

WINE OUTLOOK TO 2009-10

returns to improve in the medium term

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- **'New world' wine production growth is projected to slow over medium term.**
- **By 2009-10, Australian red wine grape prices are projected to recover to average around A\$570 a tonne, mainly driven by declining growth in plantings.**
- **Australian export sales are projected to rise to around 1.2 billion litres by 2009-10, valued at around \$4.4 billion (in 2004-05 dollars).**

Vintage 2004

The Australian wine grape industry harvested an estimated record crop of almost 1.9 million tonnes in 2003-04 — 34 per cent higher than the drought affected 2002-03 harvest and around 18 per cent higher than the previous record of 1.6 million tonnes in 2001-02. This increase in production was largely a result of above average yields and a moderate expansion in bearing area (around 4 per cent).

In 2003-04, new vineyard plantings declined overall by around 6 per cent to around 5800 hectares. Premium white varieties continued to make up over half of all new plantings, with chardonnay remaining the dominant premium white variety. Prices for premium white wine grapes increased slightly in 2003-04, while premium red wine grape prices continued to decline, particularly for cabernet sauvignon.

Sales of Australian wine reached nearly 1 billion litres in 2003-04, made up of 417 million litres of domestic sales and exports of 581 million litres. Despite a significant expansion in Australian wine grape production, growth in domestic sales have remained around 4 per cent a year. In 2003-04, export sales grew by around 14 per cent in volume terms, easing from 22 per cent in the previous year. Export unit values continued to fall, however — down 6 per cent to around A\$4.40 per litre.

Wine exports are increasingly important to the Australian industry, with around 43 per cent of total production exported in 2003-04. Given this importance, understanding the key drivers behind international demand and supply is crucial to the outlook for the Australian wine industry.

International wine demand

Changing market demands

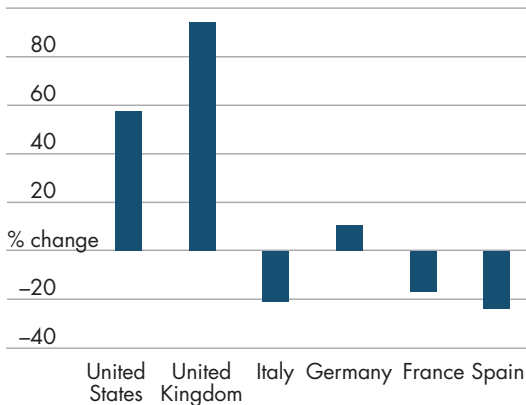
In 2004 the global market for wine continued to grow, with volumes increasing by nearly 2 per cent. The major listed wine companies, Constellation, Southcorp and Fosters, indicated strong demand for premium wine in 2004. Constellation (the largest wine company in the world, by value) attributes recent record net sales results for its third quarter ended November 2004 to strong growth in sales of premium branded wine. Strong sales growth was reported across all major markets, with wholesale growth and strong demand for Californian and Aus-

lian wines, particularly in the European Union (Constellation Brands 2005).

In 2004, continued strong demand for premium wines, principally from 'new world' countries, was the result of increasing incomes, changing lifestyles and ongoing consumer interest in the potential health benefits attributed to wine consumption. In contrast, declining demand for low quality table wine from traditional European producers continues to dominate falls in aggregate wine consumption across France, Spain and Italy.

However, growth in consumption remained positive in Australia's key export markets — the United Kingdom (up 7 per cent), the United States (up 5 per cent) and Germany (up 2 per

Change in wine consumption per person, 1993–2005



cent) in 2004 (World Drink Trends 2004). As much of global demand depends on the performance of these markets, a more detailed analysis for these markets is provided.

United Kingdom – a shifting market

With only a small domestic industry, the United Kingdom relies on imported wine for domestic consumption. Large increases in per person wine consumption (up 90 per cent) to around 24 litres per person a year over the past decade have resulted in the United Kingdom becoming the most important export market for new world wine producing countries. It is Australia's most

important export destination, by volume and value.

However, over the past decade, retail consolidation and the growing importance of grocery stores in total wine sales has shifted the market focus for exporters to the UK market. In addition, changing consumer lifestyles and attitudes to dining out and increased alcohol consumption by women have made significant impacts on overall wine sales.

Retail consolidation in the United Kingdom has left around ten major retailers handling around 80 per cent of the off-premise sales (McPhee 2003). Off-premise trade — that is, sales for consumption off licensed premises — accounts for 80 per cent of all wine sales in the United Kingdom. The retail consolidation has increased competition for shelf space in the market place, with significant discounting at the retail end. While around 10 per cent of wines sell for over £5 a bottle, 70 per cent sell for less than £4 (McPhee 2003).

Australia continues to lead the off-premise trade, with sales accounting for 24 per cent by value and 21 per cent by volume (AC Neilson 2004). Data from AC Neilson reveal that six of the top ten wine brands in the United Kingdom are Australian — from there on, however, only five more Australian brands appear in the next forty top brands. This dominance of Australian wines in the UK market is increasingly under pressure from wine imports from the United States, Chile and South Africa.

In the medium term, increasing on-premise sales (that is, sales mainly for consumption on licensed premises) will be necessary to maintain strong value and volume growth to the UK market — as only moderate growth (around 6 per cent per year) in the off-premise segment is projected over the medium term.

On-premise sales have delivered volume growth around 10 per cent higher than that off-premise sales. UK market research has forecast this growth pattern to continue into the medium term (McPhee 2003).

Traditionally, European imports have dominated on-premise sales; however, sales from nontraditional exporters, such as Australia, have been growing at the expense of their European

counterparts. In 2003, France and Australia held 41 per cent and 13 per cent respectively of on-premise sales in volume terms (McPhee 2003). In 2004, however, France's share had declined to 34 per cent, while Australia's had grown to around 17 per cent.

US consumption – changing tastes

In the United States, beer continues to dominate the alcoholic beverage market, with annual consumption steady at around 82 litres per person. However, the US wine market has shown signs of increasing maturity, with higher per person consumption and increased demand for higher priced premium wine. In addition, changing consumer preferences to everyday wine purchases instead of wine as a 'special occasion' beverage are expected to continue in the medium term.

US consumption of wine has increasingly focused on imported wine, with imports increasing by around 50 per cent between 1999 and 2004. Consumption of domestically produced wine, on the other hand, rose by 5 per cent over the same period. Allied-Domecq estimates that, over the medium term, 35 per cent of US wine consumption will be from imported products, up from around 25 per cent over the past decade.

In 2004 the strongest growth occurred in the US\$3–7 category as consumers 'returned to better known brands that offer more consistent quality' (KPMG 2004). For example, Australian sales of brands such as Yellow Tail have contributed to the continued success in this category (Gomberg Fredrikson 2004).

Germany – crucial to global wine trade

Germany is the largest importer of wine globally (1.2 billion litres in 2003) and therefore remains crucial to global wine trade, with imported wine constituting around 72 per cent of total wine consumption (USDA 2004c). In 2004, wine sales fell by around 3 per cent as economic conditions in the country were poor.

In Germany, similar to the United Kingdom and the United States, competition remains intense, with discount hyper and supermarkets accounting for around 65 per cent of total

sales. Around 80 per cent of import sales occur through this channel with just over half of those sales at 2.90 euros a bottle or lower. Sales growth continues to remain the strongest in red table wine, which is mostly filled by imports from both within the European Union and from new world exporters.

Asia – an emerging market

Asia continues to represent a potential growth destination for wine exports. Growth prospects to Asian markets — for example, China and Japan — will depend on a number of factors, including the potential for increases in consumption per person (currently extremely low) and rising disposable incomes.

China has the elements necessary to provide a long term opportunity as an export destination. Still wine sales are currently estimated to be around 180 million litres a year, with domestically produced wine accounting for around three quarters of total consumption. Imported wine makes up the remaining quarter of total consumption (Bedingham 2004).

The Chinese wine market is currently handicapped by regulations. However, the market may soon be opened to increased competition. Since joining the World Trade Organisation in 2001, there has been a commitment from the Chinese Government to significantly reduce tariff levels on wine imports. In addition, a more relaxed attitude to direct foreign investment may provide the impetus for new entry and expansion of major beverage partners in the Chinese market.

Global market in the medium term

In the medium term, global demand for premium wine is projected to increase as growth in per person consumption increases. In the traditional wine consuming countries, Italy, France and Spain, per person consumption is projected to remain around current levels as premium wine consumption surpasses that of low quality table wine.

In Germany, consumption growth is expected to slow in the short to medium term because of an assumed weaker economy. Despite this, new world wines are projected to continue to capture

increasing market share. Red wine shipments in bulk containers are expected to continue to drive growth in the medium term, with unit values projected to remain at current levels or slightly lower.

In the United States, wine consumption is projected to rise by around 29 per cent over the medium term, making the US market the fastest growing market in the world (Decanter 2005). Market growth is expected to result from the increasing availability of high quality, well priced wines and the broader acceptance of wine by consumers as an everyday purchase.

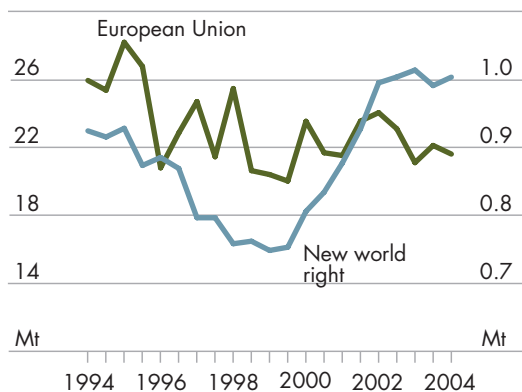
Second only to the United States, growth in UK wine consumption is projected to be around 16 per cent in the medium term — to be around 28 litres per person.

Emerging European wine consuming countries, such as Ireland, Sweden and the Russian Federation, are projected to increase per person consumption in the medium term. In addition, although sales to the emerging markets in Asia are encouraging, it is important to recognise that such markets are a long term prospect. A change in traditional consumer preferences and increasing incomes will be needed for significant consumption growth.

International wine supply

Over the past decade, strong economic growth and consequent demand for premium wine

World wine grape production



styles from non-European (new world) countries provided the impetus for accelerated plantings of wine grapes in the United States, Chile, South Africa, Argentina, New Zealand and Australia. In contrast, over the same period the areas dedicated to wine grape production in the European Union (EU-15) remained relatively stable, at around 3 million hectares (ABN-Amro 2005).

In 2004, global wine production is estimated to have reached 28.7 billion litres, up around 10 per cent from the previous year (Beverage Daily). As a result, production is expected to have again surpassed world wine consumption. With an estimated global surplus of around 5.7 billion litres in 2004, strong indications suggest that both traditional and new world producers will carry significant inventories into the 2005 vintage.

New world production slows

Over the past five years, growth in global wine grape supply has exceeded that of global demand. This has led to increasing inventories and downward pressure on grape prices. The lower returns achieved as a result have caused vineyard expansion to slow. In 2004, new world vineyard bearing areas increased by just 1 per cent (ABN-Amro 2005).

Despite this decline in area growth, new world wine production in 2004 is estimated to have increased by 6 per cent to around 6.8 billion litres (ABN-Amro 2005). Argentina, Australia and New Zealand experienced well above average crops, while production in the United States and Chile remained low. South African expectations of an average year were realised, with production around 1.0 billion litres.

The 2004 vintage in California fell slightly from the previous year, driven primarily by a fall in the production of white wine grapes. As a consequence of lower supply, prices for wine grapes improved slightly. California continues to account for a significant proportion of total wine grape production in the United States. Hence, California is taken to be indicative of the US industry as a whole.

Red varieties continue to dominate total plantings in the United States at around 60 per cent — cabernet sauvignon is the dominant premium

International vineyard bearing areas

	1985	1995	2000	2004	Change 1985–2004
	'000 ha	'000 ha	'000 ha	'000 ha	%
Traditional					
France	1063	927	917	847	-20
Italy	1103	927	908	837	-24
Spain	1593	1196	1174	1149	-28
New world					
Australia	64	73	140	164	157
New Zealand	6	8	12	18	202
Chile	106	54	104	111	5
United States	334	305	413	382	14
Argentina	295	210	209	202	-32
South Africa	110	103	117	126	15

Source: ABN-Amro (2005).

red variety. However, despite the dominance of premium red wine grape areas, chardonnay remains the largest individual variety.

Chilean vineyard areas have expanded moderately over the past five years, with around three quarters of the total planted area dedicated to red wine grapes. Cabernet sauvignon is the dominant red wine variety — making up around half of this total area (USDA 2004a). Growth in premium varieties has expanded to include varieties such as shiraz, chardonnay and sauvignon blanc. The impact of new technology adoption in production and wine making is assisting in industry efforts to improve quality. Improvement in quality has been a priority for the Chilean

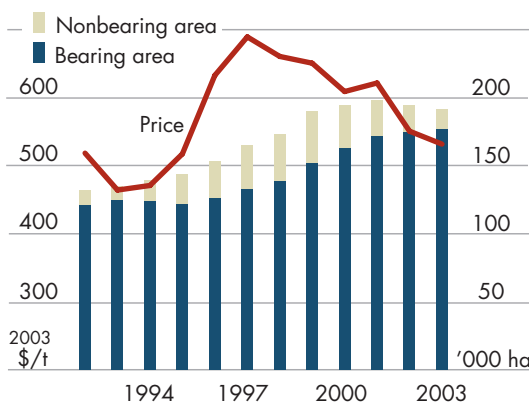
industry as it seeks to compete in the ultrapremium and premium categories of the market.

White wine grape varieties dominate the South African industry, with just under 60 per cent of bearing total area. Premium red varieties have continued to grow as a proportion of total plantings, now making up around 40 per cent of total area (up from only 18 per cent in 1996). In 2003, net plantings were dominated by cabernet sauvignon, chardonnay and shiraz. These plantings are replacing traditional areas allocated to chenin blanc (SAWIIS 2004).

Over the past decade, New Zealand areas allocated to wine grape production almost tripled to around 18 100 hectares in 2004. Area growth has favored the premium varieties of sauvignon blanc, chardonnay, pinot noir and merlot. In particular, New Zealand's 'signature wine' sauvignon blanc accounted for around a third of total bearing area and 42 per cent of total production in 2004 (New Zealand Wine Grape Growers 2004).

For these key New Zealand varieties, prices have remained around those received in 2003, despite a record vintage of around 166 000 tonnes. In contrast to other new world countries such as Australia and the United States, New Zealand exporters have maintained increasing unit returns as their cool climate wines found a niche in international markets. As a result, strong investment interest will continue to

Californian wine grape area and price



drive increasing areas, with total vineyard areas projected to increase in the medium term.

Surpluses re-emerge in the European Union in the short term

France, Italy and Spain — the three largest traditional wine producing countries — contributed around half of the increase in global wine production in 2004. Following a period of declining bearing area and declining yields, a trend of increased production is reappearing. For the 2004 vintage, yield increases resulted in production rising to around 30 per cent above consumption across the European Union.

In 2004-05, wine production is forecast to increase by 23 per cent in France and 6 per cent in Italy. In contrast, wine production in Spain is projected to decline. The increases in production, particularly in France, place additional pressure on returns to wine grape growers as a result of increased stock levels in the European Union.

In response to these rising stocks, the European Commission has committed to its largest support package since the 1999 reforms — setting aside around 450 million euro to support conversion of high yielding low quality vines to international varieties. These funds are available across the EU-25, with the largest proportion (145 million euro) allocated to Spain, the largest producer of basic table wine in the European Union. France will be the second largest recipient. Italy received 138 million euros, with allocations spent in southern Italy where low quality 'table' wine still dominates production (USDA 2004d).

In addition to the traditional EU-15 producers, EU-25 expansion has included six new wine producing countries, Cyprus, the Czech Republic, Hungary, Malta, Slovakia and Slovenia. Although these countries are currently producers of traditional table wine varieties, benefits from EU support policies and increasing investor interest in the 'new Europe' will place an emphasis on plantings of international varieties. Some commentators suggest that some countries, such as Hungary, may experience a pattern of development similar to that recently experienced by new world producers.

Production growth to slow in the medium term

On balance, global wine production is forecast to increase moderately in the medium term. This projection is based on moderate increases in bearing area in new world countries and assumed decreasing yields in the European Union, as growers strive to improve quality.

However, the supply outlook, in part, depends on changes to the level of wine stocks currently held by the European Union. In 2004, for the first time in a decade, France's estimated surplus production reached around 200 million litres (Decanter 2005). As a result of current surpluses, low value table wine production is projected to continue to decline in the medium term. This fall in production is the result of a decline in vineyard areas, particularly in France and Italy, and a decline in yields as growers seek to improve wine quality.

Australia, Chile, New Zealand, Argentina and South Africa will all experience continued growth in bearing areas over the medium term. In the United States, areas allocated to wine grape production are expected to stabilise from the declines in vineyard area over the previous two years. Urban encroachment and water constraints may limit significant area growth in California. Resurgence in red wine grape planting is expected by 2009-10. This is the result of more favorable returns to red wine grapes projected for the later part of the medium term.

Australian wine and grape price outlook to 2009-10

In the short term, a combination of lower export values and above average yields in the previous vintage are expected to result in further reductions in prices for both red and white wine grapes in 2004-05.

On average in 2004-05, prices for shiraz and merlot are forecast to remain stable at around the prices received in 2003-04 (A\$554 per tonne and A\$480 per tonne respectively), while per tonne returns for cabernet sauvignon are forecast to be lower. The Australian red wine grape indi-

cator price is forecast to fall around 13 per cent, to average around A\$439 per tonne. However, tighter supplies and improved demand from wineries will result in a price recovery in the medium term.

The Australian indicator price for white wine grapes is forecast to fall for the first time since 2001, declining by 6 per cent to average around A\$629 a tonne in 2004-05.

Overall, by 2009-10, prices for both red and white wine grapes are projected to gradually converge as the industry continues to mature and growth in wine grape production stabilises.

Australian wine production

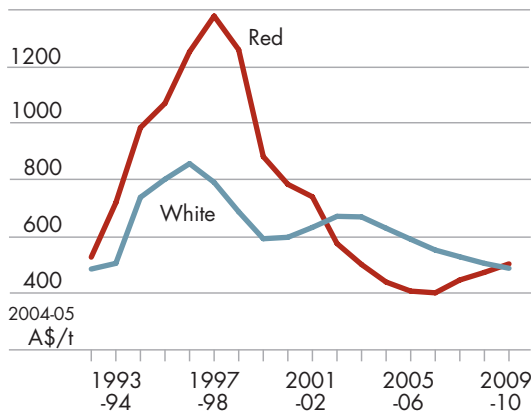
2005 vintage

Seasonal conditions varied across Australian wine producing regions in 2004-05. Some regions such as the south east of South Australia experienced above average winter rainfall, whereas in the warmer climate inland regions winter conditions were dry and mild. A hot dry spell in early spring reduced potential yields, particularly in nonirrigated vineyards. In many regions, late rainfall in spring was useful but too late for many to gain significant benefit.

A mild start to summer continued in January in most regions, with harvest of early varieties getting under way around the beginning of February in some areas. As a result, wine grape production is projected to decline slightly, albeit from a record crop in 2003-04.

Australian production is forecast to be around 1.87 million tonnes in 2004-05, with an increase

Australian wine grape prices



Australian wine grapes outlook

	Unit	2002 -03	2003 -04	2004 -05 f	2005 -06 z	2006 -07 z	2007 -08 z	2008 -09 z	2009 -10 z
Bearing area	'000 ha	140	146	153	159	163	167	171	176
Wine grape production s									
Red wine	kt	804	1 093	1 050	1 039	1 058	1 077	1 096	1 115
White wine	kt	519	683	727	744	783	821	859	897
Multipurpose	kt	88	119	95	95	93	84	82	82
Total	kt	1 411	1 895	1 872	1 879	1 933	1 982	2 037	2 095
Wine exports									
Quantity	ML	508	581	679	778	880	980	1 082	1 181
Value									
– nominal	A\$m	2 386	2 545	2 791	3 082	3 409	3 826	4 274	4 811
– real a	A\$m	2 502	2 606	2 791	3 013	3 251	3 560	3 879	4 260
Australian weighted average price									
White	A\$/t	655	669	629	603	579	568	556	551
– real a	A\$/t	687	685	629	590	552	528	505	488
Red	A\$/t	562	501	439	417	421	480	521	568
– real a	A\$/t	589	513	439	407	401	446	473	503

a In 2004-05 Australian dollars. s ABARE estimate. f ABARE forecast. z ABARE projection.

Sources: ABS, *International Trade*, electronic data service, cat. no. 8504.0; Australian Wine Export Council; Australian Wine and Brandy Corporation, *Approved Wine Shipments*, Adelaide; ABS, *Australian Wine and Grape Industry*, cat. no. 1329.0; ABARE.

of 5 per cent in estimated bearing area to over 153 000 hectares.

Plantings to remain subdued

Australia's new vine plantings remained subdued in 2003-04, down 6 per cent on the previous year. This decline in new plantings is in part the result of expected lower returns to wine grapes, particularly in premium varieties such as cabernet sauvignon and more recently chardonnay.

Australian wine grape plantings

In 2003-04, new areas planted to chardonnay fell by around 8 per cent. This was the first decline since the resurgence in popularity of the variety three years ago. The planting resurgence was driven by higher relative prices for chardonnay. Changing expectations about future returns may now be partly responsible for the decline in 2003-04.

In addition to the decline in total new plantings there has been an increase in the area of vines removed in the past few years. The area of vines removed increased by 17 per cent in 2003-04. This rise in removals exacerbates the declining growth in vineyard areas, with the highest grubblings being of sultana and cabernet sauvignon.

Over the next five years the bearing area of wine grapes is projected to increase by around 15 per cent to 176 000 hectares by 2009-10. This growth is dominated by white wine grape plantings. Premium white wine grape areas are

Australian production of major premium varieties

	2004-05	2009-10	Change
	kt	kt	%
Shiraz	449	497	11
Cabernet sauvignon	316	313	-1
Merlot	112	117	4
Premium red	970	1 020	5
Chardonnay	376	508	35
Semillon	105	106	1
Columbard	74	82	12
Premium white	674	829	23

projected to grow by 27 per cent, while premium red wine grape areas are projected to increase by 7 per cent over the period.

Wine grape production over the next five years is projected to increase by around 12 per cent to reach around 2.1 million tonnes by 2009-10. White wine grape production is projected to increase by 23 per cent to nearly 900 000 tonnes. In the medium term, chardonnay is projected to have taken number one place as Australia's largest produced variety, increasing by 35 per cent to around 508 000 tonnes.

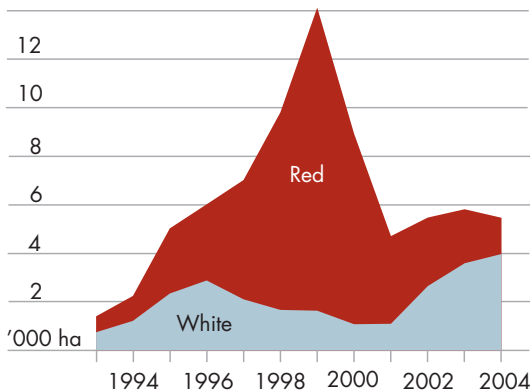
Red wine grape production is forecast to grow moderately over the outlook period, increasing 5 per cent to 1.02 million tonnes. Shiraz will remain the highest produced red variety (and second to chardonnay in aggregate), with production projected to increase to 497 000 tonnes, up 11 per cent between 2004-05 and 2009-10.

Over the outlook period the proportion of wine grape production from cool climate regions is projected to fall. This mainly reflects higher new plantings and subsequently higher growth in bearing areas in the inland warm climate regions, which have a projected production growth of around 14 per cent.

By the end of the outlook period, chardonnay production in warm climate regions is projected to reach around 357 000 tonnes, an increase 40 per cent from the 2004-05.

Production of premium red grapes in warm climate regions is projected to be approximately 540 000 tonnes in 2009-10, around 7 per cent

Australian wine grape plantings



higher than in 2004-05. This projected growth over the medium term is higher than that for production of premium red grapes in cool climate regions (a rise of 3 per cent to around 480 000 tonnes by 2009-10).

Wine sales outlook

In 2003-04 the Australian wine industry reached annual sales of just under 1 billion litres — domestic sales of 417 million litres and exports of nearly 581 million litres. Sales of Australian table wine accounted for over 92 per cent of total export and domestic sales, with domestic sales accounting for around 40 per cent of total table wine sales.

Despite a significant expansion in Australian wine grape production, growth in domestic sales has been modest (at an annual rate of around 3–4 per cent). Sales of Australian wine have become increasingly dependent on demand from key export markets. In 2003-04, export sales grew by around 14 per cent in volume terms, easing from 22 per cent in the previous year.

Domestic wine sales

Over the outlook period, Australian wine consumption is expected to continue to favor bottled table wine. Sales growth is projected to decline to around 2 per cent, with projected total sales of just under 500 million litres by 2008-09. Assumed slowing consumption growth is the basis for this forecast, with Australian per person consumption expected to remain around 23 litres a year.

Australian wine imports were around 19 million litres in 2003-04, representing 4.5 per cent of domestic consumption. The value of wine imports rose by 9.5 per cent to \$152 million in the same year.

Sparkling wine import shipments by Australia increased by 24 per cent, most of which was higher value French champagne, with value up 21 per cent to A\$65 million. Over the medium term, unit import values are expected to fall from current levels as a result of falling per litre values of bottled wine from New Zealand (the largest source of imported wines in volume terms).

Australian export sales favor red wine

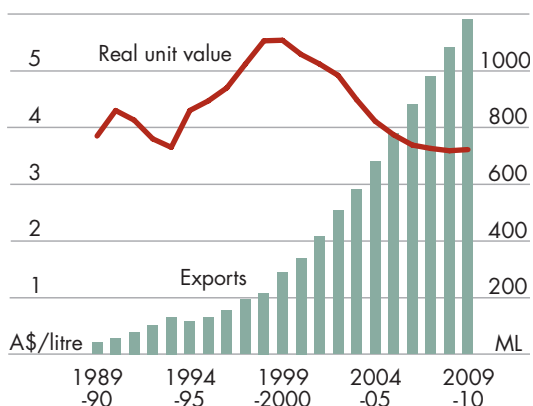
Australian wine exports reached a record 581 million litres in 2003-04 (valued at \$2.5 billion). Shipments of red still table wine continued to drive export performance, increasing by around 18 per cent in volume terms. Increases in bulk wine shipments relative to those of bottled and cask containers reflect a shift toward sales of lower valued products.

In 2003-04, the largest growth across all value segments was in the ‘popular premium’ category (\$2.50–4.99 a litre), increasing by 32 per cent. At the same time, the bulk category (less than \$2.50 a litre) continued to perform solidly, rising by 22 per cent on the previous year.

Australian wine exports are projected to rise by 17 per cent in 2004-05 to 679 million litres, having a value of \$2.8 billion. Unit values are projected to fall in four of the five key Australian markets (the United Kingdom, the United States, Canada, Germany and New Zealand), with New Zealand being the exception.

Unit values of exports to New Zealand increased by around 20 per cent to \$3.63 a litre in 2003-04. This increase was the result of a 17 per cent decrease in shipments of mostly lower valued wine. This decline in New Zealand wine imports from Australia reflected a combination of increased domestic supply in New Zealand and increased availability from alternative suppliers at highly competitive prices. This trend

Australian wine exports



is expected to continue in 2004-05, with imports from Australia projected to decline by a further 11 per cent, and value falling just over 7 per cent. Therefore, average unit export values to New Zealand are forecast to rise again in 2004-05.

In the medium term, Australian exports are well positioned to take advantage of consumer preferences for premium wine consumption. By 2009-10, Australian exports are projected to increase to around 1.2 billion litres, with a value of around \$4.3 billion.

By 2009-10, the United States is projected to surpass the United Kingdom to become Australia's number one export destination in both volume and value terms.

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