Income elasticity of demand(YED)

- **Income elasticity of demand(YED)** measures the responsiveness of quantity demand to changes in income.

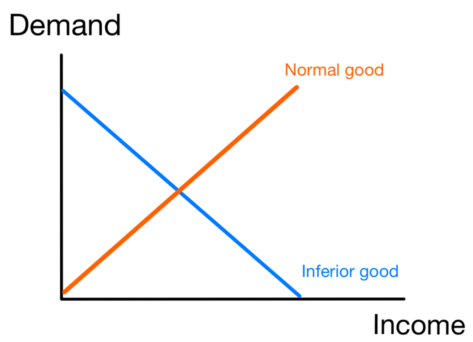
$$\textbf{YED} = \frac{\textbf{\% change in quantity of demand}}{\textbf{\% change in income}}$$

Value of YED	**Types of product**	**Explanation**
YED > 1	Luxury goods	When income rises, demand for luxury goods will increase by the larger proportion)
0 <YED < 1 or YED = 0	Necessity	It is essential for living e.g. food and medicine
YED > 0	Normal goods	Demand for normal goods rises when income rises e.g. cloth, shoes
YED < 0	Interior goods	Demand for inferior goods rises when income falls e.g. instant noodle

Income elastic demand: |YED| > 1

Income inelastic demand: 0 < |YED| < 1

<u>Diagram demand for normal and inferior goods</u>



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How businesses can use knowledge of YED ?

1. Firms can predict sales and adjust production scale.

e.g. During recession, firms selling inferior goods are likely to have higher sales so they should increase scale of production to respond higher demand.

2. During boom economy people are likely to have higher income, firms should switch to sell normal/luxury goods to gain higher sales.

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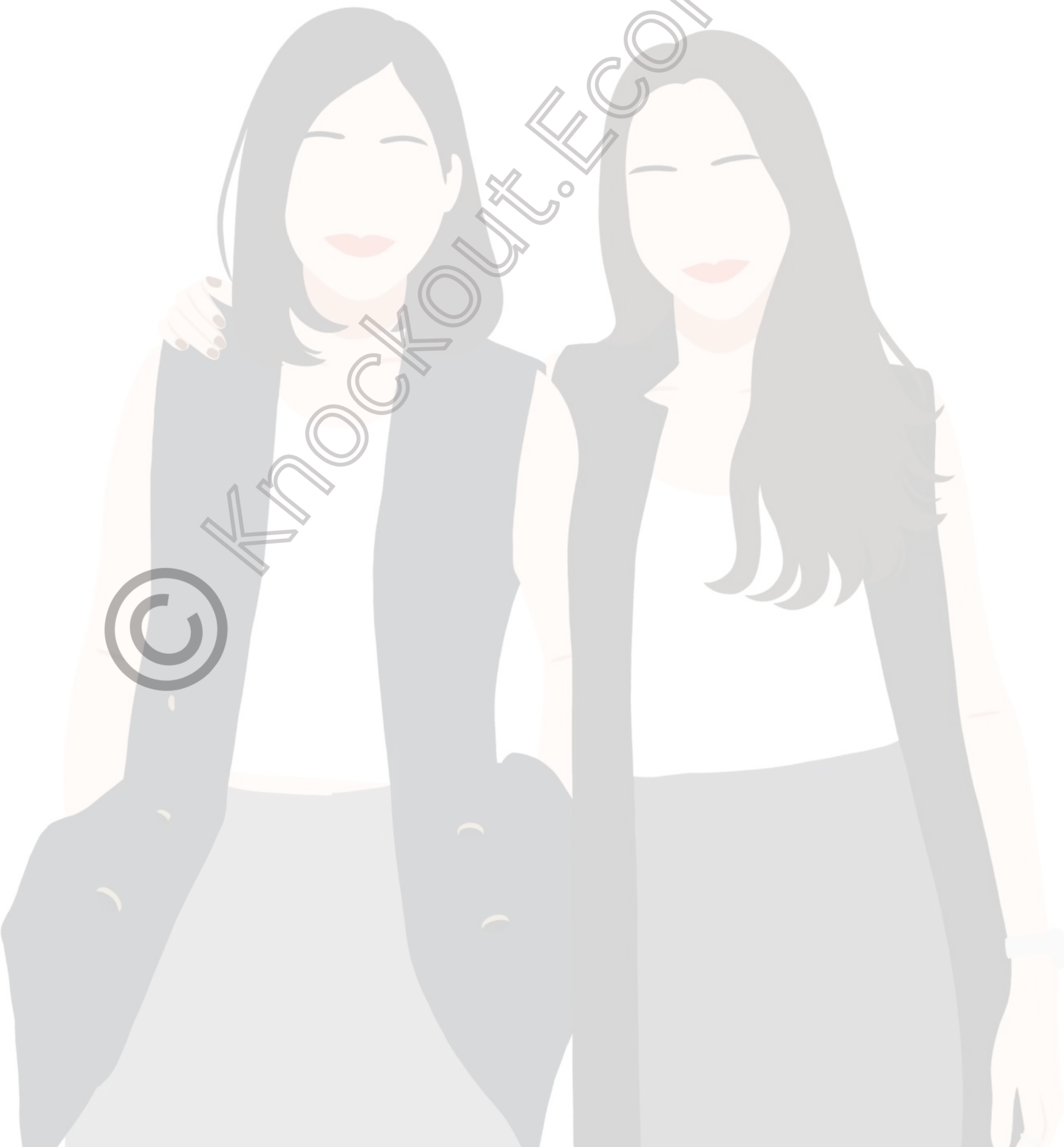

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