Edexcel (A) Economics A-level

Theme 1: Introduction to Markets and Market Failure

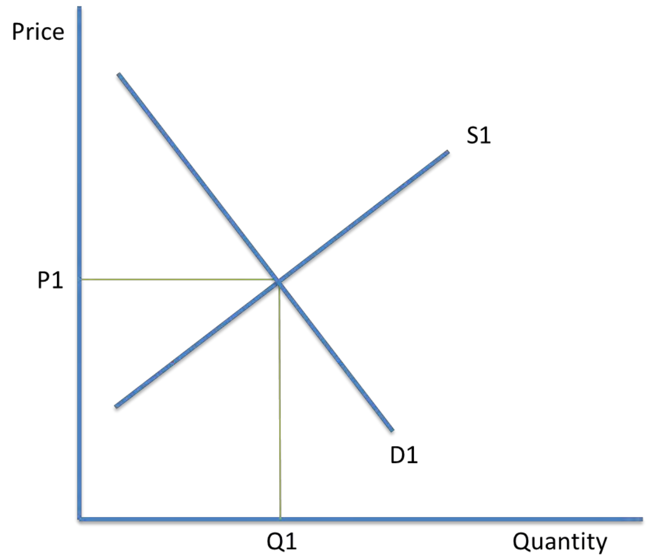
1.2 How Markets Work

1.2.6 Price determination

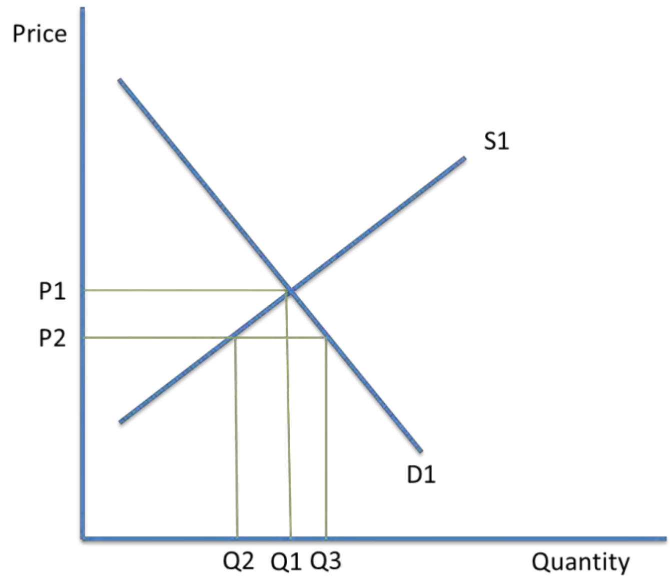
Notes

Equilibrium price and quantity

- This is when supply meets demand. On the diagram, this is shown by P1 and Q1.
- At market equilibrium, price has no tendency to change, and it is known as the **market clearing price.**



Excess demand

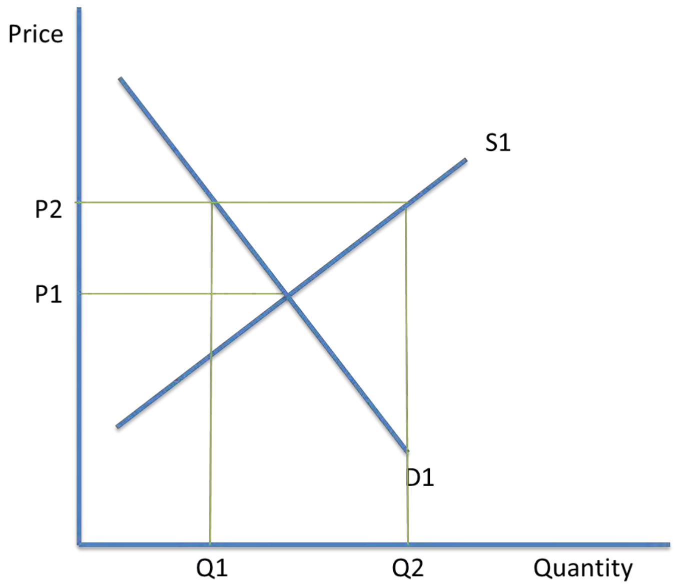


- At Q2, price is at P2 which is below market equilibrium. Demand is now greater than supply, which can be calculated by Q3-Q2.

- This is a **shortage** in the market. This pushes prices up and causes firms to supply more. Since prices increase, demand will contract.
- Once supply meets demand again, price will reach the market clearing price, P1.

Excess supply

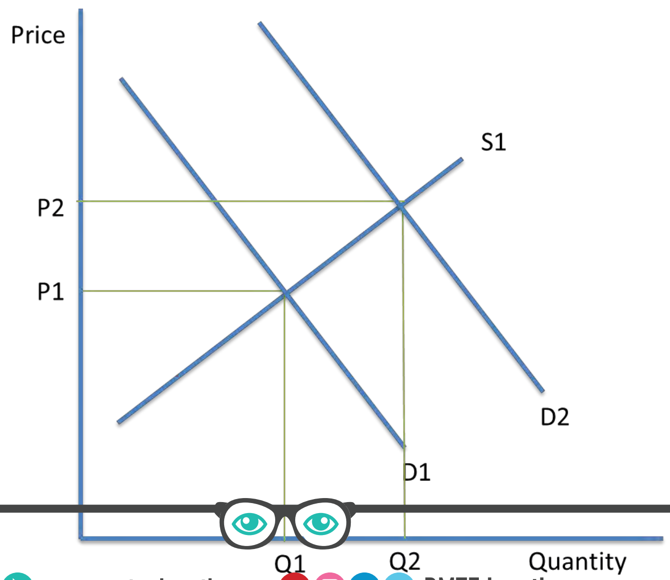
- This is when price is above P1.



- Supply is now at Q2 and demand is at Q1. There is a **surplus** of Q2- Q1. Price will fall back to P1 as firms lower their prices and try to sell their goods. The market will clear and return to equilibrium.

New market equilibriums

- When the demand or supply curves shift due to the PIRATES or PINTSWC reasons, new market equilibriums are established.



- For example, if there was an increase in the size of the population, demand would shift from D1 to D2.
- Price would increase to P2 and suppliers would supply a larger quantity of Q2. A new market equilibrium is established at P2 Q2.