

Interaction of Supply & Demand

The price of some goods change slowly over time; others are more volatile. This is caused by changes in supply and demand working or interacting with each other responding to circumstances.

1	Equilibrium Price	In any market the price is set where the wishes of the consumers are matched exactly with those of producers. This price, called the equilibrium price, is where supply and demand are equal to each other.
2	Market Clearing Price	Another name of the Equilibrium price. This is because the amount supplied in the market completely bought up by the consumers. There are no buyers left without goods and no sellers left with unsold stock.

Changes

The market does not stay in an equilibrium and from time to time changes occur:

1	Demand	If demand increases prices will rise. This is because producers react to rising customer demand by putting up their prices. They can do this because consumers are wanting the product in higher numbers. If demand was to fall then the opposite would happen because consumers would lower their prices, otherwise they would be left with too much stock.
2	Supply	A change in supply will effect the equilibrium price. If the a supplies of the good increases then prices will fall. If supply was to fall then the opposite would happen

The Diagrams

1	Equilibrium	Diagram 1 shows the that supply and demand are in balance with each other. Therefore the market is in equilibrium The equilibrium point is shown on the diagramed where the supply and demand curves intersect each other.
2	Contraction of supply	Diagram 2 shows that a decrease in supply has caused an inward movement of the supply curve from S_1 to S_2 . Demand for the product has increased and demand curve has moved from D_1 to D_2 . Accordingly the price has risen to reflect the new equilibrium point from P_1 to P_2
3	Contraction of Demand	Diagram shows an inward movement of the demand curve due to a contract of demand. A demand drops a new equilibrium point is found where S_2 and D_2 intersect each other. Accordingly the price has dropped from P_1 to P_2 .

Diagram 1

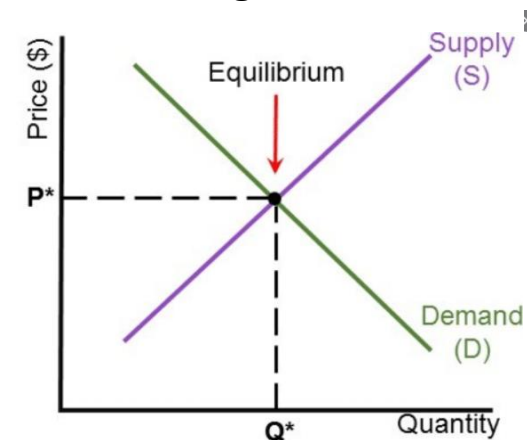


Diagram 2

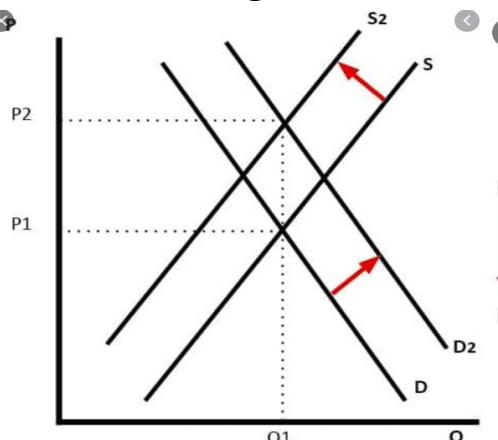
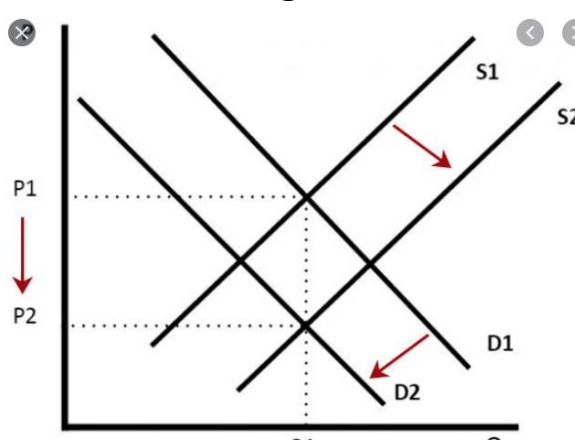


Diagram 3



When drawing supply and demand diagrams always remember to annotate the diagram correctly