Here is a sample writing that you might learn from when composing an essay. (Doesn't mean that it is the best, but I think it is complete and concise.)

1. **Begin with a short-summary of your answer. This paragraph should provide you a clear intuition on what happens. Your main results.**

Loss in the confidence over the Sub-prime mortgage problem will cause investors to rebalance the portfolio allocation from risky assets to safe asset; cash is the safest asset. We are likely to see a rise in market interest as investors rapidly walk away from the financial market. The consequence of an increase in market interest rate is likely to negatively impact the real sector; we expect to see a lower in private spending, and hence the level of overall all economic activities measured by GDP. The ultimate outcome is a rise in the unemployment rate. Price and inflation tends to fall after the problem as well.

1. **Get into details. Link to the theory. Graphs are always helpful, but make sure that you analyses are consistent throughout.**

The impact of Subprime crisis can be predicted (explained) by using the IS-LM/AD-AS framework that we discussed in class. To understand this, we begin with assuming the initial condition as given in figure 1 below. In the figure, equilibrium output is Y0 while equilibrium price is P0; this is shown in the subfigure 1b where we present the AD-AS figure. (The equilibrium point can be indicated by "A0" in the figure.) The equilibrium is consistent with the level of equilibrium interest rate r0, which is shown in the subfigure 1a where the IS0 and LM0 curves are presented. (The equilibrium can be indicated by "E0" in the figure.)

A loss in the confidence in Sub-prime mortgage problem lead to an increase in the demand for money; investors switch to hold a safe asset, rather than holding the risky assets. The impact of such a change can be captured by an exogenous increase in money demand; money or cash is the safest asset. Given the level of initial equilibrium price (p0), LM curve is shifting up from LM0 to LM1 after an exogenous increase in money demand. Without the price adjustment, market interest rate is expected to rise to r1. Output is expected to fall to Y1; this is due to the fall in private spending. Our fixed-price equilibrium predicted by the IS-LM model can be indicated by "A0" in the figure 1a.

The impact of a decline in private spending can alternatively be captured by the backward shift of the AD curve from AD0 to AD1. Unless price can be adjusted, the equilibrium impact of the loss in the confidence in Sub-prime will be indicated by point A1. At that point, equilibrium output is Y1; meanwhile, equilibrium price remains at P0. However, with the slow adjustment in price, the economy will temporarily experience an excess supply

after a drop in aggregate demand; at price p0, demand is less than supply. This leads to a decline in market price, causing a slight increase in quantity demanded which partially attenuates the initial impact of a fall in aggregate demand. The equilibrium output and price are Y2 and P1, respectively; this is referred to the equilibrium with price adjustment, which is indicated by point A2. The reason that we observe the attenuation can be captured by the figure 1a where we notice a right shift of LM curve from LM1 to LM2. The shift in LM occurs because of a falling price; this leads to an increase in the "real" money supply, and hence a slight drop in the market interest from r1 to r2. The price adjustment process allows economy to partially mitigate the impact of adverse situations; the overall decline in output will be slightly less than that would arise if price cannot be adjusted at all. This can be compared by considering the two equilibrium points in figure 1a, i.e. E1 and E2.

2. **Add this to the analysis on labor employment; you probably don't need to get into the same level of detailed discussion as you provided in the previous part. Just think about initial and final outcome, and compare and contrast the similarities and differences. (Don't need to try combination when price is fixed and wage is variable. There's no point of making discussion over this if you already explained the core in the previous paragraph.)**

The impact of a decrease in real economic activities causes a slackness in the labor market outcomes. Since price will be falling in the equilibrium and the economy will experience a contraction, one expects a short-fall in labor demand. Figure 2 below illustrates the impact of market economy that exhibits a downfall of labor employment. In the figure, our initial equilibrium in the labor market is B0 where labor employment equilibrium remains at N0; this is indicated by point B0 in the figure. Following the decline in market price and overall demand for goods, demand for labor inputs will drop as well; this is due to the lower firm's profitability condition, causing a shift in Ld0 to Ld1. As predicted by the theorem, the equilibrium labor employment will fall. However, we note that the extent to which our economy experiences a decline in labor employment depends on the rigidity in the labor. Figure 2 plots two different scenario of aggregate labor supply; variable wage and fixed wage. Under the fixed wage, a decline in labor market will be at its full force (equilibrium point B1) while the decline in labor employment will less severe under the variable wage scheme (equilibrium point B2). The result reiterates the importance of labor market rigidities in shaping the equilibrium outcome in the labor market; the more rigidity, the worse labor market outcomes we experience.

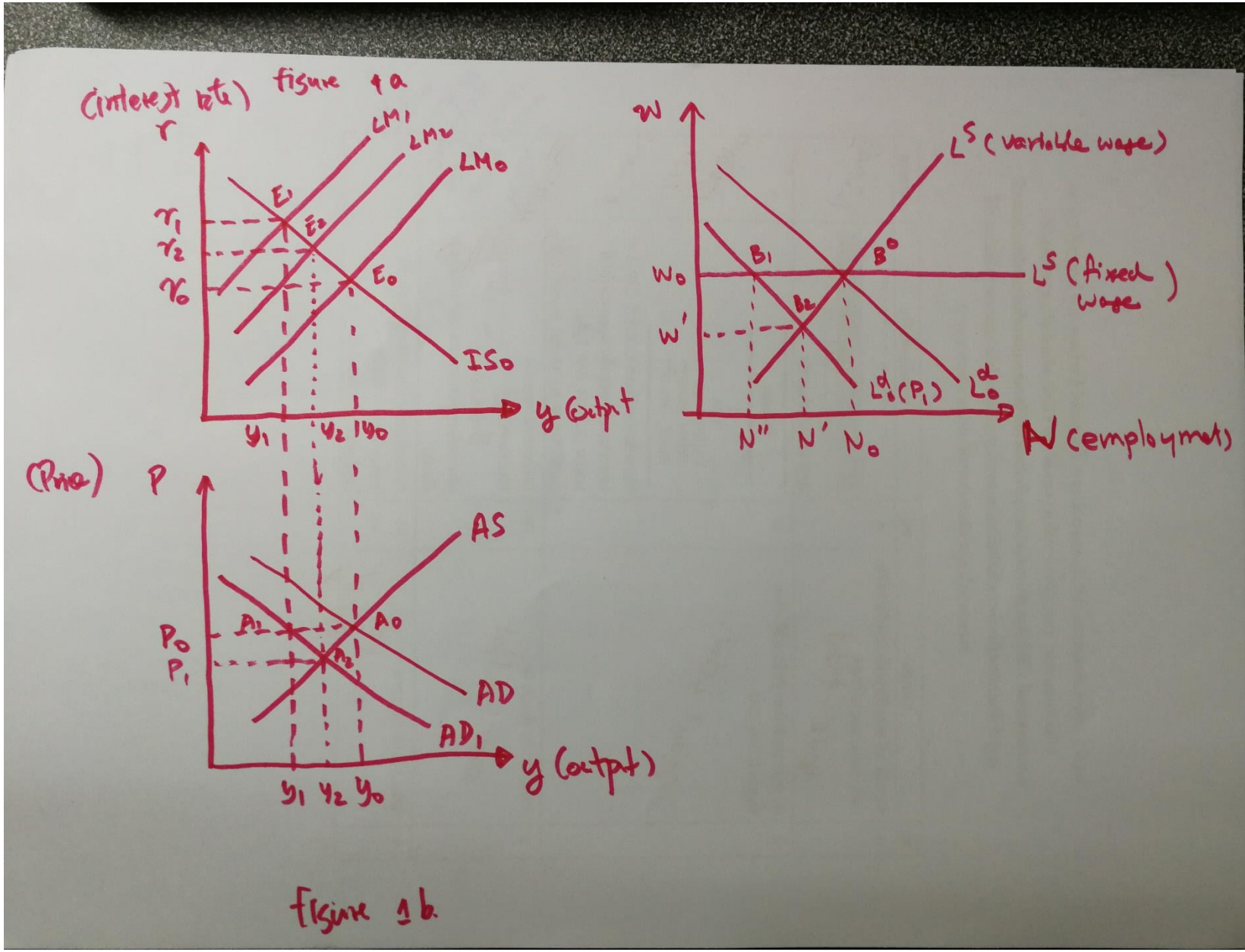
(interest rate) figure 1a
r
LM1
LM2
LM0
E1
E2
E0
r1
r2
r0
IS0
y (output)
y1
y2
y0
W
LS (variable wage)
B1
B0
W0
LS (fixed wage)
B2
W'
Ld1(P1)
Ld0
N''
N'
N0
N (employment)
(Price) P
AS
A1
A0
P0
P1
A2
AD
AD1
y (output)
y1 y2 y0

figure 1b