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Trivium China

Markets Note

October 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 late-October.

Fighting while embracing: That's one of the phrases Chinese officials started using to characterize the US-China economic relationship a few years back, at the onset of the trade war during the Trump years.

- The concept rings even more true today.

Over the past month, the two countries have in some ways pulled each other tighter, with high-level and working-level dialogues continuing to move forward – almost certainly setting the stage for a Xi-Biden meeting in November.

However, both sides have continued to throw gut punches in the midst of the embrace.

- The US added over 40 Chinese companies to the Commerce Department's Entity List – for allegedly supporting Russia's defense industry with chip supplies.
- What's more, US officials pushed through widely anticipated updates to controls on exports of US semiconductor technology to China, near the one-year anniversary of the original export control rollout.
- For its part, China reacted by implementing new export controls on certain types of graphite – used in both electric vehicle battery production and semiconductor production – due to go into effect on December 1.

Importantly, US officials reportedly undertook a more proactive approach in communicating the new export control changes to the Chinese side in advance – to explain the underlying rationale and to avoid catching the Chinese off guard.

- This messaging was an effort to keep the gut-punching moves from derailing the months-long buildup to the Xi-Biden tête-à-tête in November.

And so, the slight improvement in bilateral relations has inched forward yet again over the past few weeks – even as ongoing economic coercion remains the order of the day in the background.

What to watch: Once the expected Xi-Biden summit takes place, the two sides may have less immediate incentive to play nice. The all-of-government efforts to secure a productive head-of-state meeting will recede, while the dynamics of economic competition and coercion remain deeply in place.

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

The mood in DC

The positive

1. All signs are pointing to a likely meeting between Xi Jinping and US president Joe Biden next month at the APEC gathering in San Francisco.

The latest: Wang Yi is on a three-day visit to the United States, from October 26-28, to meet with US Secretary of State Antony Blinken. Just as we went to press, media reports confirmed Wang will also get an audience with Joe Biden at the White House on Friday (October 27).

- The trip is widely expected to lay the groundwork for the heads of state to meet in a few weeks' time.

And at the working level, **the US Treasury convened with Chinese financial regulators for the first meetings of the Economic Working Group (EWG) and the Financial Working Group (FWG)**, on October 23 and 25 respectively.

- The groups were announced following Treasury Secretary Janet Yellen's trip to Beijing in July.

First up: On October 23, the US Treasury and China's Ministry of Finance (MoF) convened the EWG.

Per Treasury's readout:

"The delegations met virtually for two hours and had a productive and substantive discussion on topics including domestic and global macroeconomic developments."

Per MoF:

"The two sides had an in-depth, frank, and constructive discussion on global macroeconomic trends and policy, the bilateral economic relationship, and how to cooperate to address global challenges."

Next up: On October 25, the Treasury and the People's Bank of China (PBoC) inaugurated the FWG.

Per the Treasury, the meeting touched on topics like:

- Domestic and global financial stability
- Financial supervision and regulation
- Sustainable finance
- Anti-money laundering and countering the financing of terrorism

At time of writing, the PBoC hadn't released a statement.

Our take: While the readouts are thin, no one expected major outcomes from these first meetings.

- Nonetheless, these dialogues are unequivocally positive for the stability of the bilateral relationship.
- In time, the hope is that they will become a forum for concrete policy cooperation.^{1 2 3 4}

1 MoF: 中美经济工作组举行第一次会议

2 U.S. Treasury Department: Treasury Department Announces Launch of Economic and Financial Working Groups with the People's Republic of China

3 U.S. Treasury Department: READOUT: First Meeting of the Economic Working Group Between the United States and the People's Republic of China

4 U.S. Treasury Department: READOUT: First Meeting of the Financial Working Group Between the United States and the People's Republic of China

The negative

2. On October 17, the US Commerce Department's Bureau of Industry and Security (BIS) **updated its semiconductor export controls** (first released on October 7, 2022), further tightening China's access to advanced chip technology.

The big change: The updated rules will shut down the workaround Nvidia used to sell dumbed-down versions of its flagship AI chips to China.

- Nvidia is the go-to chip supplier for developing sophisticated AI models.

There's more bad news: Commerce also placed leading Chinese AI chip designers Biren and Moore Threads on the US Entity List.

- That potentially bars the companies from having their AI chips manufactured by chip foundries like TSMC.

The move also:

- Requires companies to obtain licenses for export of advanced chips to all countries with which the US maintains an arms embargo (as part of an effort to ensure countries don't re-export advanced chips to China).
- Requires companies to notify the US government when exporting specific types of high-end gaming chips.

Our take: The impacts on China's tech sector will be mixed.

- The restrictions are a major blow to companies like Baidu and Alibaba, who rely on Nvidia to develop frontier AI models.
- On the flip side, they open up opportunities for Chinese AI chipmakers to replace Nvidia, ultimately making China more self-reliant over the longer term.^{5 6}

3. On October 6, the US Commerce Department's Bureau of Industry and Security (BIS) **added 42 Chinese companies to the Entity List for alleged support of the Russian military.**

- A total of 49 entities from multiple countries were added.
- This is the most widespread single action the US has taken against Chinese companies in relation to Russia's war in Ukraine.

The entities were added because they:

"Supplied Russian consignees connected to the Russian defense sector with U.S.-origin integrated circuits."

Our take: This is pretty strange – we're surprised that BIS was able to uncover 42 Chinese companies that were forwarding chips to Russia.

Our other take: If US intelligence is indeed accurate, Chinese support for Russia would appear to be much more extensive than initially imagined.

⁵ BIS: Commerce Strengthens Restrictions on Advanced Computing Semiconductors, Semiconductor Manufacturing Equipment, and Supercomputing Items to Countries of Concern

⁶ Caixin: 美国升级芯片管制② | 美国芯片巨头业务受阻 股价暴跌

Our other other take: However, with China very much in need of its own chips and long wary of directly supporting the Russian war effort, it's hard to find a rationale on the Chinese side.

- **Speculation:** It could be that DC is stretching its intel to find reasons to further cut off the flow of chips to China.^{7 8}

4. On October 2, speaking at an event held by Fortune magazine, **US Treasury Secretary Janet Yellen said that the US is overdependent on China in critical supply chains**, such as clean energy tech.

Yellen said that to counter China's massive subsidies in this industry – and in semiconductors – the US should consider increasing its own industrial policy.

She continued to say:

"I don't believe we should decouple at all from China, but I do think we need to de-risk in the sense that we have overdependence on China in areas that are critical to our national wellbeing."

Our take: The US has taken major steps to both restrict the development of China's semiconductor industry and boost domestic American capacity.

- We haven't seen that yet with clean energy tech, but it increasingly appears that the industry will be a US-China (and EU-China) battleground in the not-too-distant future.^{9 10}

The mood in Beijing

The positive

1. On October 9, a **bipartisan congressional delegation led by US Senate Majority Leader Chuck Schumer met with key officials in China – starting with Chinese Minister of Commerce Wang Wentao.**

Per the readout of the meeting from China's Ministry of Commerce, Wang said:

"We hope the US side can clearly state their boundaries vis-à-vis security, avoid making [the economic relationship] overly politicized, and avoid overly emphasizing the concept of national security."

Wang raised concerns related to:

- Export controls
- Investment restrictions
- Sanctions
- Restrictions on personnel (i.e., restrictions on American citizens working for Chinese semiconductor companies)

7 Federal Register: Addition of Entities to the Entity List

8 BIS: COMMERCE ADDS 49 ENTITIES TO THE ENTITY LIST FOR PROVIDING

9 Reuters: Treasury's Yellen says US overdependent on China for critical supply chains

10 Fortune: CEO Initiative 2023: The US Economic Outlook

Our take: It's positive that these exchanges are happening, but the American restrictions that Chinese officials are most concerned about – those on high-tech exports – will only become more expansive.^{11 12}

2. Also on October 9, **Schumer and co. met with Xi Jinping.**

- While the meeting was less directly focused on concrete trade and investment concerns, both the Chinese foreign ministry (MoFA) readout and a statement from Schumer's office touched on high-level economic issues.

Per MoFA, Xi underscored the critical importance of US-China ties:

"Given the high degree of integration between the Chinese and U.S. economies and their closely entwined interests, both countries stand to benefit from each other's development."

"Competition and confrontation is not consistent with the trend of the times."

He also urged more communication:

"It is hoped that the two legislatures will have more interactions, dialogues, and exchanges to increase mutual understanding and make a positive contribution to the stabilization and improvement of the China-U.S. relationship."

Schumer was less conciliatory:

"The United States is ready to compete vigorously with the PRC, and we must also hold China accountable for any unfair practices that undermine the relationship between our countries."

He called for China to further open up to US companies, particularly in regards to:

- Semiconductors
- Financial services
- Aerospace

But while Washington wants China to become more open, it also intends to tighten its own restrictions.

"While we must ensure that our trade policies are fair, the United States will also prioritize our economic and national security, including protecting advanced technologies."

Our take: This meeting represents something of a diplomatic role reversal.

¹¹ SCMP: China's commerce chief presses US Senate leader Chuck Schumer over trade restrictions

¹² MOFCOM: 王文涛部长会见美国国会参议院多数党领袖舒默一行

- Usually, Beijing utilizes these forums to excoriate the US for its unfair policies toward China – but that sentiment is nowhere to be found in Xi’s remarks.
- Might this mark a turn toward a friendlier tone from Beijing in its dealings with DC?

Get smart: Content of the meeting notwithstanding, this high-level link up between Xi and Schumer was yet another positive effort in setting the stage for a Xi-Biden meeting next month.^{13 14}

3. On September 26, **China’s Vice President Han Zheng and top diplomat Wang Yi met separately with former US Treasury Secretary Hank Paulson** in Beijing.

Their message: American companies are welcome in China.

Han told Paulson that US companies shouldn’t count China out:

“Since the beginning of this year, the Chinese economy has maintained a positive trend of recovery.”

“We will further optimize the economic structure [and] deepen reform and opening up.”

“We welcome more American companies to invest and develop in China.”

Wang worked the geopolitics angle, calling for less hostility and more investability.

“The low point in China US relations is not in line with the interests of the two peoples.”

“[I hope the US will] work with China to explore the path of peaceful coexistence.”

Our take: China’s currently dire economic situation is showing signs of bottoming out, but continued Sino-American tensions mean US firms will remain wary of committing more aggressively to the China market, in the near term.^{15 16}

The negative

4. On October 18, **the Ministry of Commerce (MofCom) released an official response to the recent tightening of US controls on the export of semiconductor equipment to China.**

Per MofCom:

13 MoFA: President Xi Jinping Meets with Delegation of U.S. Senate Led by Majority Leader Charles Schumer

14 Senate.gov: Majority Leader Schumer Statement Following Meeting With Chinese President Xi Jinping

15 MoFA: 韩正会见美国前财长鲍尔森

16 MoFA: 王毅会见美国前财政部长鲍尔森

"China strongly [and] firmly opposes [the updated rules]."

"China will take all necessary measures to vigorously defend its legitimate rights and interests."

Reactions from domestic industry were more interesting.

An unnamed chip industry professional told Caijing the move would most impact large platform companies:

"[The new restrictions] will directly affect AI development of companies like Alibaba and ByteDance."

Another anonymous industry source said:

"The scope of the restrictions has far exceeded industry expectations."

Some takes were more optimistic. Major semiconductor media outlet Ijiwei sees the restrictions as the necessary impetus to galvanize the domestic industry:

"This will lead to a breakthrough in China's AI chip industry, which will achieve full autonomy and control over its supply chain."

Finally, Gartner's VP Sheng Linghai pointed out that:

"If China wants to make a breakthrough in [AI chips], it will need to rely on Huawei."

Our take: Sheng's right – Huawei is becoming the loudest voice rallying domestic firms to develop AI chip alternatives.

Our other take: That potentially makes Huawei the key beneficiary of the new US restrictions.

- Alibaba and friends will soon have no choice but to opt for domestic AI chips.^{17 18 19 20 21}

5. On October 20, **China's Ministry of Commerce slapped controls on high-grade graphite**, effective December 1, 2023.

- This move broadens MofCom's existing controls on graphite materials to include high-purity and spherical graphite.

The official explanation? Preventing nuclear proliferation.

- Graphite does play a role in creating nukes, but it is also used in a variety of important industrial applications, such as in electric vehicle batteries and semiconductor equipment.

17 MofCom: 商务部新闻发言人就美商务部发布对华半导体出口管制最终规则答记者问

18 Caixin: 美国升级芯片管制② | 美国芯片巨头业务受阻 股价暴跌

19 Caijing: 美升级对华AI芯片制裁力度, 美芯片企业提出担忧

20 Ijiwei: 美国禁令升级全面压制我国AI芯片发展 加快构建全国产供应链势在必行

21 Caixin: 美国升级芯片管制③ | 严卡中国AI芯片设计 壁仞等13家公司被纳入“实体清单”

ICYDK: China dominates global graphite production, accounting for roughly 65% of world production.

Our take: Tightening access to critical minerals has become Beijing's go-to strategy for retaliating against chip controls.

- When Japan and the Netherlands rolled out chip export controls a few months ago, MofCom responded with its own export controls on gallium and germanium.
- That makes us think Beijing already has a playbook of mineral controls, ready to use whenever the US or its allies make additional moves against China.

The big question: What's the next critical mineral control poised for deployment?^{22 23 24}

The mood in Brussels

1. On October 10, the FT scooped that the EU is preparing an investigation into Chinese steel subsidies.

- That follows similar investigations into electric vehicle and wind turbine subsidies announced in recent months.

According to FT sources:

"The EU is planning to announce anti-subsidy investigations against Chinese steelmakers at a summit with the US this month."

For the EU, the investigations are more about pleasing America than hurting China:

"Washington had asked Brussels to move against Chinese steel producers in return for avoiding the reimposition of tariffs on EU steel imposed by president Donald Trump in 2018."

EU tariffs on Chinese steel are hardly novel:

"The EU already has punitive tariffs in place on 20 grades of Chinese steel and stainless steel products and has set import quotas as part of measures to safeguard its market until mid-2024."

Our take: The practical consequences of these moves will be minimal.

- It will probably be at least a year before any tariffs are imposed.
- And if tariffs are imposed, they will have little impact on China's steel industry. China exports less than 10% of the steel it produces, and very little of that goes to the EU (or America).

22 MofCom: 商务部 海关总署关于优化调整石墨物项临时出口管制措施的公告

23 MofCom: 商务部新闻发言人就石墨相关物项出口管制政策应询答记者问

24 USGS: GRAPHITE (NATURAL)

Our other take: These investigations are important because they signal the EU's increasing willingness to put up barriers to trade and investment with China as part of an overall "de-risking" strategy.^{25 26}

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.

25 Reuters: EU plans anti-subsidy probes to secure steel deal with US

26 FT: EU plans anti-subsidy probe into Chinese steelmakers

Need anything more?

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