

[For Immediate Release]

Xinhua Finance/MNI China Business Survey: Conditions Plunge

Shanghai, September 26, 2006 – Xinhua Finance (TSE Mothers: 9399) and Market News International (MNI), a part of the news service line of Xinhua Finance, today announced the third-quarter Xinhua Finance/MNI China business sentiment survey. The results of the survey suggest that government efforts to slow investment and credit growth have resulted in a sharp slowdown for listed Chinese companies. But the survey also indicates that companies expect the current conditions are only temporary, with indexes showing future expectations recovering from their plunge in the second-quarter survey.

The survey was carried out September 11-22 with 154 listed companies responding. A result greater than 50 implies growth or improving conditions. (See accompanying story for more on the survey methodology.

The full survey results can be found at

<http://www.xinhuafinance.com/en/main/chinabizsurvey.html>

Chinese companies still report rising production, new orders, overall business conditions and most of the other factors measured by the survey. But the pace of growth has fallen sharply, in the case of production and overall business conditions to the lowest index levels recorded in the survey, which began in the first quarter of 2005.

Prompting the deterioration in current overall conditions and production was a slower pace in new orders and a drop in order backlogs, which showed a declining backlog for the first time since the fourth quarter last year. The index for employment showed more companies than ever before in the life of the survey complaining that they had too many workers.

The government responded to scorching first-quarter Chinese growth with a range of measures designed to slow investment and credit growth.

The second-quarter Xinhua/MNI survey, which was completed around the time the measures were being introduced, showed companies were bracing for a major slowdown as sentiment levels plummeted.

Those expectations appear to have borne out, with the index for overall business conditions falling to 66.99 in the third-quarter survey from 72.22 in the second quarter and the index for production down to 65.85 from 71.69 in the second quarter. The results for both overall conditions and production were the lowest ever in the survey, although still well in positive territory, and were down from 67.74 and 71.55 respectively in the same quarter a year ago.

Also hitting the lowest level yet in the survey history was the index for employment, which indicates whether companies feel they have too many or not enough employees. The third-quarter result was 43.42 while the previous survey showed a result of 49.32 and the result a year ago was 47.20. A result under 50 shows more companies reporting they have too many employees.

"The large increase in businesses that feel they have too many employees relative to the previous quarter suggests that cost pressures are significant at the present time," said Logan Wright, Beijing analyst for Stone and McCarthy Research Associates, a sister company of MNI. "At the same time, these firms believe these pressures will relent by the end of the year," he added.

Indeed, while the results for current conditions were down virtually across the board in the third-quarter survey, the indexes showing expectations for conditions in three-month's time recovered from the levels seen in the second quarter. The index for employment expectations, for example, rose to 52.63, with the balance of companies saying they expect to have too few employees by the end of the year.

The indexes for overall business conditions showed the survey's biggest gap ever between current conditions and future expectations. While the index for current business conditions fell to 66.99, the index for expectations in three month's time was almost a full 10 points higher at 76.80, up from 74.65 in the previous survey. The future expectations index has only been higher once, in the first quarter of this year before the government introduced measures to slow the economy, and was at 72.98 in the same quarter last year.

"The results reflect optimism among businesses that the government's macroeconomic control measures are likely a short-term phenomenon, or will not impact their operations significantly, as expectations for the next quarter are higher in virtually every category," noted Wright.

Another possible indication that companies expect the slowdown to be temporary was the indexes for production capacity, which showed companies barely altered their production capability despite the slowdown in actual production they reported. While the index for production capacity in the third quarter was, at 64.63, the lowest ever recorded in the survey, it was down just a point from 65.63 in the second quarter and from 66.53 a year ago.

The index for production capacity in three months rose to 71.43 from 70.83 in the previous survey but was down slightly from 72.58 in the same quarter last year.

After first-quarter data showed the economy was expanding faster than deemed healthy, the government responded by raising interest rates, hiking the reserve requirement for banks and by using "window guidance" and other administrative measures to slow credit growth. It also used targeted money market operations to penalize banks it thought were lending more than they should and attempted to clamp down on local governments it thought were not responding to its orders to slow the pace of investment.

At the company level, the effect has been more expensive credit and increasing scarcity in the amount of credit available. The index for interest rates paid rose to 66.67 in the survey from 64.29 in the last survey and 53.07 in the survey in the same quarter last year. A result greater than 50 shows a balance of companies reporting they were paying higher interest rates.

The index for expectations of interest rates in three months suggests companies expect the cost of credit will continue to rise at around the same pace, at 62.41 in the current survey from 62.78 in the previous one.

But in China, many companies have been funding their operations with retained earnings rather than loans, a factor that has made it harder for the government to use monetary measures to slow growth.

Out of 154 companies surveyed, almost 10% said they did not use or need loans for their operations. A further indication of the difficulty of using monetary policy to control growth in certain areas of the economy can be seen in the comments companies were invited to provide.



Coal production is one of the areas the government has been trying to slow but from the comments of one coal company taking part in the survey, monetary controls are unlikely to have much of an effect: "We do not need loans," said the coal company official who took part in the survey. His comment was echoed by an official of a steel producer, another sector the government feels has overheated, and other officials in heavy manufacturing.

Meanwhile, an official from a company involved in tourism and the domestic service industry, an area where the government is trying to promote growth, complained, "We are trying to get more loans and the lending rate depends on the government's national policy adjustments."

The Xinhua Finance/MNI China Business Sentiment Survey will become a monthly survey at the end of October after successfully charting the fortunes of China's business community on a quarterly basis since January 2005. The survey will be released on the last Friday of every month starting in October.

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Xinhua Finance/MNI China Business Survey Methodology

The Xinhua Finance/MNI China Business Sentiment Survey was conducted September 11-22 with 154 companies taking part.

Survey questions were modeled on Japan's Tankan survey and the U.S. Institute for Supply Management's Report on Business.

Results were compiled for both current conditions compared with a month ago and for expectations of conditions three months ahead.

Indexes were compiled using the Institute for Supply Management's example: adding half of the percentage saying conditions were unchanged to the percentage of those saying conditions had improved generated the index. Therefore, a result higher than 50 indicates a net positive response.



Companies agreed to participate in the survey, and to provide comments about business conditions, under the assurance that individual survey responses would not be divulged except as part of the overall results.

Companies surveyed were all listed on domestic stock markets or in Hong Kong, although some also have foreign listings. The companies chosen were a mix of manufacturers and non-manufacturers with about 75% of the companies responding to the survey in manufacturing.

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Notes to Editors:

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About Market News International

Market News International (MNI), a Xinhua Finance company (www.xinhuafinance.com), is a financial news and information company dedicated to the global fixed income and foreign exchange markets. MNI joined the Xinhua Finance family in March 2004, bringing its niche expertise and extensive distribution network. Headquartered in New York, MNI has news bureaus and offices throughout the US, Europe and Asia.

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