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BA Economics Honours | Semester III | Calicut University

Financial Literacy and Personal Finance

Course Code: ECO3FV108 • Module 1

Module I: Personal Financial Planning / Financial Literacy

Financial literacy represents the confluence of financial knowledge, skills, attitudes, and behavioral practices essential for making informed economic decisions, achieving financial security, and optimizing wealth accumulation across the human lifecycle. Personal financial planning translates macroeconomic principles into household budget optimization, risk management, and long-term asset development.

Unit 1, 2, 3 & 4: Basics of Financial Planning and Time Horizons

Personal financial planning is a comprehensive evaluation of an individual's current financial standing and future financial objectives:

- **Importance of Financial Planning:** Mitigates financial distress, ensures debt sustainability, facilitates asset creation, safeguards dependents against mortality and morbidity shocks, and secures dignified post-retirement living.
- **Risk vs. Return Dynamics:** In efficient financial markets, higher expected return is inexorably linked to higher risk exposure. Key risks include:
  - **Inflation Risk:** The purchasing power decay of nominal financial returns over time.
  - **Market Risk:** Systemic volatility in asset prices driven by macroeconomic shocks, interest rate shifts, and geopolitical crises.
  - **Exchange Rate Risk:** Value fluctuations in foreign-currency denominated assets or liabilities.
- **Planning for Multiple Horizons:**
  - **Short-Term (0 to 12 months):** Liquidity maintenance, emergency reserve accumulation (3 to 6 months of living expenses), funded via savings accounts, liquid mutual funds, and treasury bills.
  - **Medium-Term (1 to 5 years):** Capital preservation and steady growth for capital expenditure (vehicle purchase, down payment for home), funded via debt funds and fixed deposits.
  - **Long-Term (5+ years):** Aggressive wealth generation for higher education, home acquisition, and retirement corpus, invested in equities, real estate, and pension instruments.

Unit 7, 8, 9 & 10: Time Value of Money and Macroeconomic Concepts

The **Time Value of Money (TVM)** is the foundational axiom of finance: a rupee received today is worth more than a rupee received in the future due to its earning capacity (interest) and the erosion caused by inflation.

Key mathematical and analytical formulations:

- **Compounding Formula:** Future Value (FV) is calculated as:

  $$FV = PV \times (1 + r)^n$$

  where PV is Present Value, r is interest rate per period, and n is number of compounding periods. Albert Einstein famously described compounding as the "eighth wonder of the world."
- **Discounting Formula:** Present Value (PV) is calculated as:

$$PV = \frac{FV}{(1+r)^n}$$

- **Nominal vs. Real Rate of Interest (Fisher Equation):**

$$(1+i) = (1+r)(1+\pi) \implies r \approx i - \pi$$

where i is nominal interest rate, r is real interest rate, and π is the inflation rate. If nominal return is 7% and inflation is 6%, the real economic wealth expansion is merely ~1%.

- **Absolute Income vs. Real Income:** Absolute income denotes nominal currency received; real income measures purchasing power adjusted for the Consumer Price Index (CPI).

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Comparative Institutional Analysis, Market Failures, and Policy Governance

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Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

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However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

Policy Synthesis and Analytical Evaluation

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