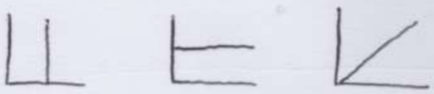
Section 3: Price determination in a competitive market

Factors affecting demand (PASIFICO)

- Population
- Advertising
- Subsidies
- Incomes
- Fashion / Trends
- Interest rates
- Complementary product prices
- Optimism

- **Ostentatious consumption** - buy the product and flaunt at the consumption of it
- **Speculative demand** - interested in market price rising in the future as it could lead to capital gain

PES - Price elasticity of supply

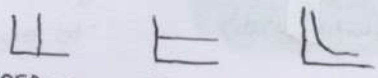
- Always positive
- $PES = \frac{\Delta \% QS}{\Delta \% P}$
- $0 \leq PES \leq 1$ = price inelastic
- $PES \geq 1$ - price elastic
- 

PES = 0   PES = ∞   PES = 1 unitary

Factors affecting elasticity of supply (PLSST)

- Production lag
- Level of stocks
- Level of space capacity
- Ease of factor substitution
- Time period

PED - price elasticity of demand

- Always negative
- $PED = \frac{\Delta \% QD}{\Delta \% P}$
- $0 \leq PED < -1$ = price inelastic
- $PED \leq -1$ = price elastic
- 

PED = 0   PED = ∞   PED = 1 (unitary)

Revenue

- Elastic demand - ↑price = ↓Revenue (vice versa)
- Inelastic demand - ↑price = ↑Revenue (vice versa)
- Unitary - ↑P = same revenue (same for price↓)

Factors affecting elasticity of demand (SPLATB)

- Availibility of substitutes
- % income spent on product
- Luxury / necessity
- Addictive nature of good
- Time period (LR = most good are elastic)
- Broad or specific market definition

Factors affecting supply (PINTSWC)

- Productivity of labour
- Indirect taxes
- Technology
- Subsidies
- Weather
- Cost of production - wages, raw materials, commodity prices, oil price, VAT, Import prices

YED - Income elasticity of demand

- $YED = \frac{\Delta \% Q}{\Delta \% I}$
- +ve value = normal good (↑I = ↑D)
- -ve value = inferior good (↑I = ↓D)
- $0 \leq YED \leq 1$ = income elastic
- $YED > 1$ = income inelastic

XED - cross elasticity of demand

- $XED = \frac{\Delta \% \text{ Q demanded for product A}}{\Delta \% \text{ P of product}}$
- +ve value - A and B are substitutes
- -ve value - A and B are complements

Interrelationships between markets

- **Joint demand (complementary goods)** - 2 or more goods demanded together e.g. pens and ink
- **composite demand** - when goods have more than 1 use e.g oil in plastic and fuels
- **Derived demand** - demand for good / FoP is used in making another good / service
- **Competitive demand (substitute goods)** - goods that are alternative to each other
- **Joint supply** - a process that producers 2 or more outputs e.g. more beef = more leather

Equilibrium market price

- supply = demand
- Goods are sold at market clearing price

Explaining Disequilibrium

- state change that has happened (shif of curve)
- shortage / excess of demand / supply
- Demand curve extends / contracts along the curve to change prices (price mechinism)
- Explain change in quantity
- causes demand and supply to settle at new equilibrium