

Estimating the quality risk premium: the case of greater China

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Abstrak

ABSTRAK

The expected equity risk premium is a key input in various financial applications. Different methods exist for estimating the risk premium. This paper applies two approaches to estimate it in the markets of Greater China. More specifically, the historical average and relative estimation are carefully examined. The first approach is applied to estimate the equity risk premium when the markets are recovering from a trough. Then the relative estimation approach is applied to justify those findings, taking into consideration the lower rate of return required of Chinese investors due to a lack of investment opportunities. After these adjustments, the risk premium in Mainland China is found to be close to those in Hong Kong and Taiwan. All of these markets have a higher risk premium than in the US market. The risk premiums for the Shanghai and Shenzhen markets are about 8% and 10%, respectively. The risk premiums for the Hong Kong and Taiwan markets are 8% and 9% compared to a long-term forward-looking risk premium of about 4% for the US market.