



Chapter IV: SUPPLY AND DEMAND

Introduction

In every economy, goods and services are produced and exchanged. But how are prices determined? Why do prices increase or decrease? Why do some products disappear from the market?

To answer these questions, economists use the model of **supply and demand**. This model explains how buyers and sellers interact in a market and how prices are determined.

Supply and demand are one of the most important foundations of microeconomics.

I. The Market

A **market** is a place or system where buyers and sellers interact to exchange goods and services. A market does not have to be physical. It can be:

- A supermarket
- An online platform
- A financial market

In a market, prices are determined by the interaction between supply and demand.

II. Demand

1. Definition: demand is the quantity of a good or service that consumers are willing and able to buy at different prices during a given period.

2. Law of Demand: there is an inverse relationship between price and quantity demanded:

- When price increases → demand decreases
- When price decreases → demand increases

→This is called the **Law of Demand**.

3. Factors Affecting Demand

Demand can change because of:

- Consumer income
- Tastes and preferences
- Prices of related goods
- Expectations about future prices
- Population size

III. Supply

1. Definition: supply is the quantity of a good or service that producers are willing and able to sell at different prices during a given period.

2. Law of Supply: there is a direct relationship between price and quantity supplied:

- When price increases → supply increases
- When price decreases → supply decreases

→This is called the **Law of Supply**.

3. Factors Affecting Supply: supply can change because of:

- Cost of production
- Technology
- Taxes and subsidies
- Number of producers
- Expectations

IV. Market Equilibrium

The **equilibrium price** is the price at which quantity demanded equals quantity supplied.

At equilibrium; there is no shortage, no surplus, and the market is balanced.

1. Surplus: If price is too high:

- Supply > Demand
- Unsold goods remain.

2. Shortage: if price is too low:

- Demand > Supply
- Not enough goods available

→ The market naturally moves toward equilibrium.

V. Importance of Supply and Demand

The supply and demand model helps to:

- Explain price changes
- Understand economic decisions
- Predict market behaviour
- Analyze government policies

→ It is a basic tool in microeconomics.

Conclusion

Supply and demand explain how markets function. Consumers influence demand, producers influence supply, and their interaction determines prices.

When supply equals demand, the market reaches equilibrium. Understanding this model helps explain price fluctuations, shortages, surpluses, and overall market behaviour.

Supply and demand remain one of the most powerful tools for analysing economic activity.

Let's practice

ACTIVITY 1 – Concept Application

Answer the following questions:

1. What happens to demand if the price of a product increases?
2. What is the difference between shortage and surplus?
3. If production costs increase, what happens to supply?
4. Define equilibrium price.

ACTIVITY 2 – Case Study

Read the situation and answer the questions:

“Due to bad weather, agricultural production decreases. At the same time, consumer demand for food remains high.”

1. What happens to supply?
2. What happens to price?
3. Is there a shortage or surplus?
4. What will likely happen to the market price in the long run?

Key Answers :

Activity 1

1. Demand decreases.
2. Shortage = demand greater than supply.
Surplus = supply greater than demand.
3. Supply decreases.
4. The price at which quantity demanded equals quantity supplied.

Activity 2

1. Supply decreases.
2. Price increases.
3. There is a shortage (demand > supply).
4. Price will rise until a new equilibrium is reached.