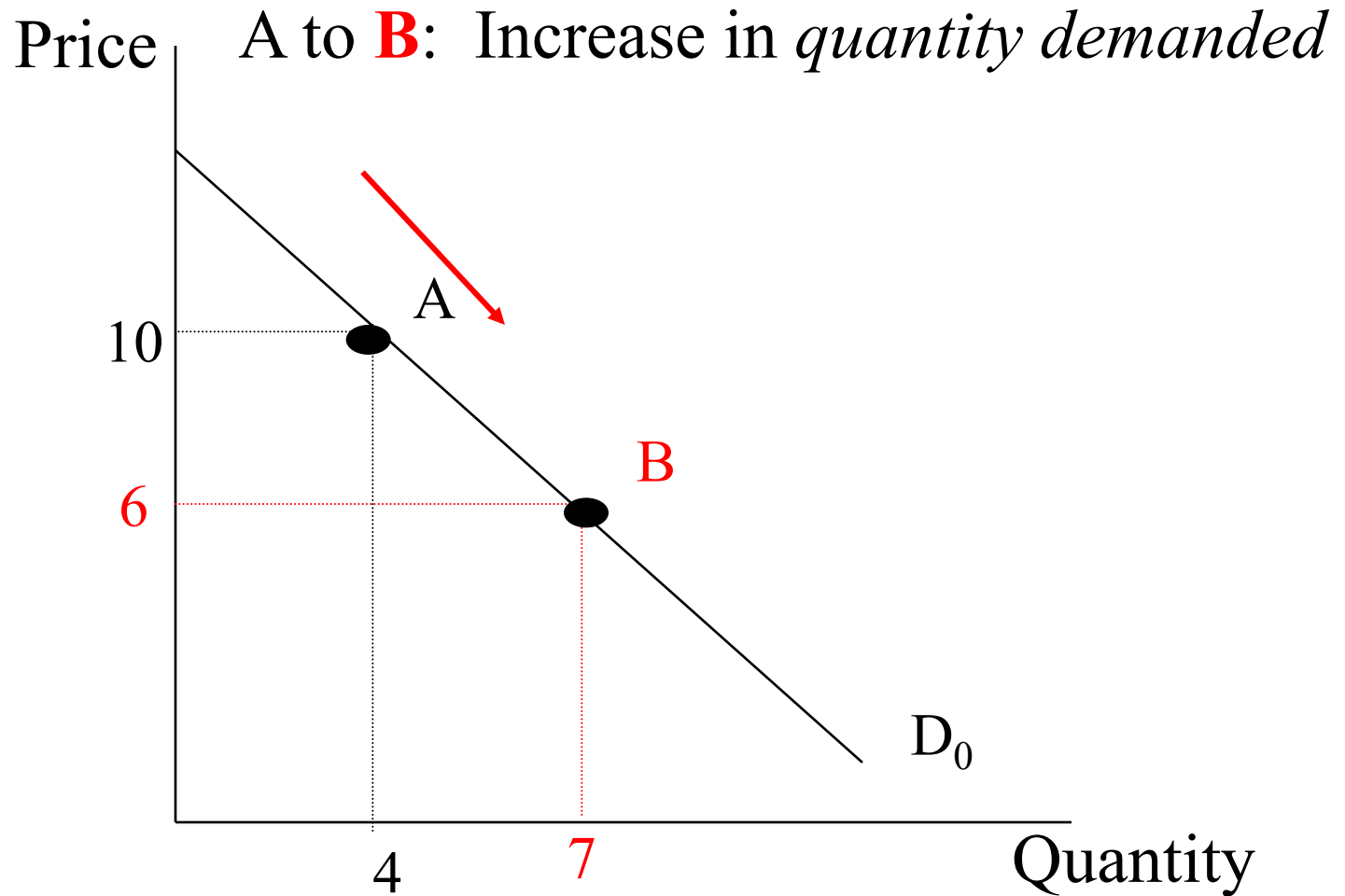


Change in Demand



**What is the difference
between a change in the
quantity demanded and a
change in demand?**

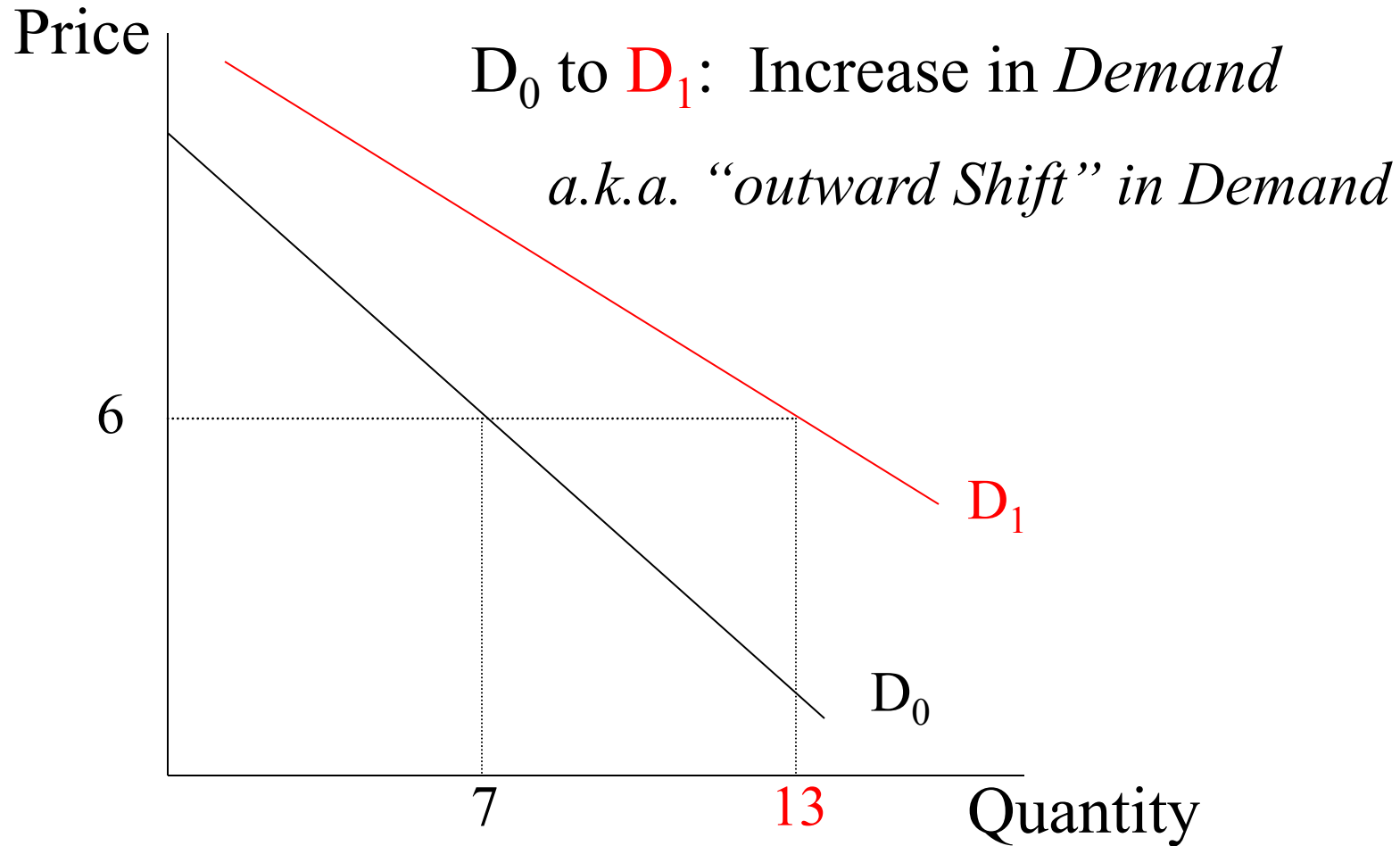
Change in Quantity Demanded



What Causes a Change in the Quantity Demanded?

**Only one thing - a change in the
price of the product!**

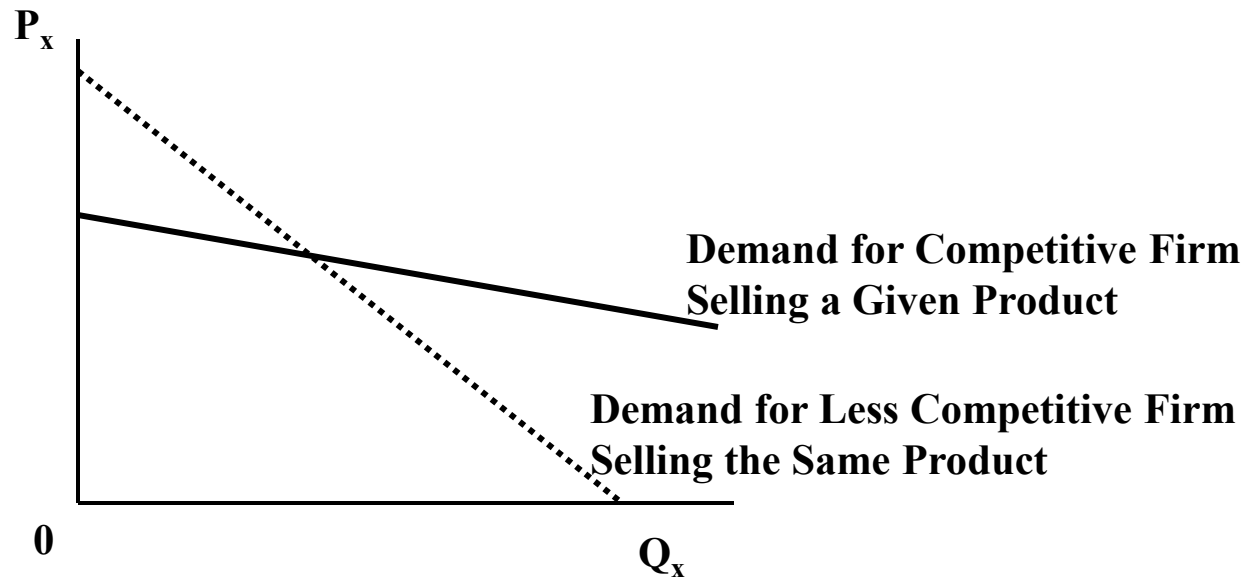
Change in Demand



What Causes a Change in Demand?

- **A change in one of the ceteris paribus conditions. What are they?**
 - **A change in the income of the consumer.**
 - **A change in the consumer's taste (the whole point of advertising).**
 - **A change in the price of a related product.**
 - **Substitutes**
 - **complements**
- **For the market, a change in the number of potential consumers.**

The more competition, the less the slope of the demand curve.

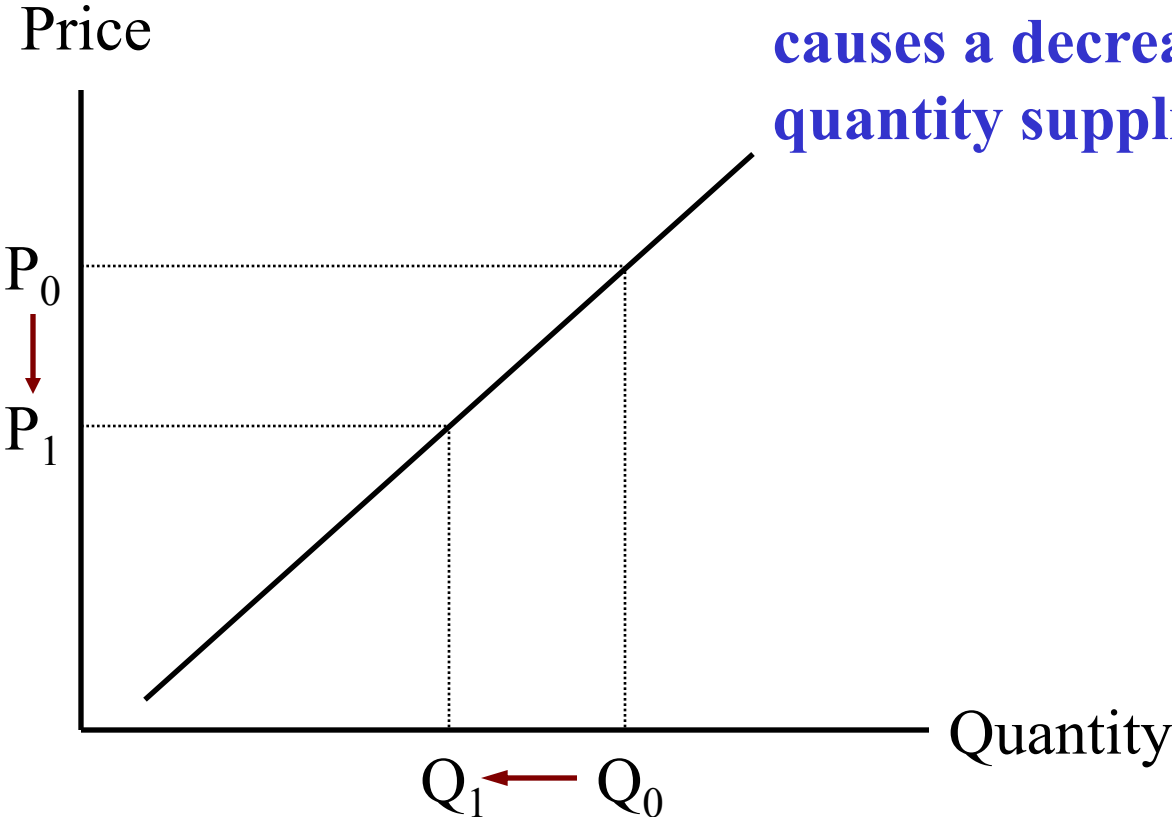


Law of Supply

- A decrease in the price of a good, all other things held constant, will cause a decrease in the quantity supplied of the good.
- An increase in the price of a good, all other things held constant, will cause an increase in the quantity supplied of the good.

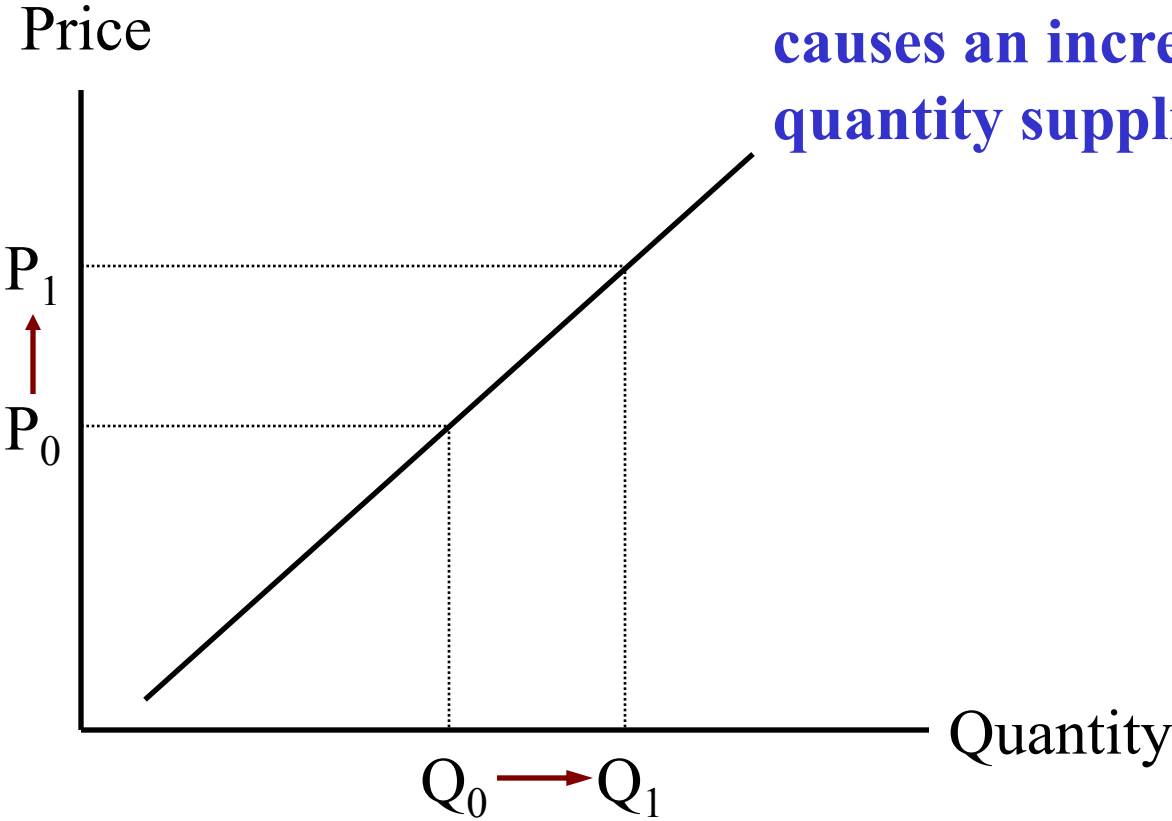
Change in Quantity Supplied

A decrease in price causes a decrease in quantity supplied.



Change in Quantity Supplied

An increase in price causes an increase in quantity supplied.

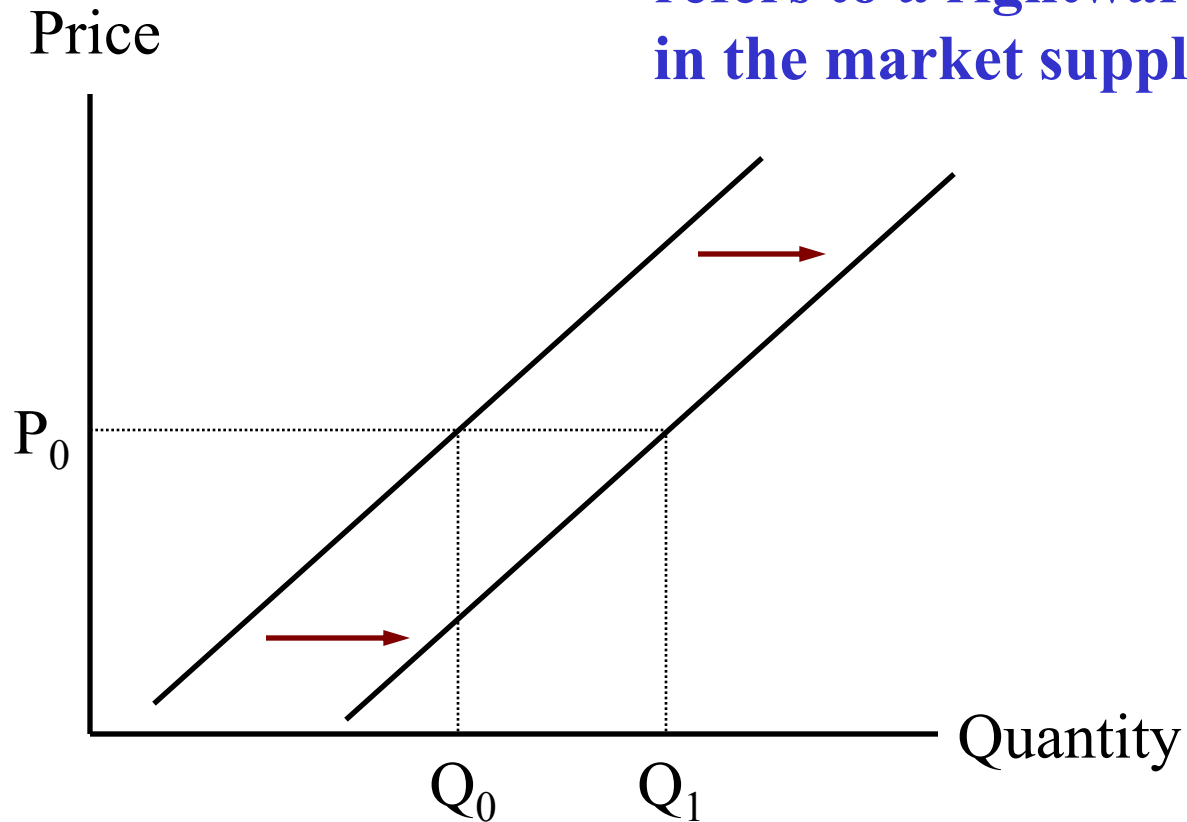


Changes in Supply

- Change in Production Technology
- Change in Input Prices
- Change in the Number of Sellers

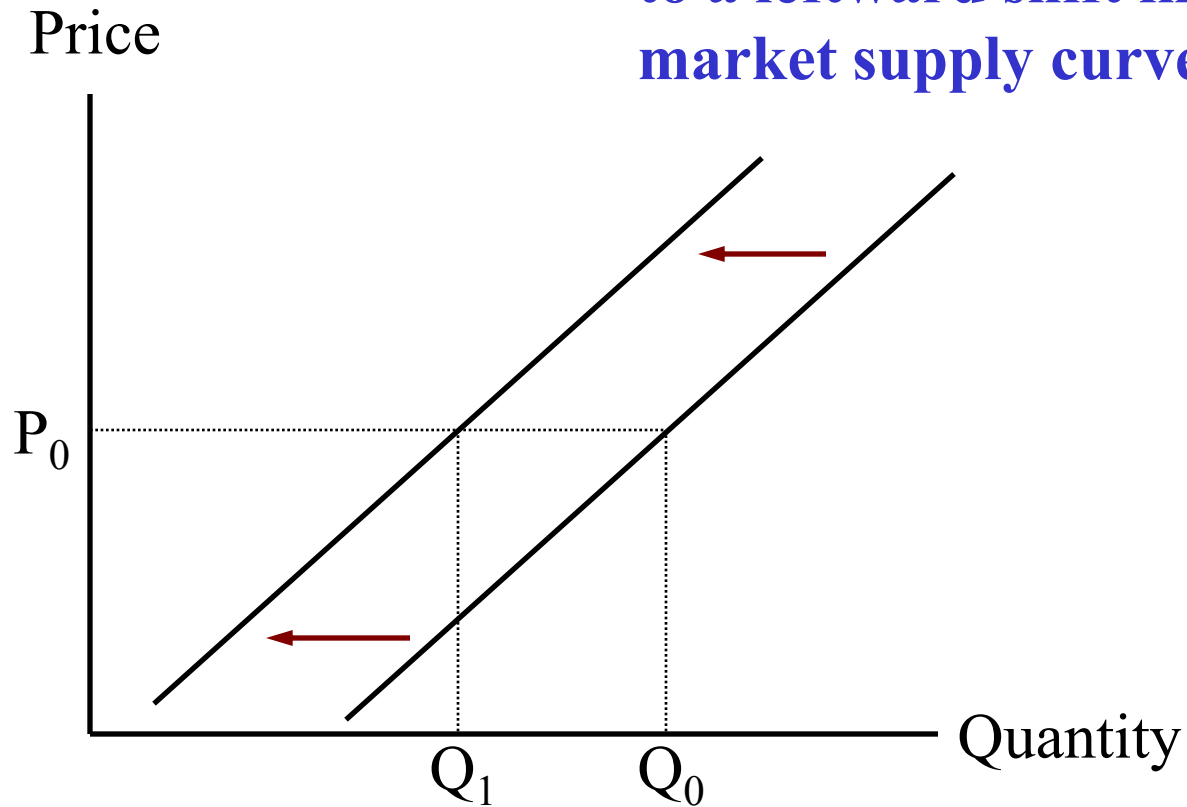
Change in Supply

An increase in supply refers to a rightward shift in the market supply curve.



Change in Supply

A decrease in supply refers to a leftward shift in the market supply curve.



Supply Shifters

- **Input prices**
- **Technology or government regulations**
- **Number of firms**
- **Substitutes in production**
- **Taxes**
- **Producer expectations**

The Supply Function

- An equation representing the supply curve:

$$Q_x^S = f(P_x, P_R, W, H)$$

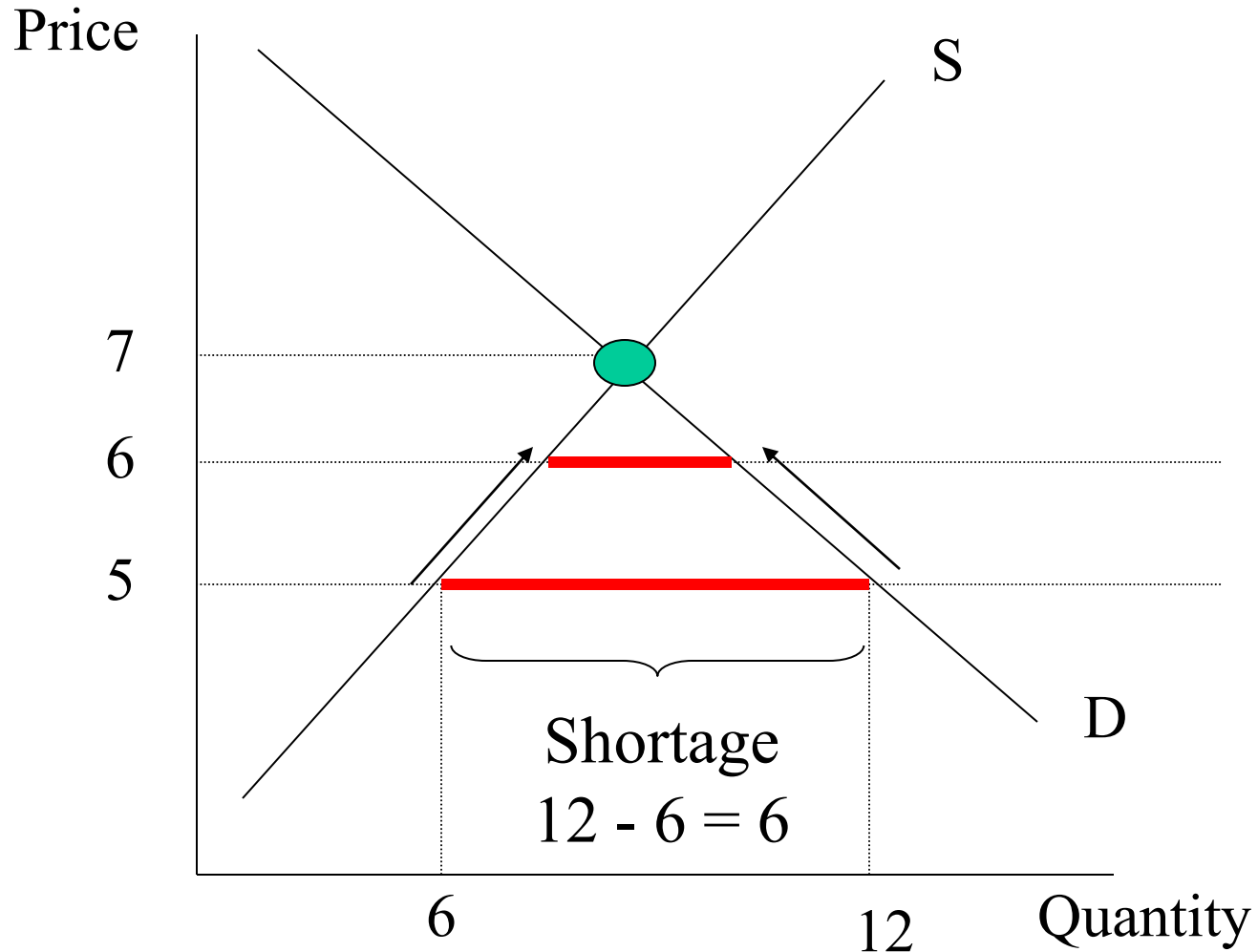
- Q_x^S = quantity supplied of good X.
- P_x = price of good X.
- P_R = price of a related good
- W = price of inputs (e.g., wages)
- H = other variable affecting supply

Market Equilibrium

- Balancing supply and demand

$$Q_x^S = Q_x^D$$

If price is too low...



If price is too high...

