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Trivium China

Markets Note

September tech and trade war roundup

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

Here's where things stand as of late September.

We almost can't believe we're writing this, but over the past month a spate of small signs emerged that US-China bilateral relations are genuinely beginning to stabilize.

- You may have to squint to see them, but they are there.

Disclaimer: It's important to note that stabilization does not necessarily equate to significant, let alone lasting, improvement. But at this stage, any positive move – however slight – should be welcomed by companies and investors.

Key developments on this front included:

Both sides announced new financial working groups to establish more regular dialogue in late September.

- Specifically, the Chinese central bank and the US Treasury announced the formal establishment of two bilateral economic issues working groups – the implementation of an agreement forged during US Commerce Secretary Gina Raimondo's meeting with Minister of Commerce Wang Wentao in China last month.
- These mechanisms for dialogue come on the back of the commercial issues working group formed between China's Ministry of Commerce and the US Commerce Department, announced during Raimondo's Beijing trip – and will hold regular meetings led by officials at the vice-ministerial level.

Also on September 22, the US Department of Commerce released finalized national security guardrails to prevent the "improper use" of CHIPS and Science Act subsidies.

- The upshot: The Biden administration has tempered its approach to take the concerns of allied countries and US businesses into account, with the final version less restrictive than many chipmakers initially feared.
- To be clear, this isn't any kind of concession to Beijing – it's all about recalibrating some of the more onerous requirements so that companies are incentivized to tap into the funding.
- Still, here's a quote from the top integrated circuit publication in China (ICWISE):

"This represents a change from previous inflexibility by the US."

"Warm winds between China and the United States have blown often in recent days. This seems to herald a slight recovery from the ice age, introducing new variables to recent technological confrontation between China and the United States."

- Now that's quite a statement.

Finally, on September 21, the Ministry of Commerce announced that it has been approving export licenses for the critical minerals gallium and germanium.

- Reminder: China dominates 80% and 60% of respective global production for these key inputs in semiconductor manufacturing.
- MofCom rolled out export controls on gallium and germanium back in July to counter controls on semiconductor exports adopted by the US, Japan, and the Netherlands.
- But this latest news has, for now, [assuaged fears](#) that Beijing's controls on the minerals will throw sand in the gears of the global chips supply chain.
- **And perhaps most importantly, Beijing Tongmei, the Chinese subsidiary of US-headquartered AXT, subsequently confirmed its export request was approved.**
- **Our take:** Including the subsidiary of a US company in the first batch of approvals is a carefully calculated friendly gesture, only adding to the recent love-in.

Okay, you can stop squinting now. But you put all this together and what emerges are tiny rays of light for the relationship.

- Indeed, as we wrote last month – the export control and wider economic coercion game is now centered around implementation.
- And this month saw two highly important signals that implementation efforts are increasingly being calibrated to avoid an escalatory spiral.

Tracking implementation of these various policies will continue to be critical in the months ahead – as will understanding the nature, frequency, and seniority of the renewed discussions between the two sides.

- And that's largely where we'll focus our efforts in this monthly note.

Still, it goes without saying that all is not hunky dory between Beijing and Washington.

- There were also plenty of developments over the past month that could threaten to disrupt the nascent stabilization – like Huawei's victory lap on its Mate 60 Pro launch and the ensuing investigation by the US Commerce Department;
- Or European Commission President Ursula von der Leyen announcing an anti-subsidy investigation into electric vehicle imports from China – which US officials will also follow closely.

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

The mood in DC

1. On August 31, western media reported that **the US government has barred Nvidia from shipping some of its high-end chips to "some" Middle Eastern countries.**

The info came from an August 28 regulatory filing by Nvidia, which stated:

"The US Government informed us of an additional licensing requirement for a subset of A100 and H100 products destined to...some countries in the Middle East."

Nvidia's not alone: AMD also reported they had received similar instructions.

Our take: Our best guess here is that, rather than institute an industry-wide or country-specific ban, BIS has restricted a couple of leading chipmakers from selling their most advanced technologies to Gulf states that have gotten cozy with China.

- Saudi Arabia, for example, has increased sci-tech cooperation with China in recent years.
- That might provide a backchannel through which Chinese firms could access advanced chips or computing power.

Our other take: If this is true, it won't materially hurt Nvidia's bottom line.

- But the US could end up shooting itself in the foot by pushing China and the Middle East into closer cooperation.

2. On September 4, **US Commerce Secretary Gina Raimondo spoke about her recent trip to China on Face the Nation.**

She started on a positive note:

"I think we made a great deal of progress. In terms of concrete deliverables, I was able to open three specific lines of communication with the Chinese, which is a huge step forward."

But Raimondo was clear that the US is far from fully satisfied:

"They need to be less arbitrary in the way they administer regulations to actually give American businesses a fair shot to compete."

"We need to see action. And until we see action, there can be no trust."

Our take: The overriding message from Raimondo: *We'll believe it when we see it.*

Our other take: Raimondo's remarks in this interview should serve to temper the notion that her visit to China marked the beginning of a full-scale reset in relations.

- We don't expect the US to lift export controls – or even slow the pace of new controls – until DC is satisfied with the way Beijing is:
 - Treating American companies
 - Handling IP transfers
 - Scaling back the state's role in the economy

The bottom line: Ongoing stabilization and dialogue between the two countries is far from assured.

3. On September 22, **the US Treasury and People's Bank of China (PBoC) announced the establishment of:**

- **An Economic Working Group with China's finance ministry**
- **A Financial Working Group with the PBoC**

The groups will hold regular meetings led by officials at the vice-ministerial level.

Citing an unnamed senior Treasury official, Bloomberg reported:

"The groups will help each side explain their actions and allow the US to raise problems and push for solutions."

A commentary from China's state broadcaster CCTV said:

"The US continues its unilateral suppression and sanctions measures against China, so the working groups will also serve as a platform for China to continue to negotiate and fight on this issue."

Our take: Amid growing bilateral tensions, it's positive that the two sides are willing to talk more.

But don't get too excited: Both sides have entrenched positions and neither is likely to back down, so the scope for substantial progress is limited.

4. On September 22, the US Department of Commerce released **finalized national security guardrails to prevent the "improper use" of CHIPS and Science Act (CHIPS Act) subsidies.**

- The finalized guardrails add specificity to limitations on chip-related manufacturing, licensing, and research involving China and other "countries of concern".

Some context: The CHIPS Act, passed in August 2022, allocated USD 52.7 billion in subsidies for chip firms willing to set up foundries in the US.

- But companies that take CHIPS money may not continue to expand investment in China for a period of 10 years after the subsidy award.

The tl;dr on the finalized guardrails: The Biden administration has tempered its approach to take the concerns of allied countries and US businesses into account.

- The final version is less restrictive than many chipmakers initially feared.

But: The final rules still hold firm on national security, putting any chip manufacturer benefitting from the CHIPS Act between a rock and a hard place.

Official Chinese sources, like the Ministry of Foreign Affairs, have not publicly commented on the finalized rules at time of writing.

- But the reaction from Chinese semiconductor industry media has been largely positive.

Our take: This story is just getting started.

- The release of the final rules means CHIPS Act subsidy payouts – many of which remain undistributed – should now start to flow in earnest.

Our other take: As we watch the downstream impacts of the CHIPS Act unfold, Beijing will be gearing up to play the long game by pouring its efforts into boosting domestic innovation capacity.

The mood in Beijing

1. On August 29, **Huawei kicked off a surprise launch of its new flagship smartphone, the Mate 60 Pro.**

- And it looks like the phone is 5G-enabled.

Why that's a big deal: After Huawei was placed on the US Entity List, the company was unable to get its hands on enough 5G chips to produce 5G-enabled smartphones.

- The move threatened to tank Huawei's smartphone business.

What we know: Since being sanctioned, the company has been going all-out to develop its own chips and build up alternative supply networks.

- According to speed tests and tear-down videos, the new phone is equipped with domestic 5G radio frequency (RF) modules.
- China heavily relies on foreign 5G RF modules, so this is a win for Huawei's Chinese RF suppliers.

Where the other chips came from is less certain:

- There are rumors going around that the Mate's system-on-chip (SoC) – the phone's core computing unit – was fabricated on SMIC's 7nm process.
- But insiders told Caixin that SMIC's fabrication process has a high rate of defects.

Our take: Making chips with high defect rates is equivalent to setting money on fire.

- We wouldn't be surprised if state subsidies are propping up companies like SMIC as they burn cash to produce product.

2. On September 6, SCMP sources reported that **government ministries involved with investment, trade, or international affairs will ban the use of iPhones at or for work.**

- The decision expands a previous ban – which was never publicly confirmed – already rumored to be in place at several ministries.
- Government procurement of non-iPhone Apple products has been forbidden since 2014.

On September 7, Bloomberg reported the ban may be even bigger than SCMP's initial read:

- It could include not just state agencies, but also as-yet-unnamed SOEs and government-controlled organizations.

When asked about the ban on September 13, Ministry of Foreign Affairs (MoFA) spokeswoman Mao Ning responded:

“China did not issue any law, regulation or policy document that bans the purchase and use of cellphones of foreign brands, such as iPhone.”

That’s cheeky: Mao’s answer sounds definitive – but she actually dodged the question.

- An internal communique or *de facto* order to keep iPhones out of sensitive areas can be circulated without issuing a “law, regulation, or policy document.”

Our take: Without official confirmation, it’s hard to tell how stringent or widespread these bans are – or where the orders are coming from.

- That said, these media reports are in line with efforts to ban US-made hardware – like Teslas – at sensitive locations.

The bottom line: Apple has gone all-out to build relationships in China – and we don’t read this reported move as a hit directed at the company itself.

- Even so, as long as the US continues trying to ban Chinese apps and network gear, US hardware will never be as trusted by Beijing as domestic alternatives.

3. According to posts circulated on social media on September 7, it appears that a committee on national security within **the Ministry of Public Security (MPS) banned Teslas from driving into “sensitive areas”** back in 2021.

Some context: A screenshot of a notice issued to Wuhan’s high speed rail authorities states that “foreign-invested smart vehicles,” specifically Teslas, are not allowed in “sensitive areas,” including some parking lots.

- The notice cites a 2021 order by the MPS as the basis for the move.

Our take: There’s no public-facing directive in terms of what constitutes a “sensitive site.”

- But it’s clear that either the definition of a “sensitive site,” or the enforcement of foreign hardware bans, is expanding.

Our question: US-made network equipment manufactured by Cisco is still allowed in sensitive Chinese networks.

- Will that change?

4. On September 14, **China’s securities regulator (CSRC) confirmed that two companies have completed the registration process to list in the US.**

The most notable: CheChe Technology, an auto insurance technology platform, will go public on the Nasdaq via SPAC.

- It will be the first to list as a variable interest entity (VIE) since new rules on overseas listings were released in February.
- As of January, the Tencent-backed company was valued at USD 841 million.

Refresher: Following Didi's ill-fated IPO in mid-2021, the CSRC overhauled its overseas IPO rules and brought VIEs into the new regulatory framework.

Plus: In January 2022, the cyberspace administrator (CAC) announced that online platform companies with over one million users must pass a security review before listing abroad.

Our take: CheChe is listing via two complex legal structures (VIE and SPAC) and could well have over one million users.

- Regulators will have given its IPO a thorough review.
- The experience should give them more confidence in the process, and speed up future reviews.

5. At a September 15 press conference, MoFA spokeswoman Mao Ning announced that **China has imposed sanctions on Lockheed Martin and Northrup Grumman**, in accordance with the Anti-Foreign Sanctions Law.

- The companies were sanctioned for selling weapons to Taiwan.

Our take: Neither Lockheed nor Northrup conducts China-based business, which means these sanctions are effectively symbolic.

6. At a regular press briefing on September 21, commerce ministry (MofCom) spokesperson He Yadong disclosed that **several companies have now been granted export licenses for the minerals gallium and germanium**, which are key to manufacturing semiconductors.

ICYMI: MofCom recently imposed export controls on gallium, germanium, and any related compounds, effective August 1, citing national security concerns.

- China customs data show exports of the minerals fell to a big fat zero in August after surging in July ahead of the curbs.
- The restrictions were widely seen as retaliation against US, Japanese, and Dutch restrictions on semiconductor exports to China.

He's disclosure came in response to questions about whether any companies have applied for – and received – licenses since the restrictions began:

"[MofCom has] approved several export applications that comply with regulations, and relevant enterprises have obtained export licenses for dual-use items. The Ministry of Commerce will continue to review other license applications in accordance with legal procedures and make licensing decisions."

- No other details were given on which companies got licenses or what the terms were.

Following He's remarks, Beijing Tongmei, the Chinese subsidiary of US-headquartered AXT, confirmed that its export request was approved.

- AXT produces semiconductor wafers, and Tongmei is AXT's exclusive supplier of gallium and germanium.

Our take: MofCom's response lines up with what we've said before – China's export controls are an adjustable vice, tightening or loosening based on the aggressiveness of implementation by foreign countries that have imposed export restrictions on China.

- Approval or rejection of critical-mineral licenses will continue to depend on whether chip export licenses are being approved by the US, Japan, and the Netherlands.

Our other take: Including the subsidiary of a US company in the first batch of approvals is a carefully calculated friendly gesture.

- Beijing is demonstrating that it's not looking to escalate matters – it will deploy these controls reactively, not proactively.

The mood in Brussels

1. On September 13, **European Commission (EC) President Ursula von der Leyen announced an anti-subsidy investigation into electric vehicle imports from China.**

What caught our eye: Von der Leyen's exact words were "electric vehicles coming from China."

- That means the scope of the investigation could cover not only domestic brands but also foreign brands producing in China for export, such as Tesla.

Guess what – China's furious. The commerce ministry (MofCom) called it "naked protectionism."

Despite MofCom's protestations, the EC investigation has merit:

- NEV producers enjoy significant government support through preferential policies including cheap loans and land.
- Consumers also enjoy significant tax exemptions.

Our take: Both sides have a lot at stake.

- China will fight hard to maintain access to key export markets for its world-beating NEV industry.

The outlook's stormy: We're headed for months of uncertainty for automakers and a ratcheting up of political tensions between the EU and China.

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 are 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.

Need anything more?

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