

SECTION NOTES 2

Covering material from Lecture on January 17th

CLASS OUTLINE

1. Consumer Price Index
2. Supply Curve: What is it and who is it for?
3. Demand Curve: What is it and who is it for?
4. Supply and Demand Together

1 Consumer Price Index

Some quick definitions:

- Nominal Price: Absolute Price of a good, unadjusted for inflation.
- Real Price: Price of a good relative to an aggregate measure of prices; price adjusted for inflation.
- Consumer Price Index: Measure of the aggregate price level.

The CPI is just *one* way in which real prices can be measured. When doing economic analysis does one of these prices have more meaning than the others?

Problem: (P&R, Ch.1, Problem 2)

The following table shows the average retail price of butter and the CPI from 1980 to 2000.

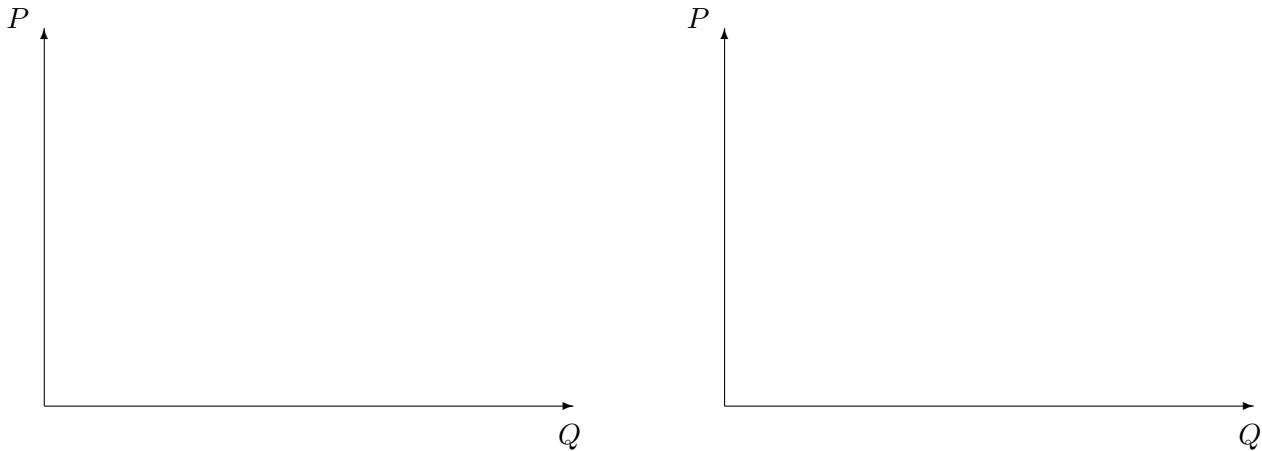
	1980	1990	2000
CPI	100	158.56	208.98
Retail Price of Butter	\$1.88	\$1.99	\$2.52

1. Calculate the real price of butter in 1980 dollars.
2. What is the percentage change in real price from 1980 to 2000?
3. Convert the CPI into 1990 = 100 and determine the real price of butter in 1990 dollars.

2 Supply Curve: What is it and who is it for?

The supply curve is given by: $Q_S = Q_S(P)$, but what goes into making it and which individuals does it represent?

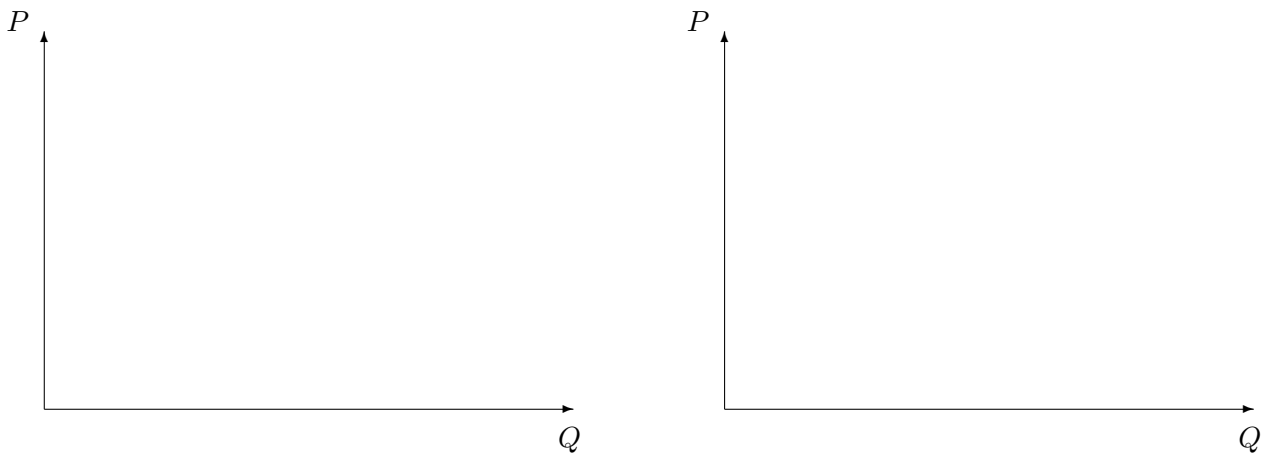
Graphically we have:



3 Demand Curve: What is it and who is it for?

The demand curve is given by: $Q_D = Q_D(P)$, but what goes into making it and which individuals does it represent?

Graphically we have:



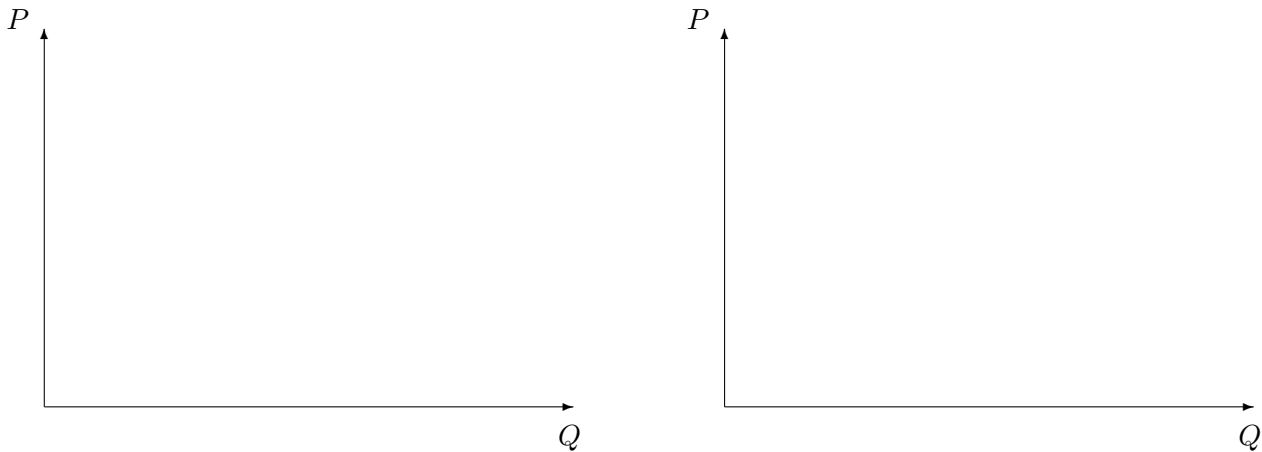
4 Supply and Demand Together

Let's look at an example of supply and demand curves and how they work together. Assume Supply and Demand are given by the following two equations:

$$Q_D(P) = 100 - 2P$$

$$Q_S(P) = -20 + 2P$$

First graph them and find where the market equilibrium is. What can cause a potential disequilibrium? What about factors that affect supply and demand? What if the government intervenes?



Problem: (P&R, Ch.2, Exercise 5)

Much of the demand for U.S. agricultural output has come from other countries. In 1998, the total demand for wheat was $Q = 3244 - 283P$. Of this, total domestic demand was $Q_D = 1700 - 107P$, and domestic supply was $Q_S = 1944 + 207P$. Suppose the export demand for wheat falls by 40%.

1. U.S. farmers are concerned about this drop in export demand. What happens to the free-market price of wheat in the United States? Do farmers have much reason to worry?
2. Now suppose the U.S. government wants to buy enough wheat to raise the price to \$3.50 per bushel. With the drop in export demand, how much wheat would the government have to buy? How much would this cost the government?