1.2.6 Price determination

a) Equilibrium price and quantity and how they are determined
b) The use of supply and demand diagrams to depict excess supply and excess demand
c) The operation of market forces to eliminate excess demand and excess supply
d) The use of supply and demand diagrams to show how shifts in demand and supply curves cause the equilibrium price and quantity to change in real-world situations

- Equilibrium means a state of balance between supply and demand i.e. supply demand and there is no excess supply or demand
- Equilibrium is determined by the interaction supply and demand curves. The equilibrium price and quantity would not change unless there was a change in the conditions of demand or supply
- Prices where demand and supply are out of balance are called points of disequilibrium
- A disequilibrium theoretically won't exist in a free market because if there is excess supply market forces will cause the price to decrease leading to an extension of demand and a contraction of supply. If there is excess demand there will be an extension of supply.
- A change in the equilibrium price is caused by changes in the conditions of demand and/or changes in the conditions of supply
- Equilibrium price is a trade-off for buyers and sellers- higher prices are good for the producer (higher revenues and profits) but they make the product more expensive for the buyer
- Pe is known as the 'market clearing price'
- Excess supply happens when quantity supplied is greater than quantity demanded which causes a price reduction to get rid of stock
- Excess demand is when quantity supplied is less than the quantity demanded which causes an increase in price to decrease demand/ increase supply
- An inward shift of market demand (ceteris paribus) or decrease in demand leads to a fall in equilibrium price. Supply curve is fixed in short term. Price decreases to increase demand and meet equilibrium
- Increased demand causes a right shift and a rise in price
- An outward shift in the supply curve or increased supply leads to a fall in equilibrium price and an expansion of market demand
- Decreased supply causes a left shift, rise in price and a decrease in quantity demanded
- When both supply and demand shift a bigger shift in demand than supply causes an increase in price and vice versa
- Effects of price changes:
    - Production: lower price causes a contraction in supply
    - Revenues and profits: lower revenues may impact incomes and employment
    - Manufacturing costs- other industries will benefit from lower input costs

- Total revenue= market price x quantity sold (PQ)