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Trivium China

## Markets Note

# November tech and trade war roundup

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Welcome to another edition of Trivium's US-China tech and trade war roundup. In these monthly reports, we break down key geopolitical developments shaping the economic relationship between Beijing and Washington.

### Here's where things stand as of early-December.

The big news from November was the Xi-Biden summit that took place in San Francisco last month.

We cover the details of the meeting and its outcomes below, but suffice to say, the meeting was the culmination of a months-long effort to put a floor under the bilateral relationship.

- In our view, the tete-a-tete turned out as good as could be expected.
- In fact, we'd say it even exceeded expectations – low though they were – in terms of imbuing some constructive energy into US-China ties.
- This builds on the positivity that we've highlighted over the past couple of months.

Of course, as we've also regularly pointed out, the structural challenges in the relationship have not changed – and so the room for improvement is decidedly limited.

Still, our broad reading from both markets and the corporate sector is that China-related geopolitical risk has been firmly, albeit modestly, notched down for now.

- That's barring some unforeseen development – which these days come fast and often.

Speaking of which, as we look ahead, the obvious next risk node is the Taiwanese presidential election, looming in mid-January.

- It's important to note that this election is very much a live race – despite media headlines claiming it's the ruling party's (DDP) race to lose.
- Despite the implosion of the joint KMT-TPP ticket, Beijing's preferred candidate (from the KMT) is now polling just a few percentage points behind the DPP.
- And there's plenty of time for the dynamics to shift over the next six weeks.

**The key question:** Will Beijing be able to hold itself back from aggressive and overt intervention in the Taiwanese election?

- For now, it appears that Beijing's approach will be to offer economic inducements to KMT constituencies – in order to convince the Taiwanese population that a KMT victory will materially improve cross-strait ties.
- But if the mainland tacks back to aggressively attacking the DPP – or markedly increasing information warfare to influence the election – such tactics could spark a backlash.

Any heavy handed intervention from the mainland would draw ire from both Taiwan and the US – and geopolitical tensions could once again surge.

Despite the geopolitical tripwires still in place, US-China relations look to be seeing a fragile-but-marked improvement.

We cover all the key developments from the last month below – and we'll continue to do so going forward.

## The mood in DC

### The positive

1. On November 15, **Xi Jinping met with US President Joe Biden** on the sidelines of the APEC Summit in San Francisco.

It went about as well as could be expected.

- The summit took place over four hours and featured a lunch and private walk between the two leaders, giving Xi and Biden ample time and space to get down to brass tacks.

The meeting produced key deliverables, namely pledges to:

- Restart military-to-military dialogue
- Cooperate on combating fentanyl trafficking and establish a counternarcotics working group
- Hold bilateral talks on managing the use of AI (though this fell short of reports that they would agree to ban the use of AI in autonomous weapon)

In addition, the two agreed to:

- Increase flights between the US and China
- Expand people-to-people exchanges in education, business, and cultural spheres

It wasn't all well-wishes and working groups, though:

- Xi reportedly took Biden to task over weapons sales to Taiwan and American economic suppression of China.
- Meanwhile, Biden griped about China's human rights record, non-market economic practices, and support for Russia.

**Our take:** For the first time in a long time, we're feeling optimistic.

- By highlighting areas for cooperation and doubling down on communication, Xi and Biden are defining the acceptable limits of US-China competition.

**But, but, but:** One good meeting does not equal a reset in relations.

- We'll be tracking how much the dialogue mechanisms accomplish and whether the US dials down its economic pressure tactics, to determine whether relations are really on the up.<sup>1 2 3 4</sup>

1 White House: Readout of President Joe Biden's Meeting with President Xi Jinping of the People's Republic of China

2 Gov.cn: 习近平同美国总统拜登举行中美元首会晤

3 AP: Takeaways from Biden's long-awaited meeting with Xi

4 Reuters: Biden, Xi's 'blunt' talks yield deals on military, fentanyl

2. On November 16, the day after the Xi-Biden meeting, the US removed the Ministry of Public Security's Institute of Forensic Science (IFS) from the Entity List (EL).

The IFS – which oversees forensic work for major crimes in China – was added to the EL in May 2020 over alleged abuses against Uyghurs, effectively banning it from importing from US suppliers.

It's extremely rare for the US to remove Chinese entities from the EL, and the IFS removal looks like a special case:

- The IFS's national drug lab is instrumental in China's anti-drug work.
- During the Xi-Biden meeting, both sides agreed to cooperate on combating fentanyl trafficking and establish a counternarcotics working group.

Indeed, on the very day IFS was struck from the EL, US Commerce Secretary Gina Raimondo reaffirmed the US stance on export controls, calling them "not negotiable."

**The bottom line:** Tensions over US export restrictions on high-tech goods will be an enduring feature of US-China relations.<sup>5</sup>

3. **A large delegation of American agribusinesses**, organized by the US Department of Agriculture (USDA), **attended the China International Import Expo (CIIE)** in early November.

- It's the first time in CIIE history that a US federal agency has officially participated.

The delegation represents a wide range of agribusinesses, including:

- Industry associations representing grain, soybean, meat, and nut producers, and more
- Well-known agri-food brands like Fortune 500 meat packer Hormel and iconic salt company Morton

**That's not all:** 20 US state governors have tagged along to promote their states' products.

- That's a big deal given the spate of anti-China restrictions introduced by state governments in recent years.

**Our take:** China stocking up on American agricultural exports is one of the few places Beijing and Washington usually see eye to eye.

- As both sides try to stabilize the bilateral relationship, agricultural commodities trade will soar.<sup>6 7 8 9</sup>

5 Reuters: Biden removes sanctions from Chinese institute in push for fentanyl help

6 China Daily: US delegation to CIIE shows agricultural trade is a ballast

7 Reuters: U.S. farm leaders, visiting China, talk up agriculture trade

8 Global Times: Largest US business delegation flocks to CIIE, eyes closer cooperation with China

9 CGTN: Why does the CIIE do better and better?

4. On November 16, **Minister of Commerce (MofCom) Wang Wentao met with his US counterpart Gina Raimondo** on the sidelines of the APEC summit.

- The last time the pair met, back in August, they agreed to establish a commercial issues working group and an export control enforcement information mechanism.

This time around, they agreed on even more dialogue, including:

- Discussions regarding the protection of commercial and trade secrets in January 2024
- Vice-ministerial level talks at the next commercial issues working group in Q1 2024

**But, but, but:** The two sides talked past each other (again) on fundamental trade issues.

- Wang raised concerns about US export controls and sanctions on Chinese companies.
- Raimondo hit back saying US export controls are “not negotiable.”

**Our take:** Increased dialogue will help prevent trade tensions – which are mainly focused on high-tech goods – from impacting the broader trade relationship.

- But the US’s flat-out refusal to negotiate on export controls – a priority for China – leaves little hope for total economic reconciliation.

**The bottom line:** More dialogue won’t resolve China-US trade tensions, but it can prevent them from spiraling out of control.<sup>10 11</sup>

## The negative

5. On November 14, the **Federal Retirement Thrift Investment Board (FRTIB)** – the main US federal government pension (and the largest pension fund in the US) – revealed that it **will exclude investments in Hong Kong** from its USD 68 billion international fund.

- The fund already excludes investments in mainland China.

**Some context:** Numerous pension funds, including in Japan, Canada, and the US, have scaled back China investments in recent years.

The FRTIB quoted investment consultancy Aon – who the Board consulted on the decision – as advising:

*“If the current investment restrictions on China are the beginning of further restrictions spanning China and Hong Kong investments, this level of uncertainty can outweigh the benefits of expanding the I Fund to include China and retaining exposure to Hong Kong.”*

**Our take:** While foreign investment in mainland markets is relatively small, the figure is much higher in Hong Kong.

<sup>10</sup> US Commerce Department: Readout of Secretary Raimondo’s Meeting with Minister of Commerce of China Wang Wentao

<sup>11</sup> MofCom: 王文涛部长与美国商务部长雷蒙多举行会谈

- If more large institutional investors sour on Hong Kong, the impact to the HKEX – and to Hong Kong’s role as a global financial center – will be significant.<sup>12 13</sup>

6. On November 2, **a bipartisan group of representatives introduced the Hong Kong Sanctions Act.**

- The Senate concurrently introduced companion legislation.

The bill would require the President to determine whether to impose sanctions on a list of 49 Hong Kong law enforcement officials, from judges to prosecutors, in connection to enforcement of the National Security Law (NSL).

**Some context:** In 2020, the Trump administration sanctioned dozens of Hong Kong and mainland officials – including Hong Kong Chief Executive Carrie Lam and numerous high-ranking officials in China’s legislature – after the passage of the NSL.

**Our take:** In the wake of the NSL, the US is increasingly treating Hong Kong as an agent of the mainland, and American officials no longer feel the need to tread lightly vis-à-vis enacting legislation against the city.

**Our other take:** This is a bipartisan bill that has precedent behind it – we give it a high chance to pass.

- If sanctions are ultimately imposed, they will be more symbolic than anything, though they will cause substantial inconvenience to the sanctioned officials.<sup>14</sup>

7. On November 2, the **US Treasury’s Office of Foreign Assets Control (OFAC) announced sanctions on over 200 entities – including three Chinese companies** – for *“providing Russia with much-needed technology and equipment.”*

- Specifically, the Chinese companies were added for transgressions including shipping radar components to a sanctioned Russian missile manufacturer and sending electro-optical and telecommunications equipment to a sanctioned Russian laser maker.<sup>15 16</sup>

## The mood in Beijing

### The positive

1. On November 3, the Ministry of Commerce (MofCom) announced that Minister Wang Wentao had met with Micron CEO Sanjay Mehrotra on November 1.

12 Bloomberg: US Federal Pension Fund to Exclude Hong Kong Investments

13 FEDERAL RETIREMENT THRIFT INVESTMENT BOARD: FEDERAL RETIREMENT THRIFT INVESTMENT BOARD APPROVES A NEW BENCHMARK INDEX FOR I FUND

14 Young Kim: Rep. Young Kim, Colleagues Lead Hong Kong Sanctions Act

15 U.S. Department of the Treasury: Treasury Hardens Sanctions With 130 New Russian Evasion and Military-Industrial Targets

16 FT: US targets China, Turkey and UAE in latest Russia sanctions

According to the meeting readout, Wang indicated **that Micron's regulatory troubles may soon be a thing of the past:**

*"We welcome Micron Technology to continue to take root in the Chinese market and achieve better development while complying with Chinese laws and regulations."*

Mehrotra responded that Micron would continue to expand investments in China.

**Some background:** Micron recently landed in hot water with Chinese authorities after accusations surfaced that the company had lobbied the US government to blacklist some of its strategic competitors.

- In retaliation, Chinese cyber regulators (CAC) launched a cybersecurity probe into Micron, hamstringing the company's sales and operations.

**More background:** Micron has since tried to repair the relationship:

- In June, Micron announced it would invest RMB 4.3 billion in its Xi'an chip packaging plant.
- In October, it also agreed to participate in the China International Import Expo.

**Our take:** It's looking increasingly likely that the CAC's cybersecurity probe into Micron will be wrapped up within the next few months.

- The question now is whether or not the CAC will issue Micron a fine, and how big that fine will be.
- The other question is what additional requirements the CAC will place on Micron, if any.<sup>17</sup>

2. On November 21, **China's antitrust regulator (SAMR) announced it had approved Broadcom's USD 69 billion acquisition of cloud software company VMware.**

**Some context:** SAMR's pending decision held things up for months – leading to speculation the agency might torpedo the deal in retaliation for US efforts to limit China's access to advanced technology.

- The acquisition was supposed to close by October 31, but that deadline was extended to November 26 due to SAMR's silence.

SAMR ultimately approved the acquisition on the condition that Broadcom won't impose unfair terms – such as forced bundled sales – on Chinese customers.

- That's fairly standard in such deals.

**Our take:** Beijing wants to keep the good vibes going following the positive Xi-Biden meeting at the APEC meeting in San Francisco.

- That reduces the likelihood of Chinese retaliation against US companies – for now.<sup>18</sup>

17 MofCom: 王文涛部长会见美光科技公司总裁兼首席执行官桑杰·梅赫罗特拉

18 SAMR: 市场监管总局关于附加限制性条件批准博通公司收购威睿公司股权案反垄断审查决定的公告

## The negative

3. In a readout from a November 3 meeting chaired by Premier Li Qiang, **the State Council wrote that:**

***“Rare earths are strategic mineral resources.”***

***“It is necessary to coordinate the exploration, development, utilization, and standardized management of rare earth resources.”***

The meeting also called for industry and academia to develop high-tech, eco-friendly mining and smelting processes, and new ways to produce and use rare earth-based materials.

**Why it matters:** Beijing has already instituted two rounds of critical mineral export controls, in response to restrictions on the export of semiconductors and chipmaking equipment instituted by the US and its allies.

- In July, the Ministry of Commerce (MofCom) placed export controls on gallium and germanium.
- In October, MofCom followed up with export controls on graphite.

**Our take:** We’re hearing rare earths increasingly referred to as “strategic” resources that require stricter management.

- That hints at a broader impending export control effort by Beijing.

**Our other take:** We often hear the argument that any attempt by Beijing to weaponize rare earths would be illogical, because it would accelerate efforts to write China out of the critical mineral supply chain.

- But Western countries are already moving to reduce dependence on Chinese minerals. Beijing may want to leverage its advantage now, while it still has one.<sup>19</sup>

4. On November 16, **Alibaba announced that it would not spin off its cloud services unit.**

- The company also said it would suspend the IPO of its grocery unit, Freshippo.

**Some context:** Earlier this year, Ali split its business into six separate units – the assumption was that many of those businesses (including Alibaba Cloud) would later go public.

In a statement, the firm cited US chip controls as a reason for the change of heart.

***“The recent expansion of U.S. restrictions on export of advanced computing chips has created uncertainties for the prospects of Cloud Intelligence Group.”***

***“Accordingly, we have decided to not proceed with a full spin-off, and instead we will focus on developing a sustainable growth model for Cloud Intelligence Group under the fluid circumstances.”***

<sup>19</sup> State Council: 李强主持召开国务院常务会议 研究推动稀土产业高质量发展有关工作等



**More context:** Alibaba Cloud is central to Alibaba's ambitious AI development plans.

**Our take:** Tech restrictions may be part of the story, but they aren't the only issue holding back the spinoff, as evidenced by the Freshippo IPO suspension.

- Weak market sentiment is likely another factor that caused Ali to pause the spinoff.<sup>20</sup>

**Stay tuned for next month's update – there's sure to be plenty on the boil.**

## Why the tech and trade roundup? And why now?

Geopolitics is increasingly at the center of China's economic story. Given the US is actively taking steps to reshape its relationship – and that of its allies – with China, it's become necessary for multinational companies and investors to keep track of the expanding list of China-focused economic restrictions and Beijing's evolving approach to dealing with them.

Thus, we've recently kicked off the Trivium China Tech and Trade War Roundup! Each month, we'll bring you a recap of key developments in China-related cross-border trade and investment restrictions and assess where things are headed.

We hope you enjoy it – and feel free to send through comments and suggestions for improvement any time.

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<sup>20</sup> Bloomberg: Alibaba Tumbles After Nixing Cloud Spinoff on US Chip Curbs

**Need anything more?**

**Send us mail**

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