



australian commodities

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wine grapes and wine

outlook to 2012-13

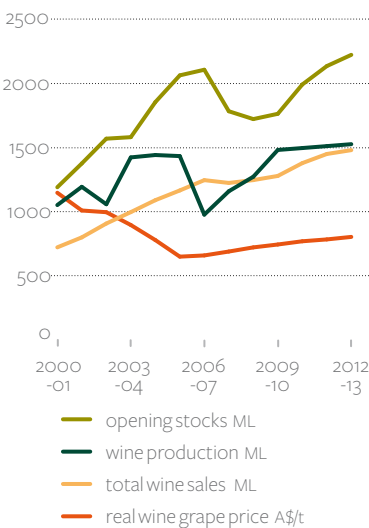
brenda.dyack,thomas.jackson,adam.foster and ian.shaw

Over the outlook period to 2012-13, wine grape prices in Australia are expected to increase. The increase reflects a combination of short term domestic supply constraints and increases in export prices. While wine grape production in 2007-08 is estimated to recover by 15 per cent from that in 2006-07, output will again be restricted by reduced water availability and will be well below the record in 2004-05.

Assuming a return to average seasonal conditions, production is forecast to increase again in 2008-09 and by 2009-10 output of wine grapes is projected to return to levels attained in 2004-05. While domestic stocks of wine are projected to begin to increase around the 2010 harvest, the stocks to forward sales ratio is likely to remain below historical levels for all of the outlook period to 2012-13.

Total sales of Australian wine are forecast to continue growing, with increasing volumes being sold in export markets. Average Australian export prices are projected to increase steadily to 2012-13. The increase is expected to be induced in part by policy reforms in the European Union, which are expected to lead to reductions in the global supply of wine, with subsequent upward pressure on world wine prices. Furthermore, increased export unit values for Australian wine are anticipated as a result of industry efforts to target higher price points in export markets, and from a general shift to bottled over bulk and cask sales.

australian wine and wine grape production



drought conditions continue to affect australian production

Wine grape production in 2007-08 is forecast to be about 1.6 million tonnes, a recovery of nearly 15 per cent from 2006-07, but still well below the record production of 1.9 million tonnes in 2004-05. The effect of the improvement in seasonal conditions has been greatest in the cool climate regions of Australia. In the warm climate regions, low availability of irrigation water has continued to constrain production.

Reflecting relatively more favourable conditions in cool climate regions, the production of red wine grapes is forecast to be greater than white wine varieties in 2007-08. The excess of red over white wine grapes represents a return to the historical norm after an unusual predominance of white wine varieties in 2006-07.

Wine grape production in 2007-08 is forecast to be approximately 650 000 tonnes in cool climate regions, an increase of around 40 per cent from 2006-

07. In warm climate regions, production is forecast to be 950 000 tonnes in 2007-08, 4 per cent higher than the 911 000 tonnes produced in 2006-07.

Availability of irrigation water is again forecast to constrain wine grape production in 2008-09. Early indications suggest that initial water allocations will be similar to those of 2007-08, reflecting very low storage levels in key reservoirs of the major irrigation systems. Accordingly, wine grape production in 2008-09 is forecast to be close to 1.8 million tonnes, a 9 per cent increase from 2007-08, but still below the previous production peak.

Assuming a return to average seasonal conditions in the following years, wine grape production is projected to increase to approximately 2 million tonnes in 2009-10, and to increase slowly from there to just over 2.1 million tonnes in 2012-13. However, if there are any repeats of the adverse seasonal conditions of the past two years, actual production in the affected years could be much lower. Bearing areas are projected to increase by 1-2 per cent a year out to 2012-13.

wine stocks begin rebuilding

The combination of improved seasonal conditions and higher water allocations in irrigated areas are projected to increase year end stocks to 2005-06 levels by around 2010-11. The combination of restricted supply over the next two years and growth in total sales will contribute to a slower recovery in stocks than might otherwise have been the case. Stocks have typically been higher on average as a ratio of stocks to forward sales than is projected to be reached by 2012-13.

australian wine and wine grape outlook

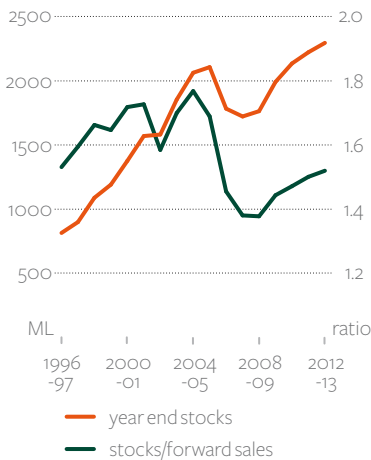
	unit	2005 -06	2006 -07	2007 -08 f	2008 -09 z	2009 -10 z	2010 -11 z	2011 -12 z	2012 -13 z
bearing area	'000 ha	158	164	164	167	169	173	177	180
wine grape production s									
red wine	kt	1 047	682	822	949	1 061	1 067	1 069	1 071
white wine	kt	786	653	721	780	908	915	929	942
multipurpose	kt	69	62	57	60	87	95	100	105
total	kt	1 902	1 397	1 600	1 789	2 056	2 077	2 098	2 118
wine exports									
volume	ML	736	798	784	809	832	887	947	987
value									
- nominal	A\$m	2 799	2 993	3 119	3 352	3 656	4 064	4 475	4 824
- real a	A\$m	2 961	3 076	3 119	3 263	3 471	3 765	4 044	4 253
australian wine grape price									
- nominal	A\$/t	615	643	691	743	786	832	869	913
- real a	A\$/t	651	661	691	723	746	771	785	805

a In 2007-08 Australian dollars. s ABARE estimate. f ABARE forecast. z ABARE projection.

Sources: ABS; Australian Wine Export Council; Australian Wine and Brandy Corporation, *Approved Wine Shipments*, Adelaide; ABS, *Australian Wine and Grape Industry*, cat. no. 1329.0; ABARE.

wine grapes

wine stocks



grape prices to increase

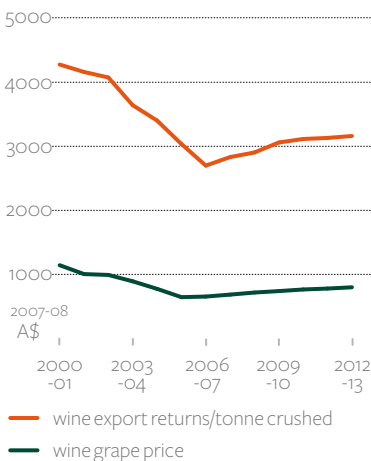
Reflecting both domestic and international developments, wine grape prices in real terms are projected to rise over the next five years, but not to levels reached during the past decade. Principal factors in the recovery are expected to be a combination of short term reduced supply in Australia and higher export prices for wine. Over the outlook period, wine reforms in the European Union are expected to reduce international wine production by enough to put upward pressure on world wine prices.

Domestically, wine grape production was driven substantially lower in 2006-07 by the effects of drought and frost in key production areas. Primarily as a result of this, wine grape prices increased in 2006-07 for the first time since 2000-01. Based on conditions leading up to the 2008 harvest, wine grape production in 2007-08 is again forecast to be limited by water availability and, hence, wine grape prices are forecast to increase further.

Assuming a return to average seasonal conditions by 2009-10, supply is projected to exceed the previous peak. Although the higher production may suggest the possibility of lower wine grape prices, this appears unlikely because of increasing wine sales at good prices on the world market. Export prices of Australian wine are forecast to average higher over the projection period as domestic producers market a greater proportion of higher value wines, including a greater proportion of bottled product.

Returns will also be assisted by projected higher world wine prices in the medium term. Improved global prices can be expected partly as a result of policy reforms that are currently under way in the European Union aimed at reducing supply. In addition to higher world market prices, export returns per tonne of grapes crushed will benefit from improved juice extraction rates. However, if the reduction in EU supply of wine over the next three to five years is less than expected, world prices are unlikely to rise by as much as indicated in these projections.

wine grapes



higher prices for Australian wine

Australian wine export earnings are forecast to benefit from increased world wine prices, and an assumed decline in the value of the Australian dollar. A lower exchange rate will assist the price competitiveness of Australian wine and contribute to greater consumption of Australian wine in markets such as the United States, Canada and the United Kingdom. Relative changes in the value of the dollar against the currencies of export competitors will also be a factor aiding the competitive pricing of Australian product.

With higher prices, there is likely to be a less than proportionate reduction in the quantity of wine demanded. This is expected because quantity demanded has not been observed to be highly responsive to price changes

in the past. At the same time, in a number of markets such as in Canada and the United States, consumers continue to demand a higher proportion of higher priced wine. Such preferences are likely to add to the quantity demanded at higher prices.

The extent to which global wine price movements are translated into the price of wine grapes depends on conditions within the Australian wine grape market. In its wine grape price projections, abare has assumed that there is no change to wine grape market conditions. However, the recent ruling of the Australian Competition and Consumer Commission allowing wine grape growers to form negotiating groups may change the market dynamics, although it would be premature to project the impact of this change on prices.

For the projections presented here, the ratio of wine grape price to export value of wine per tonne of grapes crushed is assumed to be around 0.25. That is, based on historical and forecast values, wine grape growers are estimated to share, on average, 25 per cent of the export returns per tonne of grapes crushed. Although a useful benchmark, this estimate does not take into account differences in the share of returns that growers implicitly receive from domestic sales, from various wine types, and from grapes produced in warm versus cool climate areas.

australian export outlook improves

The value of Australian wine exports in 2007-08 is forecast to increase to a record \$3.12 billion; an increase of 4 per cent on the \$2.99 billion achieved in 2006-07. However, Australian wine export volumes are forecast to decline by 2 per cent in 2007-08 to 784 million litres, mainly because of reduced domestic supply. As a consequence, average unit returns are forecast to increase by 3 per cent in real terms to \$3.98 per litre in 2007-08.

The value of Australian wine exports is projected to reach \$4.25 billion (in 2007-08 dollars) by 2012-13. The increase in value will reflect a combination of increased volumes shipped and higher Australian dollar equivalent prices achieved in part through currency changes. The average unit value of exports is projected to be more than \$4 a litre (in 2007-08 dollars) in 2012-13, an 8 per cent real price increase over the forecast 2007-08 average.

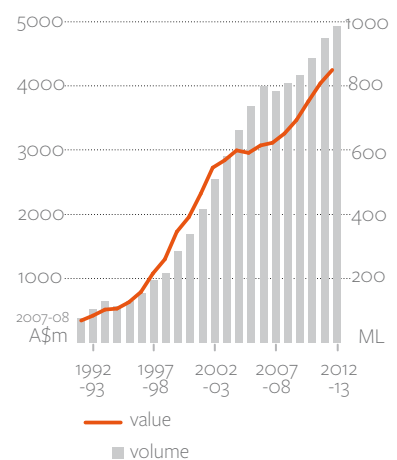
In 2006-07 the United Kingdom remained the top export market for Australian wines both in terms of volume and total value, accounting for about a third of export volume and value. Exports to the United States ranked second and constituted 27 per cent of total wine export volumes in 2006-07 and 32 per cent of total value.

In the first seven months of 2007-08, total sales values to all destinations increased over the same period last year. The principal markets remained the

average grape prices as a proportion of export returns

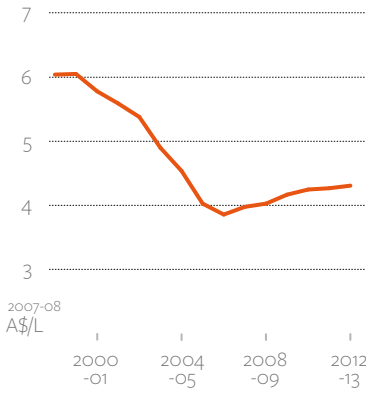


australian wine exports



wine grapes

average export unit values



United Kingdom with \$549 million (33 per cent) of total sales, the United States with \$491 million (29 per cent) and Canada with \$171 million (10 per cent).

greater emphasis on higher value sales

In an effort to improve returns, the Australian industry is putting more emphasis on sales of higher value product. Data for the first six months of 2007-08 indicate that the higher export values forecast for the year as a whole are in part the result of a larger proportion of sales in the bottled range. Sales of bottled wine were up 6 per cent relative to the same period in the previous year. In 2006-07, bottled wine sales were up 4 per cent to \$2.80 billion (in 2007-08 dollars), which is 91 per cent of total revenue. Bulk wine accounted for the remaining 9 per cent.

The industry is also focusing on a shift toward higher value export destinations such as the United States and Canada. In the 2006 calendar year, only 25 per cent of Australian exports to the United States sold for more than \$5 a litre. In 2007, sales into this category increased to 35 per cent, despite the appreciation of the Australian dollar. In Canada, 73 per cent of Australian wine exports were sold for more than \$5 a litre in 2007, compared with 46 per cent in the same price category in 2006. China is also becoming a higher value destination. In 2007, the volume of wine sold in China for less than \$2.50 a litre was 51 per cent — falling from 78 per cent of total Australian wine exports to that market in 2006.

Canada is the Australian wine industry's most valuable market in terms of value per unit sales. The average unit value of wine exports to Canada rose by 10 per cent from \$4.89 in 2005-06 to \$5.38 a litre in 2006-07. The United States was second at \$4.36 a litre and the United Kingdom was third at \$3.47 a litre.

world market developments with potential to affect australia

Developments in Europe can be expected to be of prime importance to the world market and for competitors such as Australia. The European Union, in particular, will be important in terms of policy changes (see box) and the resulting implications for wine supply and demand.

Europe is the main wine exporting region, accounting for more than 70 per cent of world exports in 2006. The Americas were a distant second at 14 per

top five australian wine export destinations

	united kingdom		united states		canada		germany		new zealand	
	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07
volume ML	269.2	280.9	213.1	220.3	51.0	49.6	38.0	40.1	27.4	36.0
value \$m	960.3	975.3	901.1	960.4	249.2	267.1	75.6	65.6	92.0	101.5

Source: Australian Wine and Brandy Corporation.

cent in 2006 while Australia and New Zealand combined accounted for 11 per cent of global shipments. The contribution of some European countries to world exports is waning, however. Europe's five leading exporting countries have declined from a 70 per cent share of world wine exports in the mid-1990s to 60 per cent in 2006. At the same time, southern hemisphere exporters plus the United States have more than doubled their share of the wine trade from 12 per cent to 28 per cent.

The Australian wine industry is likely to face growing competition from 'new world' producers such as Chile. Competition for Australian wines from these producers will be most intense at lower price points in the market. Chilean and some other new world producers tend to have a comparative advantage in supplying low cost wines because of lower input costs.

China is another country of potential competitive importance to the Australian industry. Although there is the potential to expand production by a large amount in China, the institutional constraints to doing this may delay any significant expansion. Conditions in China are very different from those in Australia. For example, China had about three times more area planted with vines than did Australia in 2005 but only one half the production (Global Wine Statistical Compendium 1961-2005). Clearly there is room for productivity improvements in China but when this may happen is not obvious.

China is also important as a potential market for Australian wine. However, the extent to which consumption may grow is debatable. While China's large population indicates that there is the possibility of substantial market growth, 2005 estimates indicate that the Chinese population drank only about 0.4 litres of wine per person a year compared with an average of over 22 litres of wine per person consumed in Australia in that year. It seems likely that consumer incomes will need to increase further and cultural changes to occur in relation to wine drinking before there is any significant growth in the Chinese market for Australian wine.

proportion of Australian export volumes shipped, by price point selected markets

	united states		canada		china		united kingdom	
	2006	2007	2006	2007	2006	2007	2006	2007
	%	%	%	%	%	%	%	%
under \$2.50	22	15	24	14	78	51	33	35
\$2.50-4.99	53	50	30	14	14	32	50	50
\$5.00-7.49	18	27	35	57	4	9	13	12
\$7.50-9.99	4	5	7	10	2	3	2	3
\$10.00 and over	3	3	4	6	2	4	1	1

Source: Australian Wine and Brandy Corporation.

reforms in the european union to present longer run challenges for competitors

In December 2007 the European Union agreed to the terms of a wine reform package that is intended to improve the competitiveness of the EU wine sector, both in EU and international markets. In the short to medium term, the restructure and modernisation of the EU wine industry is likely to result in some upward pressure on world prices as EU supplies are restricted. This is because Europe as a whole accounted for more than two-thirds of wine produced globally and more than 70 per cent of global exports in 2006 (International Organisation of Vine and Wine).

the eu wine reforms are intended to:

- facilitate a move away from the use of market intervention measures such as export subsidies and ‘crisis distillation’ of excess wine grape production
- remove 175 000 hectares of vineyards over three years — this is about 5 per cent of the total EU area under vines and is greater than the total Australian bearing area of wine grapes
- undertake vine removal as a short run measure to restore ‘market balance’ in EU production as quickly as politically possible — in the medium to long term, as new vines replace old vines, including with varieties that are in increasing market demand, both quality and quantity of production are expected to increase, with this trend expected to accelerate with the ending of restrictions on planting during the period 2015–18
- support ‘modernisation’ of the industry along the processing chain in processing facilities, winery infrastructure, innovation and new products in order to reduce average costs of production and increase yield per tonne crushed
- increase funding for promotion of exported European wines generically and to promote wines from certain regions
- allow for the use of certain wine making practices accepted by the International Organisation of Wine and Vine that had not previously been allowed — this measure will allow EU producers to be more innovative than in the past and is likely to reduce average costs and/or improve quality of EU wines
- improve wine labelling rules to allow ‘nonquality’ wines to be labelled for variety and vintage — wines with a geographic indication will be brought under the central register for EU protected geographic indications.

These measures are expected to improve the information available to consumers, help differentiate EU products, and improve market penetration of these wines.

domestic consumption rising

Per person consumption of wine in Australia increased slowly but consistently over the past decade from approximately 19 litres per person in 1996-97 to 24 litres in 2006-07. Historically, more than 90 per cent of the wine consumed in Australia has been produced in Australia.

Reflecting relatively poor seasonal conditions for both the 2007 and 2008 vintages, sales of domestically produced wine are forecast to decrease slightly in 2007-08 and 2008-09. Nevertheless, over this period total domestic consumption of wine is forecast to increase as the size of the drinking age population grows and per person consumption of wine also rises. The forecast increase in consumption will be met from imports, which traditionally have formed a relatively small yet important component of the Australian market.

Australian imports of wine increased by 26 per cent in 2006-07 to represent 7 per cent of total domestic consumption by volume. Approximately 50 per cent of all imports were from New Zealand, with Italy and France the other major sources of imported products. Imports from Chile increased strongly toward the end of 2007 as wine producers sought to maintain production by supplementing domestic supplies with Chilean wine. There was also a large increase in imports from New Zealand.

water a growing challenge

Given the reliance of much of the Australian wine grape industry on irrigation, the future availability and reliability of supply will be a major issue for the future. The difficulties of maintaining vines in the past two years of severe drought have served to highlight the seriousness of the situation for the industry.

Managing the risks associated with short and longer term water security will involve setting up contingency plans and reducing uncertainties. Responding to the challenge will include not only actions by producers but also institutional changes that governments can make. One beneficial institutional change would be removal of current restrictions on water trade. Another would be a commitment to provisions that allow irrigators to effectively carry water between years within a market based framework for water trade. If such an action were to occur, irrigators would be in a better position to manage their own water reliability risks.