Bringing the curves together

1. Create a combined demand and supply schedule (see at right).

IMPORTANT: Make sure you create an *equilibrium price* by **making one of the price levels have the exact same quantity demanded (D) and quantity supplied (S).**

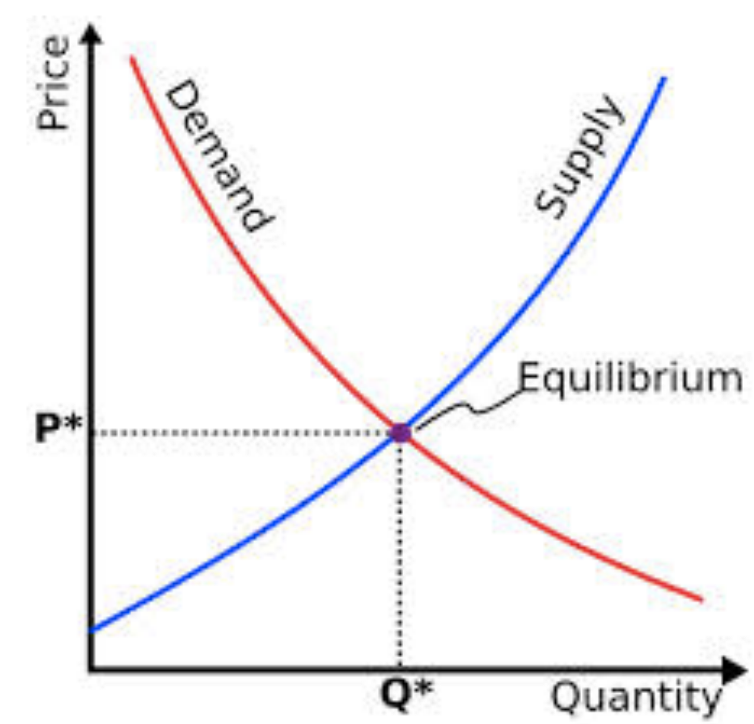
2. Now create **ONE graph** but plot both sets of points - first make the demand curve and label it D; then make the supply curve and label it S.

3. Now label the *equilibrium price* and draw dotted lines (vertically and horizontally) to show the price point at which quantity demanded and quantity supplied are equal.

Step 1

D Quantity Demanded	$ Price	S Quantity Supplied

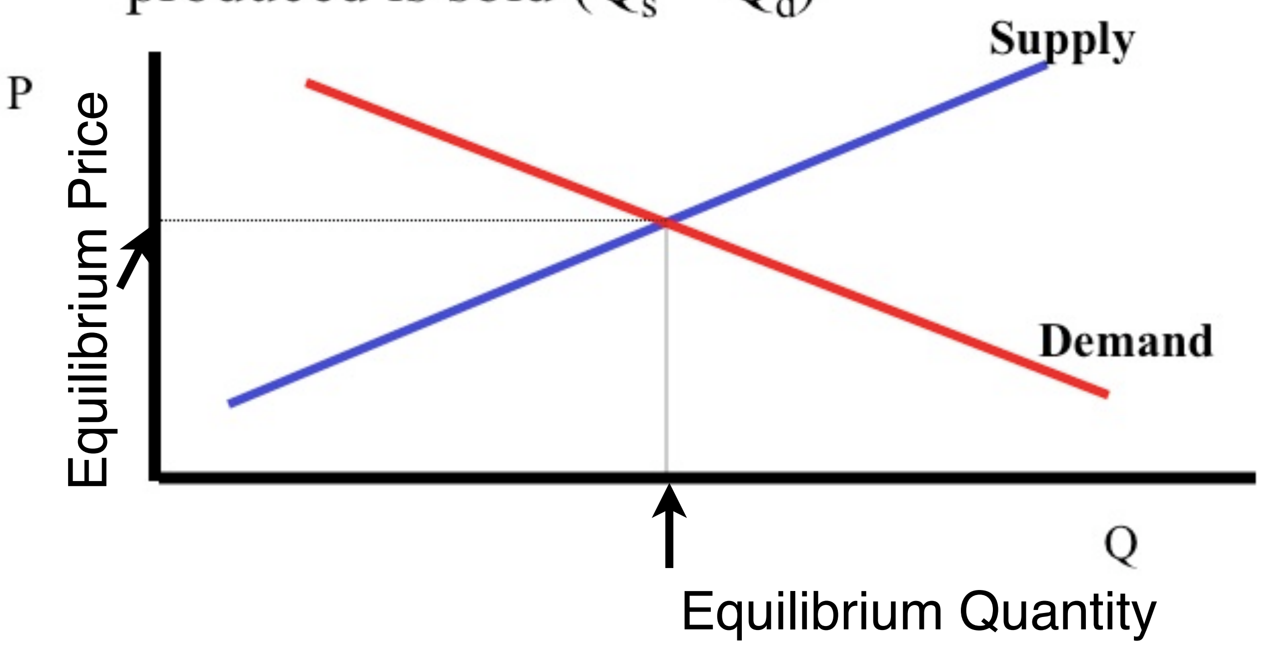
Steps 2 and 3



MARKET EQUILIBRIUM

Market Equilibrium

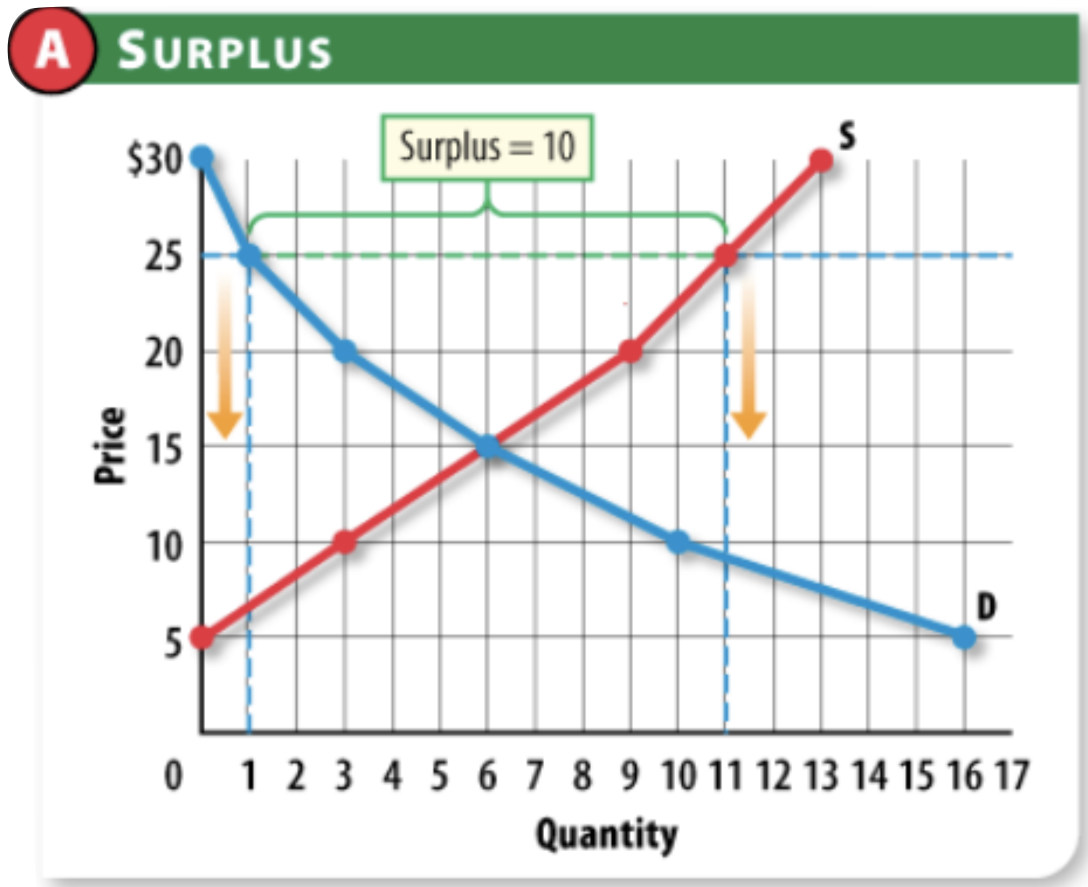
- Equilibrium Price & Quantity
- Price is a rationing tool
- Intersection – the price where all that is produced is sold ($Q_s = Q_d$)

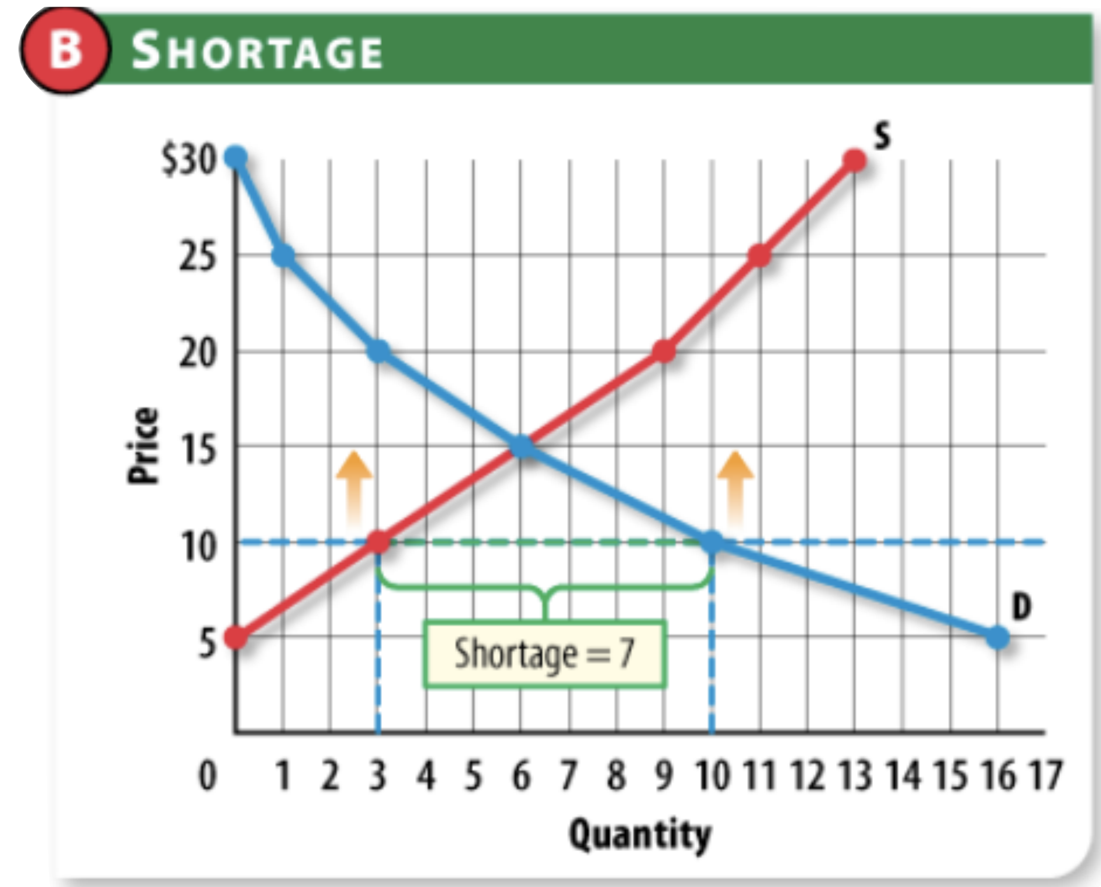


A situation in which prices are fairly stable and the quantity of goods and services supplied is equal to the quantity demanded.

The <u>equilibrium price</u> is the price that "clears the market" by leaving neither a surplus or a shortage at the end of the trading period.

What if we are at a different price and quantity than the <u>equilibrium price</u> and <u>equilibrium quantity</u>? Those situations are described on the next slide.





SURPLUS

A situation in which **Q.S. > Q.D.** at any given price.

Surplus = *unsold products* on store shelves or in warehouses.

Effects of surpluses:
(1) Price goes DOWN;
(2) Sellers REDUCE supply*, in response.

SHORTAGE

A situation in which **Q.D. > Q.S.** at any given price.

Shortage = the *product is sold out* and may be on back order.

Effects of shortages:
1) Price goes UP;
2) Sellers INCREASE supply*, in response.

ESSENTIAL QUESTION #2.

ARE MARKETS GOOD?

PRICES IN A MARKET ECONOMY

"In the final analysis, the market economy is one that 'runs itself.' There is no need for a bureaucracy, planning commission, or other agency to set prices because **the market tends to find its own equilibrium**. In addition, **the three basic economic questions** of WHAT, HOW, and FOR WHOM to produce **are decided by the participants - the buyers and sellers - in the market**."

- Textbook, p. 148