

Harvests and demand

circa February 2015



The supply and demand influences for 2015 look better than last year but poor price indications for winegrapes continue.

An analysis, and the issues, follows.

Global demand - the familiar drivers are slowing

The most recent global wine sales data are a mixed bag with data from the Office of Vitiviniculture (OIV) showing flatness for the last 5 years ended 2013 while another source, Euromonitor, reports steady growth of about 1 per cent per annum. Unfortunately neither go beyond 2013 and offer little guidance in current time. Nevertheless, it is apparent that the hot spots for demand growth are the US and China.

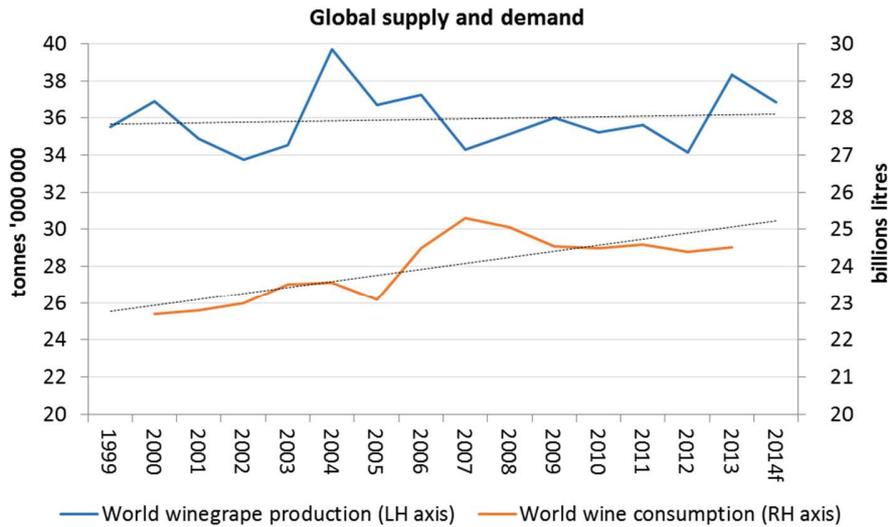
Rabobank suggests in the *World Wine Map 2014* that longer run prospects are for continued growth but at a slower pace for the recent drivers of international supply and demand that we have become familiar with. These include the growth of US and China consumption, the dramatic shift to global bulk wine trade and the growth of supply from new world producing nations (US, Australia, Argentina, Chile, New Zealand and South Africa). Vineyard expansion has slowed considerably in the latter countries – something we know about here in Australia.

The good news about slowing demand in the US and China is that the US is headed for the premium end as its economy recovers, China is headed downscale in value as the austerity measures put a dent in the elite, gift-giving sales that dominated in the past and the more 'common' consumer comes to the fore. In addition, global growth is expected to be spread across a more diverse range of markets, and importantly, emerging markets in Asia, Latin America and Africa.

Bulk wine shipments are expected to slow as the stimulus for bulk wine shipments, improved shipping technology, become fully exploited. Nevertheless, in the ten years ended 2013, the volumes of bulk to bottled wine shipments among new world wine exporters shifted from roughly 30:70 to 50:50. In this respect, the new world was merely playing catch-up with the traditional European producer countries and bulk wine trade today is a force to be reckoned with.

Rabobank suggests that the emergence of new world bulk wine trade has impacted on the ability of wine companies to build brands. Local suppliers with the advantage of local distribution knowledge and capability are better positioned to source globally and build their own brands locally, compared to companies doing this from distance. Bulk wine trade does not suit higher-valued wines for which validation of origin, in both the creation of the wine and location of bottling, is an important part of the brand's value and wine companies at distance from their target markets will continue to work in this space.

This seems relevant to a producing country like Australia, which is very distant from its major markets. It validates a push to premiumisation among private brand owners but if this holds as a national strategy, it will preclude Australia from the opportunity to take advantage of at least half of that available to new world traders. Premiumising mean a smaller Australian industry and solely premiumising means an even smaller Australian industry. Middle category (commodity) bulk wine trade remains a challenge for Australia but one which has benefits for the industry as a whole if business models can be developed to deal with our higher costs of production.



Sources: OIV Global Economic Vitiviniculture data, Oct 2104; Rabobank Wine Quarterlies; Global Wine Markets, 1961 to 2009: a statistical compendium; WGGGA calculations.

Global supply – lower in 2014, inventory improves favourably?

Global supply from 2014 is firming at a return to trend levels after a massive 2013 harvest that was driven by the big three in global production, France, Italy and Spain, but principally Spain. Despite falling back from the high of 2013, by almost 4%, world winegrape production in 2014 sits just above an upward trend in supply and is the highest harvest since 2009 (bar the exceptional 2013). Rabobank (*Q1 2015 Wine Quarterly*) suggests global inventory has declined slightly on the back of consumption increases and conversion to industrial use of Spain’s massive increase in bulk wine and the consequent price collapse for this wine.

While sales prospects for Australian wine in the US could improve through a 6% decline in US production in 2014, it will be tempered by ample US inventory after two big, preceding harvests. Some space on global markets may open up with a 20% decline in Chilean winegrape production in 2014 after devastating spring frosts.

The 2015 harvests are underway in the southern hemisphere producer countries. With nothing but very preliminary reports available, there is also nothing exceptional happening (thus far).

Domestic supply – early indication is tonnages down

Relative to the Australia's recent history of world-benchmark, foundation data availability, it is unusual to be able to report little about domestic production and sales at this time. Thankfully the Australian Grape and Wine Authority (AGWA) are working to repair the absence of viticulture statistics by funding the traditional ABS Vineyard Survey data collection for the 2015 harvest. This data should be available toward the end of 2015. The longer-term solution, for both viticulture data as well as the now defunct collections of domestic sales, wine production and wine inventory data, awaits decision-making on the basis of AGWA research into options for their collection and dissemination. All power to wise decision-making and speedy implementation.

In the meantime, and at the time of preparing this article (mid February 2015), widespread reporting of lower yields, no doubt the result of the dry spring and the effects, albeit small in the national aggregate, of some exceptional but isolated incidences (for example, early frosts in SA north of Adelaide, a strip of severe damage from a tornado just north of the Murray around Mildura, fires in the Adelaide Hills, rain at an inconvenient time in parts of NSW). An additional indicator is a rise in wine companies scouting for fruit to fill shortfalls on expectations. Therein lies some hope for higher winegrape prices toward the end of the season compared to basically a repeat of last year's prices and desperation in the growing community.

Australian wines sales - overview				
Period		2012-13	2013-14	
Domestic sales of Australian wine				
Volume	MLs	453	458	
	% change	-1.0%	1.1%	
Wine imports				
All	MLs	84.3	81.8	
	% change	3.8%	-3.1%	
New Zealand	MLs	51.1	52.2	
	% change	-6.5%	2.2%	
Other	MLs	33.3	29.6	
	% change	25%	-11%	
Domestic consumption of wine				
Volume	MLs	537.3	539.5	
	% change	-0.2%	0.4%	
Imports share of Australia wine sales	%	15.7%	15.2%	
Australian wine exports				
Volume	MLs	698.3	684.0	
	% change	-2.1%	-2.0%	
Value	A\$ million	1,821	1,778	
	% change	-2.2%	-2.4%	
Price	A\$/litre fob	\$2.61	\$2.60	
	% change	0.0%	-0.3%	
All sales of Australian wine				
Volume	MLs	1 151	1 142	
	% change	-1.7%	-0.8%	
Export share of Australian sales	%	60.7%	59.9%	

Produced by Wine Grapes Growers Australia Sources: Wine Australia, Wine Export Approval Report; Australian Bureau of Statistics Cat No 8504.0, Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers; WGGA estimates

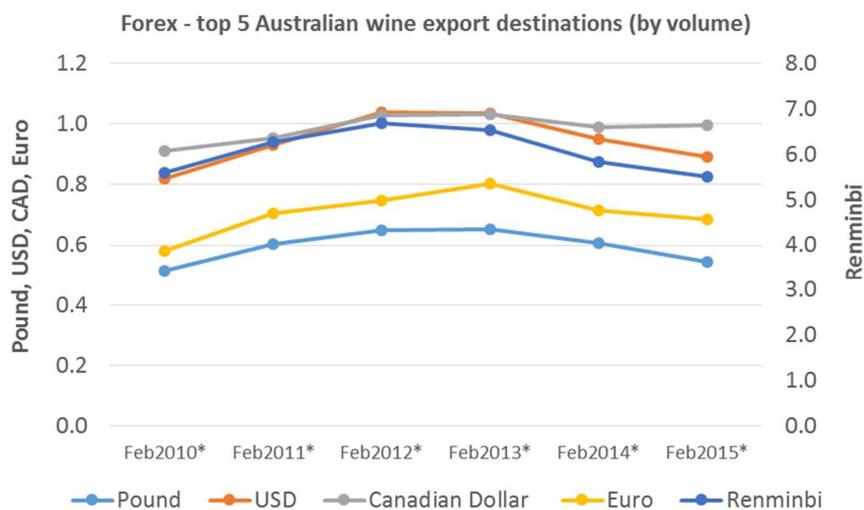
Domestic demand – when will falling AUD show benefits for winegrapes?

The last available comprehensive reporting of Australian wine sales, for the financial year 2013-14, showed an overall marginal decline on the volume of Australian wine sold which was driven by a 2% decline in export volumes (together with a marginal decline in average price). Other features include a 1% increase in domestic wine sales and a 3% decline in imports, albeit that New Zealand imports continued to grow (with a rise from a 61% share of imported wine volumes to 64%).

The last surviving data collection available to the industry, continues to be export sales. Proof of the value of industry-owned foundation data sets. The AGWA Wine Export Approval Report reported for the 2014 calendar year that the volume grew 1.9% at a steady average price per litre FOB. Bulk wine shipments rose to a 57% share of total volume, at the expense of bottled sales, after holding at a 54% share in the two prior years.

With the brightest light on the demand horizon being the weakening Australian dollar, it is of interest to reflect on why the expected benefits haven't yet flowed through to growers in winegrape prices. The data in the illustration is for Australia's top 5 markets by currency base: the UK, the US, Canada, Euro-denominated destinations and China. These accounted for 83% of Australia's exported volumes in the last year.

It shows that with the sole exception of Canada last year, the AUD has weakened in all markets for two years in a row. Price competitiveness across these markets and for at least 83% of our exports was restored in the year-end mid-February 2014, to the tune of 6.5% and a year later, by 5.5%. But the benefits haven't flowed.



* Year-end at mid-February each year Source: RBA Economic and Financial Statistics, <http://www.rba.gov.au/statistics>

Two key explanations for the lack of flow through, would appear to be the need for existing company hedging arrangements to unwind or that wine companies are waiting to restore margins before passing on the benefits. Neither factors are transparent and speculation is the only possible thing about them. Nevertheless, after two years, hedging arrangements must be starting to unwind. If so, the remaining task is to restore wine company margins. This will rest on not just the improvement in price competitiveness provided directly by a weaker AUD but also on restoring the perception and reputation of Australian wine. Roll on.

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