

## Topic 2—The Nature of Demand

Key Terms	
Demand	The quantity of a good or service that consumers choose to buy at any possible price in a given period
Diminishing Marginal Utility	Describes the situation where an individual gains less additional utility from consuming a product the more it is consumed
Law of Demand	A law that states that there is an inverse relationship between quantity demanded and the price of a good or service, ceteris paribus
Demand Curve	A graph showing how much of a good will be demanded by consumers at any given price.
Normal Good	One where the quantity demanded increases in response to an increase in consumer incomes
Inferior Good	One where the quantity demanded decreases in response to an increase in consumer incomes
Substitutes	If the demand for one good is likely to rise following a rise in the price of the other good
Complements	If the demand for one good is likely to fall following a rise in the price of the other good

### Factors that Influence Demand

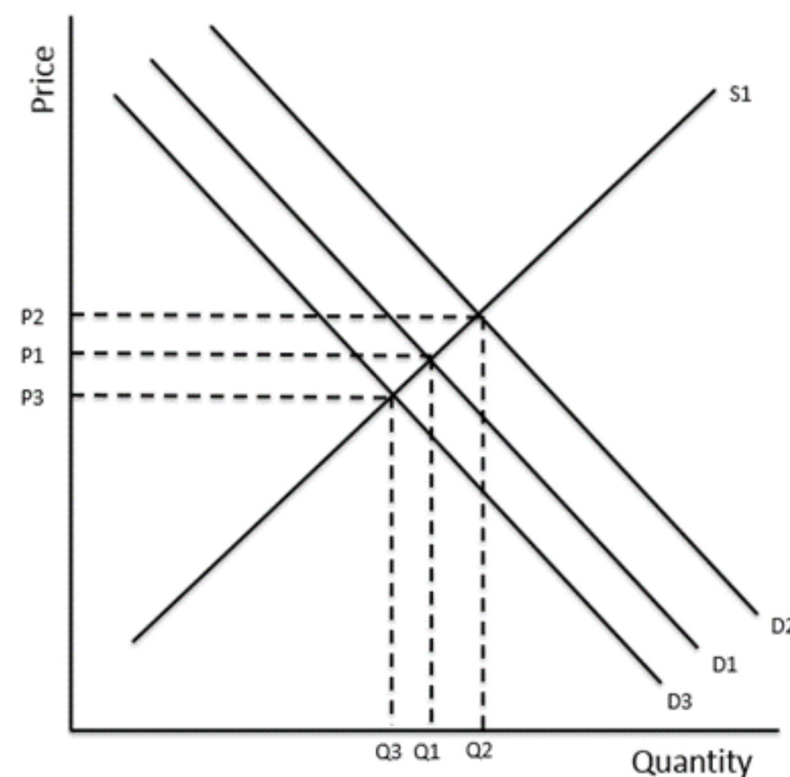
- The price of the product
- Price of other goods
- Income
- Preferences

### Demand Shift or Movement

A change in the price of a product will result in a movement along the demand curve

A change in one of the other factors mentioned above will result in a shift of the demand curve

Snob effect: This causes an upward sloping demand curve because consumers value them more due to the high



### Specification Link

1.2.1 Rational decision making

1.2.2 Demand

### Demand and Consumer Incomes

If incomes increase, there will be a rightward shift in the demand curve for normal goods and vice versa. E.g. clothing or cinema tickets

If income increases, there will be a leftward shift in the demand curve for an inferior good and vice versa. E.g. Tesco value products or bus travel

### Demand and the Price of Other Goods

There will be a rightward shift in the demand curve for good X if there is an increase in the price of good Y and vice versa. E.g. coffee and tea

There will be a leftward shift in the demand curve for good X if there is an increase in the price of good Y and vice versa. E.g. Xbox consoles and games

### Demand, Consumer Preferences and Other Influences

Examples of other factors that may affect the demand for a product:

- Advertising
- PR
- Social/friendship trends
- Fashion
- Addictiveness

In addition, it is important to consider the time aspect as well, some goods are bought but not consumed immediately. Some are bought with the plan to sell off later as an investment (e.g. paintings) therefore resale value is important

Technology is impacted heavily by time as it usually gets cheaper over time due to production costs falling. This means that people can wait for it to be cheaper before buying.

### Special Cases

Perfectly elastic demand means that any change in price will have an infinite change in QD, meaning that the demand curve becomes horizontal

Perfectly inelastic demand means that any change in the price will have no effect on QD, meaning the demand curve becomes vertical

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Elasticity	A measure of the sensitivity of one variable to changes in another variable
Relatively Elastic	A term used when the price elasticity of demand is greater than 1 but less than infinity
Relatively Inelastic	A term used when the price elasticity of demand is less than 1 but greater than 0
Unitary Elastic	A term used when the price elasticity of demand is equal to 1
Price Elasticity of Demand (PED)	A measure of the sensitivity of quantity demanded to a change in the price of a good or service
Total Revenue	The total amount of income a business receives from sales, calculated by multiplying price by quantity of units sold
Income Elasticity of Demand (YED)	A measure of the sensitivity of quantity demanded to a change in consumer income
Cross Price Elasticity of Demand (XED)	A measure of the sensitivity of quantity demanded of a good or service to a change in the price of some other good or service

Price Elasticity of Demand	
	$\frac{\% \text{ Change in Quantity Demanded}}{\% \text{ Change in Price}}$
When prices are higher, the elasticity of demand tends to be more elastic. When prices are lower, the elasticity of demand tends to be more inelastic.	
The PED answer will always be a negative figure	

Income Elasticity of Demand	
	$\frac{\% \text{ Change in Quantity Demanded}}{\% \text{ Change in Consumer Income}}$
<ul style="list-style-type: none"> <li>• If YED is positive and less than 1 = necessity</li> <li>• If YED is positive and over 1 = luxury</li> <li>• If YED is negative = inferior</li> </ul>	

### Specification Link

#### 1.2.3 Price, income and cross elasticities of demand

### Cross Price Elasticity of Demand

$$\frac{\% \text{ Change in Quantity Demanded of Good X}}{\% \text{ Change in Quantity Demanded of Good Y}}$$

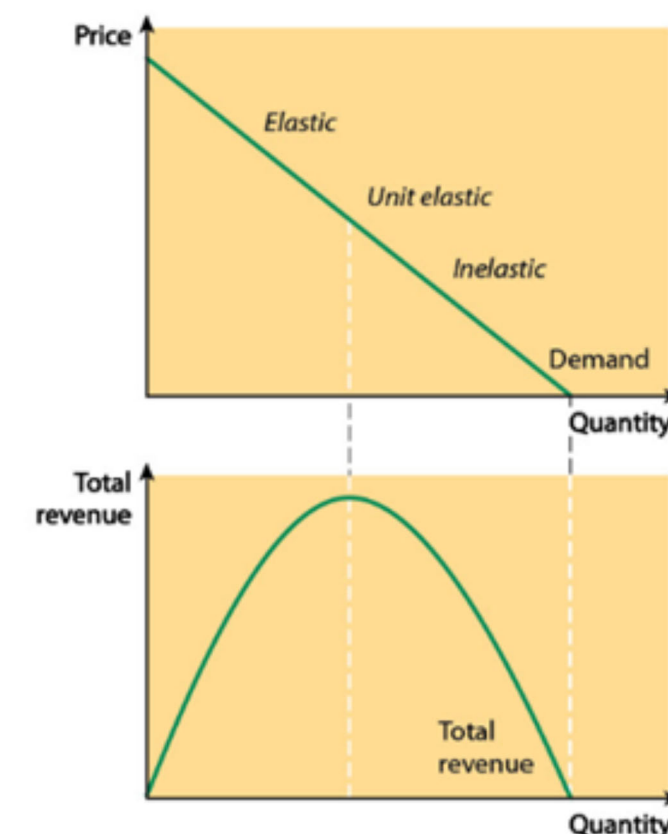
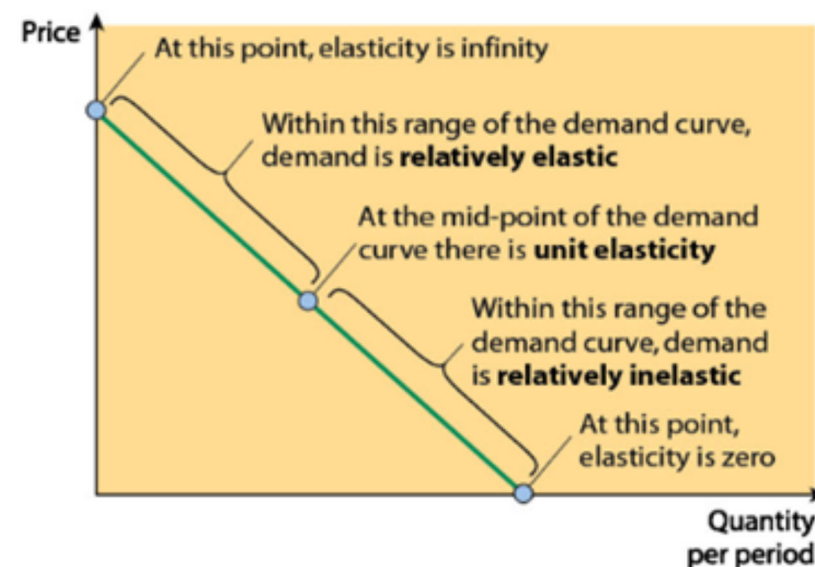
$$\frac{\% \text{ Change in Quantity Demanded of Good X}}{\% \text{ Change in Quantity Demanded of Good Y}}$$

- If the answer is positive this means it is a substitute
- If the answer is negative this means it is a complement
- A high value of XED indicates they are close complements/substitutes
- If the answer is zero, this means that the products are unrelated

### Price Elasticity of Demand and Total Revenue

It is important for businesses to understand what impact a change in price will have on the revenue of the business. There is a clear relationship as shown:

- If a product is inelastic, an increase in price will increase revenue and vice versa
- If a product is elastic, an increase in price will reduce revenue and vice versa



### Factors that May Influence Price Elasticity of Demand

- Availability of substitutes
- Whether it is a necessity or luxury
- Relative share of overall expenditure
- Time period