The supply and demand of coffee

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In accordance with economic theories and models, this report will analyze various aspects within the coffee market. Demand and supply, preferences, elasticity, alternatives, imports will be brought up in this report. Following these, a conclusion of all areas discussed will be given at the end of this report.

3. 0 Using theories and models to analyze the topic

3. 1 The supply and demand of the coffee

Demand is defined as " the quantity of goods and services that consumers are willing and able to buy at a particular price and time" (Nyunt 2008).

Mario Ritter argued that the main reason of rising coffee prices is people are willing to pay more to buy good coffee. They do not care much about the prices of the coffee because more and more people want a good cup of coffee. This demand of more good coffee leads to a rise of the coffee prices.

Another reason for the more demand of coffee is the increasing pressure from work so more and more people need to refresh themselves with coffee. An important effect of coffee is able to help people freed from tired and to recover their energy (Tom, B. 2011).

The increase of the demand of coffees will be shown by rightward shift of demand curve from D0 to D1 in Figure 1. 1. Hence, new equilibrium of quantity and price will be established that the quantity increases from Q0 to Q1 and price increases from P0 to P1, respectively.

Figure 1. 1

Supply is defined as “ the amount of goods and services that producers are willing and able to sell at a particular price and time” (Nyunt, 2008).

Hector Galvan, a senior trader at RJO Futures said that the high prices are combinations of the poor harvests in the past year and the growing demand for different types of coffee not just as inflation. One of the leading coffee producers, Sette said that Colombia has faced its third “ disappointing” crop. He also argued that poor harvest is one of the biggest factors in driving up prices. (Aaron Smith, 2011)

As indicated, the poor harvests in past years have simultaneously led to a decrease of the coffee supply. The fact is that “ disappointing” crop is one of the biggest factors in driving up prices. Hence, ceteris paribus, the decrease of the coffee supply will lead the price of the coffee go up. The decrease in supply, attributed to the poor harvest, is represented by a leftward shift of the supply curve from S0 to S1 in Figure 1. 2. Hence, new equilibrium quantity and price decrease from Q0 to Q1 and P0 to P1, respectively.

Figure1. 2

Although there is almost fifty percent increase of coffee prices in six months and prices have reached a thirteen-year high, growers expect ten percent bigger of their current crop than the last one will be achieve (Mario, R. 2011). If this expect become true, the supply of coffee is expected to increase, shown by rightward shift of supply curve from S1 to S2 in Figure 1. 3. As increase in quantity supplied from Q1 to Q2, the price of coffee will be expected to fall from P1 to P2 is explained with, ceteris paribus.

Figure 1. 3

Preference

Preferences could be defined as attitude to a set of objects when people is faced by a decision-making process.(Lichtenstein & Slovic, 2006). Alternatively, the term “ preference” is meaning the sense of liking or disliking an object (e. g., Scherer, 2005)

There are many reasons to influence the demand of coffee. Increase of people’s income level, people prefer of coffee and other reasons will lead to increased level of demand and the demand curve will be upward. Between them, preference is an important role to decide the amount of coffee demand. Mark Warmuth, a coffee seller said tastes have been changing and more people want a cup of coffee with good tastes. (Aaron Smith, 2011)

More and people prefer good coffee may be the result in the demand curve upward.

If the supply curve remains unchanged, it will make both prices and demand rise. As drawing from the following diagram, with the demand curve to the right move, the price rise from the P0 to P1, the demand increase from the Q0 to Q1.

Elasticity

According to Nyunt (2008), elasticity is “ a measure of responsiveness of quantity demanded or quantity supplied to one of its determinants”.

Price elasticity of demand (PED) is “ the responsiveness of quantity demanded to a change in price” (Sloman, 2006). Because of coffee is a luxury food product so demand for coffee is price elastics. According to this, the changes in price will lead to big changes in its consumption.

Elastic demand for coffee in the USA is represented by a flat downward-sloping demand curve D0 in Figure 3. 1. It can be observed that there is significant decrease in quantity demanded from Q0 to Q1 as price has increased from P0 to P1, ceteris paribus.

Income elasticity of demand (YED) measures the responsiveness of demand to changes in consumers’ incomes (Sloman 2006, 58). If the income rises, the demand of coffee will increase.

Income elasticity of demand describes the degree of change if income changes under the other conditions unchanged. Coffee is a normal good for majority of countries; hence, YED for coffee is positive in value because when income rises, demand for coffee will also increase. In addition, as a luxury, income elasticity of coffee demand is elastic (YED> 1). As consumer income increases, consumer demand for a commodity increases, but the magnitude of the increased demand of increase is greater than income.

Price elasticity of supply (PES) is " the responsiveness of quantity supplied to a change in price" (Sloman 2006, 57). The harvest of coffee is seasonal and relatively stable in the long term. Time period is a main factor influencing PES so in the short run the supply of coffee can not be changed rightly and soon when the prices become increasing. Then the supply of coffee is inelastic.

In the very short-run, the PES may be perfectly inelastic (PES= 0) because it takes months to grow the coffee bean. After harvested, it is difficult to change the quantity of coffee. From the Figure 3. 2, it can be seen that quantity of rice supplied will remain at QD no matter the change of the coffee price such as from P0 to P1.

3. 4 Imports

The U. S. is a big import county of coffee. Few states produce coffee so the supply of coffee can not meet the consumers' needs. The U. S. must import a lot of coffee to supply the nation's demand. For centuries, this fact has haunted Americans very much (Aaron Smith, 2011).

Before the import of the coffee from other countries, there is a shortage between coffee supply and demand in the U. S. It can be seen form the Figure 4. 1. At P0, as demand shifts from D0 to D1, there is a resultant shortage, shown by the shaded region. In Figure 4. 1, quantity demanded (Q2) exceeds quantity supplied (Q1).

At this time the producer surplus is regions A and B while consumer surplus is region E. After the import of coffee, consumer surplus will increase to regions B, C, D and E while producer surplus will decrease to just region A. As such, total surplus after trade increases from regions A, B and E to include regions C and D gained. Hence, while domestic consumers gain from increased consumer surplus and lower prices, domestic producers of coffee will lose revenue. All these are shown in Figure 4. 2.

4. 0 Conclusion

There are a lot of causes to the rising coffee prices. The changes of demand and supply are the main reason to this situation. Coffee prices will increase people’s consumption expenditure for coffee. Many theories and models of economics can explain many phenomena imagery in the reality, although actual process of an economic phenomenon is not so simple for many reasons. Through the process of using the theories and models to explain a economy phenomenon, many factors lead to the rising prices of coffee will be found.