Introduction to Economics I
Lecture 6

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The Determinants of Household Demand

1. The price of the good or service.
2. Income of buyers.
3. Prices of related goods or services.

These are either complementary, those purchased along with a particular good or service, or substitutes, those purchased instead of a certain good or service.

4. Tastes or preferences of consumers.
5. Expectations. These are usually about whether the price will go up.
6. The number of buyers in the market is the sixth determinant.

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Demand Equation or Function:

This equation expresses the relationship between demand and its five determinants:

Qd = *f* (price, income, prices of related goods, tastes, expectations, number of buyers)

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1. Price

The law of demand states that when prices rise, the quantity of demand falls. That also means that when prices drop, demand will grow. People base their purchasing decisions on price if all other things are equal.

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2. Income

normal good

When income rises, so will the quantity demanded. When income falls, so will demand.

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2. Income

inferior good

When income rises, so will the quantity demanded. When income falls, so will demand.

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3. Prices of related goods or services

Complementary goods and services

The price of complementary goods or services raises the cost of using the product you demand, so you'll want less. For example, when gas prices rose to $4 a gallon in 2008, the demand for gas-guzzling trucks and SUVs fell.[3] Gas is a complementary good to these vehicles. The cost of driving a truck rose along with gas prices.

The opposite reaction occurs when the price of a substitute rises. When that happens, people will want more of the good or service and less of its substitute. That's why Apple continually innovates with its iPhones and iPods. As soon as a substitute, such as a new Android phone, appears at a lower price, Apple comes out with a better product. Then the Android is no longer a substitute.

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3. Prices of related goods or services

Substitute goods and services

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4. Tastes

When the public's desires, emotions, or preferences change in favor of a product, so does the quantity demanded. Likewise, when tastes go against it, that depresses the amount demanded. Brand advertising tries to increase the desire for consumer goods.

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5. Expectations

When people expect that the value of something will rise, they demand more of it. That explains the housing asset bubble of 2005. Housing prices rose, but people bought more because they expected the price to continue to go up. Prices increased even more until the bubble burst in 2007. New home prices fell 22% from their peak of $262,200 in March 2007 to $204,200 in Oct. 2010. But the quantity demanded didn't grow. Sales fell from a peak of 1.2 million in 2005 to a low of 306,000 in 2011.

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6. Number of buyers in the market

The number of consumers affects overall, or “aggregate,” demand. As more buyers enter the market, demand rises.