UNIT 2: DETERMINATION OF PRICES

→ In open Competitive Market, Interaction between Demand & Supply tends to determine Equilibrium price & Quantity.

Quantity Demanded = Quantity Supplied

→ Equilibrium price = Market clearing price

→ At this price, there is no unsold stock.

Eg:-

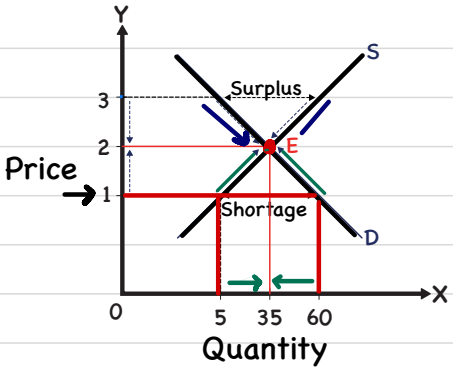
	Price [₹]	Demand [units]		Supply [units]	
	1	↓ 60		↑ 5	→ Shortage
Eq. price ←	2	↓ 35	=	35	→ Eq. Quantity
	3	↓ 20		↑ 45	→ Surplus

→ In case of **Shortage** [Quantity Demanded > Quantity Supplied]

→ Price ↑

→ In case of **Surplus** [Quantity Supplied > Quantity Demanded]

→ Price ↓



Equilibrium is said to be **Stable** if any disturbance to it is self-adjusting, so that original equilibrium is re-stored.
[other things are constant]

Change in Demand & Supply

→ **1] Increase in Demand**

At current price OP

Q.D. = OQ_2

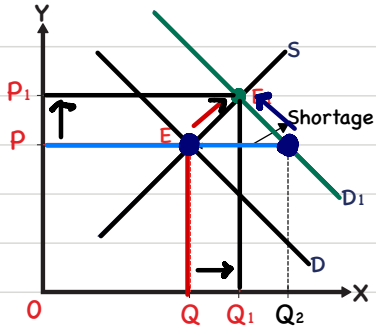
Q.S. = OQ

Q.D. > Q.S.

→ Shortage

→ Prices ↑ → OP_1

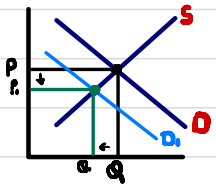
- Contraction in Demand curve
- Expansion in Supply curve

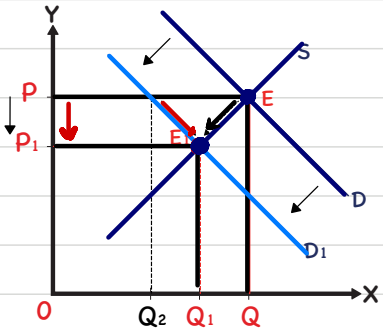


→ New Equilibrium- E_1 → Eq. Price - OP_1
→ Eq. Quantity - OQ_1

↑ in Equilibrium Price
↑ in Equilibrium Quantity

→ 2] Decrease in Demand





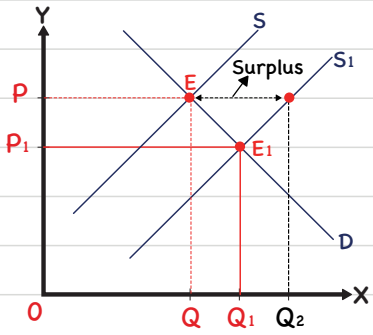
At current price OP
Q.D. = OQ_2
Q.S. = OQ
Q.S. > Q.D.
→ Surplus
→ Prices ↓ → OP_1

Expansion in Demand curve
Contraction in Supply curve

→ New Equilibrium- E_1 → Eq. Price - OP_1
→ Eq. Quantity - OQ_1

↓ in Equilibrium Price
↓ in Equilibrium Quantity

→ 3] Increase in Supply



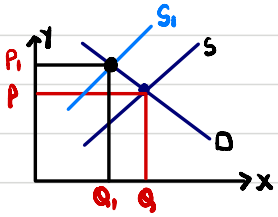
At current price OP
Q.D. = OQ
Q.S. = OQ_2
Q.S. > Q.D.
→ Surplus
→ Prices ↓ → OP_1

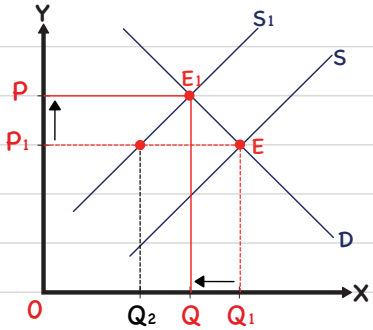
Expansion in Demand curve
Contraction in Supply curve

→ New Equilibrium- E_1 → Eq. Price - OP_1
→ Eq. Quantity - OQ_1

↓ in Equilibrium Price
↑ in Equilibrium Quantity

→ 4] Decrease in Supply





At current price OP
Q.D. = OQ
Q.S. = OQ_2
~~Q.S. > Q.D.~~ Q.S. < Q.D.
~~Surplus~~ Shortage
→ Prices ↑ → OP_1

Contraction in Demand curve
Expansion in Supply curve

→ New Equilibrium- E_1 → Eq. Price - OP_1
→ Eq. Quantity - OQ_1

↑ in Equilibrium Price
↓ in Equilibrium Quantity

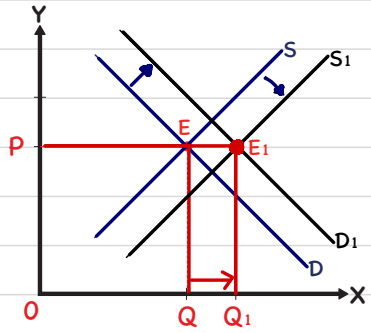
→ Simultaneous change in Demand & Supply

→ Shift in the same direction.

→ 1] Increase in Demand = Increase in Supply

→ New Equilibrium Prices = Old Equilibrium price
→ OP

→ Equilibrium Quantity ↑, from OQ To OQ_1

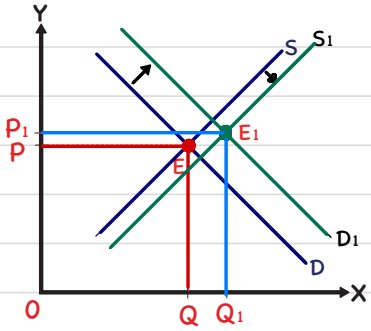


→ 2] Increase in Demand > Increase in Supply

→ Shortage

→ New Equilibrium Price - OP_1,
Higher than Old Equilibrium price - OP

→ Equilibrium Quantity ↑, from OQ To OQ_1

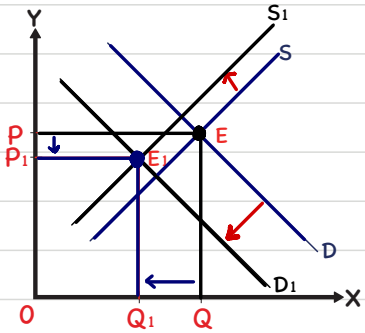


→ 3] Decrease in Demand > Decrease in Supply

→ Surplus

→ Equilibrium Price ↓, from OP To OP_1

→ Equilibrium Quantity ↓, from OQ To OQ_1

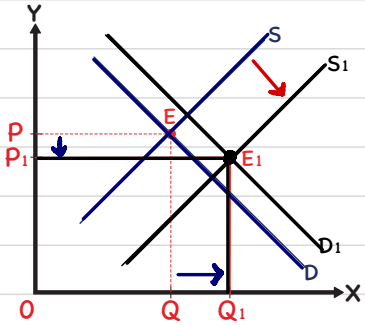


→ 4] Increase in Supply > Increase in Demand

→ Surplus

→ Equilibrium Price ↓, from OP To OP_1

→ Equilibrium Quantity ↑, from OQ To OQ_1

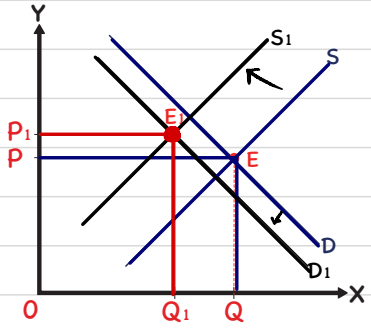


→ 5] Decrease in Supply > Decrease in Demand

↳ Shortage

→ Equilibrium Price ↑, from OP To OP_1

→ Equilibrium Quantity ↓, from OQ To OQ_1



→ Possible outcome when Supply & Demand curve shift in the same direction:

1] Both Demand & Supply ↑

↳ Equilibrium Quantity ↑

but, change in price is uncertain

2] Both Demand & Supply ↓

↳ Equilibrium Quantity ↓

but, change in price is uncertain

Quantity is certain

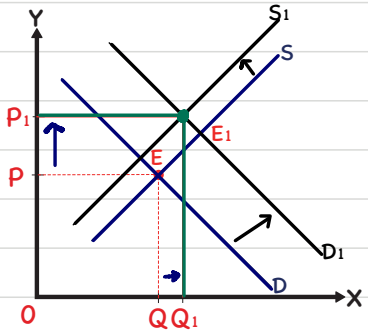
→ Shift in the Opposite direction.

→ 1] Increase in Demand > Decrease in Supply

↳ Shortage

→ Equilibrium Price ↑, from OP To OP_1

→ Equilibrium Quantity ↑, from OQ To OQ_1

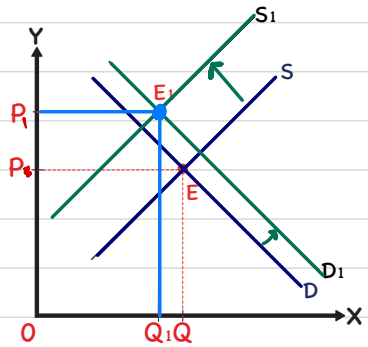


→ 2] Decrease in Supply > Increase in Demand

↳ Shortage

→ Equilibrium Price ↑, from OP To OP_1

→ Equilibrium Quantity ↓, from OQ To OQ_1

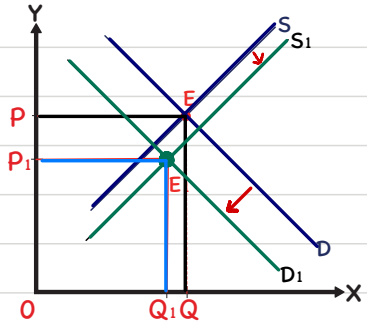


→ 3] Decrease in Demand > Increase in Supply

↳ Surplus

→ Equilibrium Price ↓, from OP To OP_1

→ Equilibrium Quantity ↓, from OQ To OQ_1

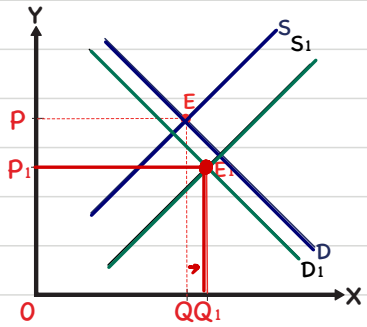


→ 4] Increase in Supply > Decrease in Demand

↳ Surplus

→ Equilibrium Price ↓, from OP To OP_1

→ Equilibrium Quantity ↑, from OQ To OQ_1



→ Possible outcome when Supply & Demand curve shift in the Opposite direction:

1] Demand ↑ & Supply ↓ ---→ ~~Surplus~~ Shortage

↳ Equilibrium Price ↑

but, nothing certain can be said about change in Equilibrium Quantity.

2] Demand ↓ & Supply ↑

↳ Equilibrium Price ↓ ---→ ~~Supply~~ Surplus

but, nothing certain can be said about change in Equilibrium Quantity.

Unit over :)