Analysis of Investment Risks in Three Economies Represented by the United States, China, and India

Haolun Si[1], Siyun Wang[2]

1. Fordham University, Sydney 2006, Australia

2. The University of Sydney, Sydney 2006, Australia.

Abstract: The continuous deepening of economic integration and globalization has led to the rapid growth of international market expansion, foreign direct investment, and institutional investment. Nowadays, more and more companies are taking the risks of international business to expand their business in order to seek huge business opportunities. Country risk analysis also provides insights into the specific investment risk components of individual countries. Many investors also choose to invest part of their portfolio in foreign securities. However, when investors enter any new market in the international business community, we must face market risks. Several international investors are paying more attention to country risk premiums when they come to assessing companies with activities in emerging markets. This article discusses the risk of investment between developing countries and developed countries represented by the United States, China, and India.

Keywords: United States; China; India; Investment Risks; Emerging Markets

---

1. Measure risk

In order to compare the 3 countries investment, we can use counties risk premium to measure the variables for example:

Economic risk: The country’s macroeconomic development status and trends, including its industrial structure (technology or labor-intensive, industrial structure and balance between industry and agriculture), GDP growth, inflation.

Foreign trade risks: The country’s trade balance and balance of imports and exports. This is crucial. Only enough exports can fully create the foreign exchange needed to repay foreign debts.

Currency Risk: Including the country’s exchange rate policy and monetary policy. Whether to implement floating or fixed exchange rate stability is crucial to a country’s economic development and international financial environment.

Political Risk: Political risk includes the international political environment, regional political environment, and national political environment. It is related to the sovereign behavior of the country where the investment is located and cannot be controlled by the operator, so it has a great impact on international investment and marketing.

Environment Risk: In the last 20 years, there has been a proliferation in investment flows, of which Foreign Direct. Investment is the main contributor. Environmental risks are closely related to a country's economic development, and at the same time, it is a manifestation of a country's comprehensive strength.

2. Analyze Risk

2.1 China

2.1.1 Political Risk

China's political risks are reflected in other countries. Take Chinese companies in Europe and the United States as an example. The management of enterprises in European and American countries mainly relies on laws: the first is for the healthy competition of enterprises, the second is to protect the legitimate rights and interests of labor and consumers, and the third is to protect the overall interests of society. For Chinese companies, some foreign policies are very unfavorable. This kind of policy risk often affects the investment philosophy of domestic and foreign investors, so we can often see very drastic changes in the stock market within a certain year.

2.1.2 Economic risk

China has an excellent economy with a high speed and steady GDP growth in recent years, according to Coface GDP grew 2.3% in 2020, this is due to the Covid-19 pandemic affecting the economic growth. However, the GDP growth will come back to 7.5% in 2021 based on the forecast. China's fast-growing GDP provides investors with a good investment environment. Compared with countries with low GDP growth, the risk of investment in China is lower. China's inflation level is relatively stable and low, staying at around 2%. This has made China's prices stable, labor costs stable, and currency value stable, encouraging foreign investors to invest in China.

2.1.3 Foreign trade risks

With the development and improvement of globalization and worldwide supply chains, China's import and export volume continues to grow. In 2020, China imported approximately 2.06 trillion U.S. dollar's worth of goods, 380,536 million U.S. dollar's worth of services, exported approximately 2.60 trillion U.S. dollar's worth of goods, 278,100 million U.S. dollar's worth of services. The gradual increase in the total volume of imports and exports has provided a guarantee for China's overall economic growth, and at the same time, it has stimulated international investors to increase investment in China.

2.1.4 Currency risk

China has traditionally tried to keep its currency competitive against others to help boost exports; that policy appears to have given way to one weighted toward preventing a destructive level of depreciation of the RMB, reflecting China's growing role as a big player in global capital markets. The Chinese government's diligence at keeping its exchange rate stable, along with its increased popularity have led to the inclusion of the renminbi in the International Monetary Fund's (IMF) 2016 basket of world currencies. China's stable currency is conducive to attracting investors to invest. Currency stability reduces exchange rate risks and reduces investors' concerns about possible losses due to exchange rate fluctuations.

2.2 India

2.2.1 Political risk

India's political risk is low to moderate. The ongoing Kashmir conflict between India and Pakistan poses ongoing military risks, while longstanding border issues with China also recently intensified. Such disputes, if they escalate, could weigh on business confidence and undermine the economic recovery. Foreign investment in India is less likely to flow into the real economy because of India's protectionist and discriminatory industrial policies against foreign investment.

2.2.2 Economic risk

From 2000-2020, Indian GDP growth rate increased. India is relatively friendly to foreign investment in the financial field. Foreign hot money can easily achieve a return of more than 6%, which is still very attractive to the hot money of mature economies in Europe and America. In recent years, a large amount of foreign hot money has poured into India's financial field. It is estimated that the current foreign hot money in India is $1.2 to $1.5 trillion.

The Indian ruble lacks regulation and is subject to interest rates in India due to the country's open market with a large number of global market participants. Therefore, it may lead to high volatility, depreciation or inflation in foreign exchange rates, which may pose a challenge to the country's economy. An export-oriented economy like India prefers to maintain a lower exchange rate to keep its low-cost advantage. If exchange rate controls disappear, India will lose its core competitiveness in the international market.

2.2.3 Inflation risk

After the serious epidemic situation slowly subsided, the rapidly rising prices have become another burden on the lives of the Indian people. The prices of tomatoes, potatoes, radishes, and other vegetables in the local market in India have increased by 1 to 1.5 times. At the same time, due to the rise in the prices of metals such as steel and copper, the prices of pots and pans and even electric lamps used by people have increased by 15%-20%. The rise in prices has forced Indians to "downgrade consumption". From 2000-2013, India's inflation rate increased, but from 2013-2020, India's inflation rate decreased.

2.3 United States

2.3.1 Political Risk

As a world financial giant, the United States also has political risks. The epidemic in the past two years has severely hit the international financial system of the United States, which is very reminiscent of the interest rate cut policy in the history of the United States. The Fed's rate cuts have led to a decline in the exchange rate of the U.S. dollar, which makes the U.S. dollar likely to depreciate. It should be noted that the U.S. dollar is an international reserve currency, which also leads to a decline in purchasing power denominated in U.S. dollars. As far as international trade is concerned, the price of imported goods will rise, and the import capacity will decline. However, lower interest rates have caused capital to flow out of banks, which will attract many domestic and foreign investors, thereby enhancing market liquidity, and objectively speaking, it can stimulate the growth of the U.S. economy.

2.3.2 Currency risk

Because COVID-19 has affected currency markets in recent years, investors have found the U.S. dollar to be a safe haven during periods of market volatility. However, the concern is that the relative strength of the dollar is now quite extreme and could lead to instability in dollar prices and thus trade imbalances. For U.S. companies doing business in other countries, a stronger dollar could weaken the value of their foreign profits when translated into U.S. dollars. As a result, U.S. financial assets may become less attractive to foreign investors.

2.3.3 Economic risk (Exhibit 1)

As a world power, the US economy has been leading the world since the last century. However, in the past two years of economic recession in the United States, the budget balance fell by more than 10% year-on-year. This is a relatively serious problem. From a trend point of view, it will take a long time for the United States to restore the market conditions before the epidemic. The US federal government has solved many problems including unemployment assistance, virus testing, paid sick leave, and corporate loans by issuing US dollars to society. But at the same time, we are facing the problem of inflation in the United States.

3. Overall from the economic perspective:

Measured the 10 years treasury bond yield, GDP, inflation rate, Current account balance, Tax and other factors which might influence the investors' decision.

Country(equity) risk premium=(country 10 years bond yield - Yield on US 10-year Treasury bond) * (Annualized standard deviation for Country A's benchmark equity index /Annualized standard deviation for Country USD-denominated sovereign bond index)

10 years treasury bond yields					
	2000	2005	2010	2015	2020
Indian	10.89%	6.91%	7.59%	7.76%	6.36%
China	2.41%	4.66%	3.66%	3.21%	2.38%
US	5.90%	4.85%	3.83%	1.93%	1.44%

Source:The World Bank

For the three countries, America has the lowest 10 years treasury bond yield and India has the highest. In the YTM formula, The yield is inversely proportional to the bond price, YTM is the discount rate in the denominator, so the higher the yield, the lower the price.

Market interest rates have fallen, discount rates have fallen, and bond prices have risen. So it means that India has the highest return of the stock market but is more risky than other two countries. For international investors, it is better for them to invest in the American market.

3.1 Economic perspective (Exhibit 2):

For investors, the GDP growth rate means, whether an economy is growing or not. Investors can make investment decisions based on the GDP growth rate. In terms of GDP Growth rate in the past 20 years, China is far ahead with an average annual GDP growth rate of 8%. Among the three countries, China has a higher BOP, which means it has more trade surplus, and China's investment capital liquidity is more active than the other two countries. A high rate of inflation represents a rapid erosion of the real value of an investment and a loss of spending or purchasing power over time. Thus affecting the actual value of investors' investment. In terms of long-term investment, Yan is more investment value than the US dollar and rupee. The import and export of goods trade can calculate and predict the economic stability of these three countries in the future. The total export volume of the United States is higher than that of the other two countries, and the United States is about the same as China. But China, the world's export factory known for its low labor costs, accounts for 28.7 percent of total global manufacturing output. We can boldly predict that the U.S. Economic market will continue to develop steadily in the future, and the Chinese economic market is more likely to develop rapidly. India is far from the other two countries.

Among the three countries, China has a higher BOP, which means it has more trade surplus, and China's investment capital liquidity is more active than the other two countries.

China's Government's final consumption is also the highest among the three countries. Chinese government spending will bring higher returns to future goods and services, and an increase in Chinese government spending represents a decrease in tax revenue. Therefore, we can conclude that the profits from the same income in these three countries will be the highest in China.

The inflow and outflow of foreign direct investment visually shows the confidence and return on investment of foreign investors in the investing country. According to UNCTAD's World Investment Report 2021, foreign direct investment inflows to the United States fell by 40%, from $261 billion in 2019 to $156 billion in 2020, mainly due to lower reinvested earnings. And China has become more attractive to foreign investors in the last 20 years.

3.2 Environmental perspective

Electricity is a necessary condition and foundation for a country's modern development. Traditional electricity is generated by coal, which consumes energy and causes environmental pollution, and coal is a non-renewable resource. From the data of the previous

20 years, among the three countries, China's renewable power output accounts for the highest proportion of total output, reaching 24%. India is second, and America is third. On the other hand, in terms of power transmission and distribution losses, according to the data, India is the highest, while China and the United States are relatively low. This means that in terms of electricity, China has the most advantage to attract foreign investors.

Energy is an indispensable factor for companies to carry out production activities. From the perspective of energy imports, both India and China are on a gradual upward trend. India's energy imports account for the largest proportion, reaching 32%, followed by China, 10%, the lowest is the United States, about 25%. From this set of data, we can see that compared to the other two countries, the United States has abundant energy resources and has less energy imports. So it is more conducive to corporate investment.

Methane is an important factor in the global greenhouse effect, and agricultural methane emissions are an important source of methane. Therefore, reducing agricultural methane emissions is an important indicator of a country's environmental friendliness. According to the data, India has the highest agricultural methane emissions at 71%, followed by China at about 36%, and the United States the lowest at about 31%. In terms of agricultural methane emissions, the lowest environmental pollution caused by agricultural production in the United States is most beneficial to attracting investors. China is the second and India is the third.

3.3 Agency perspective (Exhibit 3)

The assessment of country risk by rating agencies is also an important indicator of a country's investment risk. Countries with a high risk rating will increase the investment confidence of foreign investors, and it is estimated that investment will be made. From the point of view of the rating of the measurement agency, the U.S. investment will be more stable, while investing in India is riskier.

Conclusion

The comparative results reported in this paper indicate that the findings lead to conclusions about the importance of risk in developed and developing-country currency markets. The stabilized economic state and lack of potential for growth power imply that the widespread claims of investment of the developed countries are premature at best.The connection between economic variable change, policy developments, and the environment suggests that imperfect developing countries.

India's investment risks are relatively high and the returns are relatively high. China has fewer investment risks and lower returns. The investment risk in the United States is minimal and the return is average. Generally, we still believe that the United States is more suitable for investment.

References

[1] Seth. (2022, January 04). Top 10 manufacturing countries in the world. from https:// globalupside. com/top-10-manufacturing-countries-in-the-world/.

[2] UNCTAD WORLD INVESTMENT REPORT 2021. (n.d.). from https://unctad.org/ system/files/ official- document/ wir2021_en.pdf.

Exhibit 1:

Foreign Trade Value(*(million USD)*	2016	2017	2018	2019	2020
Imports of Goods	2,186,785	2,339,592	2,536,145	2,493,737	2,335,991
Exports of Goods	1,451,459	1,547,196	1,665,786	1,642,820	1,424,934
Imports of Services	501,800	533,900	264,900	258,500	256.6
Exports of Services	749,600	777,900	205,100	209,600	190,000

Source: Census.gov,Bureau of Economic Analysis

Exhibit 2:

GDP growth (annual%)	USA	China	India
2000	4.13	8.49	3.84
2005	3.51	11.39	7.92
2010	2.56	10.64	8.50
2015	3.08	7.04	8.00
2020	-3.49	2.30	-7.96

Foreign direct investment, net inflows (BoP, current US$ in million)	USA	China	India
2000	349125	420953	3584
2005	142344	104109	7269
2010	264039	243703	27396
2015	511434	242489	44009
2020			

Energy imports, net (% of energy use)	USA	China	India
2000	26.66	0.55	20.45
2005	29.66	6.06	22.05
2010	22.21	11.45	28.35
2015	7.31		
2020			

Inflation, consumer prices (annual %)	USA	China	India
2000	3.38	0.35	4.01
2005	3.39	1.78	4.25
2010	1.64	3.18	11.99
2015	0.12	1.44	4.91
2020	1.23	2.42	6.62

Final consumption expenditure (annual % growth)	USA	China	India
2000	4.41	12.18	3.11
2005	3.04	12.11	7.65
2010	1.53	9.73	6.47
2015	2.98	9.18	7.86
2020	-2.79	-0.91	-7.11

Renewable electricity output (% of total electricity output)	USA	China	India
2000	8.21	16.64	13.59
2005	8.58	16.18	16.62
2010	10.12	18.62	16.04
2015	13.23	23.93	15.34

Real interest rate (%)	USA	China	India
2000	6.84	3.71	8.34
2005	2.98	1.61	4.86
2010	2.06	-1.00	-1.98
2015	2.29	4.35	7.56
2020	2.30	3.65	4.38

Tax revenue (% of GDP)	USA	China	India
2000	12.97		8.81
2005	10.68	8.57	10.08
2010	8.60	10.21	10.39
2015	11.21	9.38	10.57
2020	9.97		

Renewable energy consumption (% of total consumption)	USA	China	India
2000	5.43	29.60	51.55
2005	5.84	17.44	48.53
2010	7.44	12.26	41.11
2015	9.03	12.25	34.40

Gross domestic savings (% of GDP)	USA	China	India
2000	19.97	36.43	24.31
2005	17.69	45.62	32.26
2010	14.81	51.09	34.27
2015	18.45	46.01	30.56
2020	18.20		28.35

Exports of goods and services (% of GDP)	USA	China	India
2000	10.69	20.89	13.00
2005	9.98	33.83	19.61
2010	12.39	27.19	22.40
2015	12.44	21.35	19.81
2020	10.14	18.50	18.08

Imports of goods and services (% of GDP)	USA	China	India
2000	14.41	18.52	13.90
2005	15.66	28.38	22.40
2010	15.94	23.53	26.85
2015	15.32	18.11	22.11
2020	13.25	16.01	18.39

Source: The Word Bank

Exhibit 3:

Country	Moody's	Fitch	Scope
China	A	A+	A+
America	Aaa	AAA	AAA
India	Baa	BBB	BBB-

Source: from https://tradingeconomics.com/china/rating