

Demand and Supply

Matthew Williams • Economics • May 17, 2026

Demand and Supply

Markets exist wherever buyers and sellers interact to exchange goods and services. The forces of demand and supply determine prices and quantities in those markets. Mastering this topic is essential — it underpins almost every other area of microeconomics.

What is a Market?

A **market** is any situation in which buyers and sellers communicate for the purpose of exchanging goods and services. A market does not need a physical location. Online platforms, stock exchanges, and agricultural commodity trades are all markets. Every market has four elements: buyers, sellers, the goods or services being exchanged, and a price.

Demand

Demand is the quantity of a good or service that consumers are willing and able to purchase at various prices over a given time period, holding all other factors constant.

Note the phrase "willing and able" — a want backed by purchasing power constitutes effective demand. Wishing to buy something without having money to pay for it is not demand in the economic sense.

The Law of Demand

As the price of a good rises, the quantity demanded falls; as the price falls, the quantity demanded rises — all other things being equal.

This inverse relationship arises because: when a good becomes more expensive, buyers switch to cheaper substitutes (substitution effect) and their real purchasing power falls even if their money income stays the same (income effect).

The Demand Schedule and Curve

A demand schedule is a table showing quantity demanded at each price level. The corresponding demand curve slopes downward from left to right, reflecting the inverse price-quantity relationship.

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alt="Demand curve: as price falls from P to P, quantity demanded rises from Q to Q,"

caption="Demand curve: higher price, lower quantity demanded"

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Non-Price Determinants of Demand

Price determines where you are on the demand curve (a movement along the curve). Any other factor that changes demand shifts the entire curve left or right:

Determinant	Effect on demand if it increases
Consumer income (for normal goods)	Demand rises — curve shifts right
Consumer income (for inferior goods)	Demand falls — curve shifts left
Price of substitutes (e.g. rival brands)	Demand rises — consumers switch to this good
Price of complements (e.g. cars and petrol)	Demand falls — the good is used alongside a now-pricier complement
Tastes and preferences	Demand rises if the good becomes more fashionable
Population size	Demand rises with a larger population
Consumer expectations (future price rise)	Demand rises now as consumers buy before the expected rise

Remember

A **normal good** is one whose demand rises when income rises. An **inferior good** is one whose demand falls when income rises — cheaper options are abandoned for better ones. Examples of inferior goods: cheap margarine (replaced by butter), bus rides (replaced by cars).

Supply

Supply is the quantity of a good or service that producers are willing and able to offer for sale at various prices over a given time period, holding all other factors constant.

The Law of Supply

As the price of a good rises, the quantity supplied rises; as the price falls, the quantity supplied falls — all other things being equal.

This direct relationship arises because higher prices make production more profitable, incentivising existing firms to produce more and attracting new firms into the market.

The Supply Schedule and Curve

A supply schedule is a table showing quantity supplied at each price. The supply curve slopes upward from left to right.

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alt="Supply curve: as price rises from P to P, quantity supplied rises from Q to Q,"

caption="Supply curve: higher price, greater quantity supplied"

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Non-Price Determinants of Supply

Determinant	Effect on supply if it increases
Cost of production (wages, raw materials)	Supply falls — costs rise, making production less profitable
Technology	Supply rises — more efficient production from same inputs
Number of firms in the industry	Supply rises
Taxes on production	Supply falls — effectively raises costs
Subsidies to producers	Supply rises — effectively reduces costs
Weather (for agricultural goods)	Good weather increases supply; bad weather reduces it
Producers consuming their own good	Supply to market falls

Price of related goods in production

If a related good becomes more profitable, supply of this good falls

Ceteris Paribus

Ceteris paribus is Latin for "all other things being equal." It is the assumption economists make when analysing the effect of one variable at a time. When we say "an increase in price reduces quantity demanded," we assume all other factors (income, tastes, prices of substitutes) remain unchanged.

Without this assumption, it would be impossible to isolate the effect of price on demand — changes in two or more factors simultaneously would make results impossible to interpret.

Market Equilibrium

Market equilibrium occurs when the quantity demanded equals the quantity supplied at the prevailing price. There is no tendency for price to change because all buyers who want to buy at that price can find a seller, and all sellers who want to sell at that price can find a buyer.

The **equilibrium price** is the price at which $Q_d = Q_s$. The **equilibrium quantity** is the amount bought and sold at that price.

On a diagram, equilibrium is the point where the demand curve and supply curve intersect.

Disequilibrium: Surplus and Shortage

Surplus (excess supply): When the market price is set above equilibrium, Q_s exceeds Q_d . Unsold stock builds up. Sellers respond by cutting prices, pushing the market back toward equilibrium.

Shortage (excess demand): When the market price is set below equilibrium, Q_d exceeds Q_s . Consumers compete for the limited supply. This pressure drives prices upward toward equilibrium.

Situation	Price relative to equilibrium	Q_s vs Q_d	Market response
Surplus	Above equilibrium	$Q_s > Q_d$	Price falls toward equilibrium
Shortage	Below equilibrium	$Q_d > Q_s$	Price rises toward equilibrium

Shifts vs Movements Along the Curve

This distinction is crucial and commonly tested.

A movement along the curve happens when the good's own price changes. For demand, price rises 'move up the curve; price falls 'move down. Same logic for supply.

A shift of the curve happens when any non-price determinant changes:

- Demand shifts right if income rises (for a normal good), population grows, or preferences strengthen.
- Demand shifts left if a complement becomes more expensive or tastes shift away.
- Supply shifts right if technology improves, production costs fall, or more firms enter.
- Supply shifts left if production costs rise or taxes are imposed.

Effects of Shifts on Equilibrium

When demand or supply shifts, the equilibrium price and quantity both change. The direction depends on which curve shifts and which way.

Change	Effect on equilibrium price	Effect on equilibrium quantity
Demand rises (curve shifts right)	Price rises	Quantity rises
Demand falls (curve shifts left)	Price falls	Quantity falls
Supply rises (curve shifts right)	Price falls	Quantity rises
Supply falls (curve shifts left)	Price rises	Quantity falls

Example

A drought reduces the coffee harvest in Jamaica. Supply of coffee shifts left. At the original price, there is now a shortage. The shortage causes the price to rise. As price rises, quantity demanded falls (movement up the demand curve) and quantity supplied by remaining producers rises (movement up the new supply curve). A new equilibrium is reached at a higher price and lower quantity.

Exam Tip

When a Paper 02 question asks you to use a diagram to explain a change in market conditions, always: (1) draw the original curves and label the equilibrium, (2) show the shift with an arrow, (3) mark the new equilibrium, and (4) state what happened to price and quantity in your written explanation. Arrows on the diagram earn marks only if your explanation matches them.