WINE INDUSTRY UPDATE

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After decade of battling the impact of a relatively high Australian dollar, the Australian wine industry is again benefiting from strong export growth. In the year to June 2016, the value of Australian wine exports grew by 11% to $2.11 billion. In 2016–17 exports increased to $2.31, and increase of 10%. Much of this growth has been underpinned by strong demand for Australian wines in China. The health of the export market is critical to the Australian wine industry with more than 60% of all wine produced exported.

Key industry insights:

- The 2017 vintage saw historically high production for the second year in a row – 1.98million tonnes of grapes crushed (up 8% on 2016) and 1.37 billion litres of wine produced (up 5% on the previous year).
- Wine sales totalled $5.6 billion – an 8% increase on 2016.
- An additional 59 million litres of Australian wine were sold in 2016–17, compared with the year before, with an additional value of $393 million.
- Sixty-one per cent of production was exported – that's 777 million litres (a 7% increase on 2016) valued at $2.3 billion (a 9% increase).
- Domestic sales accounted for 39% of production by volume. That's 500 million litres (up 2%) and valued at $3.3 billion (up 6%).
- Red wines dominated exports (60%) compared with whites (28%)
- At 45% whites were the largest sellers on the domestic market compared to reds (40%). Sparkling wines accounted for 11% of sales ahead of fortified wines (4%).
- Inventories of stored wine continue to increase. They now stand at 1.97 billion litres – up 3% in 2016–17. See Figure 2.
- Increased sales have been driven by the trend towards the consumption of premium brands in both the domestic and export markets. Sales of wine in the $20.00 to $29.99 were up 68%. Those in the $60.00 to $99.99 were up 52%. Sales of wines in the $15.00 to $19.99 bracket were down 18%.
- Wine sales to China exceeded $1 billion for the first time in the year to March 2018. The USA ($439 million) is the second largest market followed by the UK ($373 million), Canada ($193 million) and New Zealand ($82 million).
- Thirty-two million glasses of Australian wine are consumed worldwide daily.
- The short-term outlook for the wine sector is positive, with continuing sales growth expected, especially in export markets, and strengthening prices for wine and grapes, facilitated by global shortages in supply.

Wine production, sales and inventory, 2005-06 to 2016–17

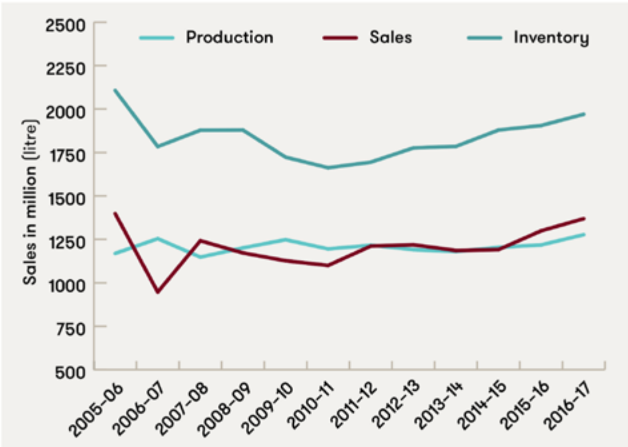

Figure 1: *Production has outstripped sales since 2014–15 adding to the inventory (i.e. wine in storage). Source: Wine Australia.*

The Chinese market

China, with it rapidly growing middle class, has been central of the revival of Australian wine exports.

In 2016–17, wine exports to China increased by 33 per cent to $721 million. Sales in the year to March 2018 posted an even more impressive increase of 51% to a total value of $1.04 billion. While part of the recent boost in sales results from the implementation of the China–Australia Free Trade Agreement (ChAFTA) the principal reason is growing consumer demand for premium Australian wines among the Chinese middle class.

The changing consumer preferences and purchasing patterns of China's middle class is reshaping both its domestic economy and the global economy more broadly.

However, in such a vast and diverse country as China, the middle class is by no means homogenous in its consumer preferences. Chinese millennials— those born between the early 1980s and the late 1990s—are more than 360 million strong and have a much different global outlook and consumption profile than older generations. Many are attracted to the trappings of a western lifestyle.

Being middle class is not just about income level—it is also a state of mind, reflecting an individual's attitudes and lifestyle. Like their counterparts elsewhere in the world China's middle-class consumers purchase products that improve their social image. The social status inherent in the consumption of particular products is one reason why Chinese consumers are so brand conscious and why China accounts for about one-third of the world's luxury purchases. The importance of 'social image' helps to explain why premium wine products have been central to the success of Australian producers in the Chinese market.

Hong Kong has played a key role in the industry's success in China. The former British colony is an important trading hub with important distribution links to mainland China. Imported wines are re-exported to other Asian destinations, with 95 per cent of re-exports going to mainland China.

Key issues:

- **Exchange rates** – An appreciating Australian dollar makes it more difficult to sell wine on the global market. A depreciating Australian dollar makes it easier.
- **Dependence on discretionary spending** – That is the money people have after they have met their essential costs (food, clothing and shelter). During periods of depressed consumer confidence people tend to reduce discretionary spending. In the case of wine they typically opt for cheaper labels. Sales of wine via restaurants will decline as people cut back on eating out.

Figure 2: *Woolworths owned Dan Murphy's is Australia's largest wine retailer.*

- **The concentration of ownership in wine retailing in Australia**

  The concentration of ownership in wine retailing puts downward pressure on the prices producers receives.

  Woolworths and Coles dominate wine retailing in Australia. Woolworths owns Dan Murphy's, BWS and Woolworths Liquor. Coles owns First Choice, Vintage Cellars and Liquorland. Together these outlets account for an estimated 72% of the $14.5 billion annual alcohol sales in Australia. Woolworths alone holds almost 50% of the retail market. Coles controls 15.5%.

  An additional concern is the trend towards home brand wines. Woolworths and Coles are actively promoting their own home brand wine labels, which are now estimated to account for 20–25% of sales, compared to just 5% a decade ago.

Figure 3: *The concentration of wine retailing in Australia puts downward pressure on the price producers receive for their wine.*

- **Competition from other beverages**

  Wine competes against a diverse range of alcohol beverages. Boutique beers and pre-mixed spirit-based drinks are popular with younger consumers. Educating young people about wine is a challenge the industry needs to embrace.

- **Climate change**

  Climate is one of the key factors controlling grape and wine production. It determines the suitability of grape varieties for particular regions as well as the type and quality of the wine produced. For the production of high quality wines, there needs to be a balance between climate, soil types and grape variety. As the climate changes this balance is upset and changes need to be made if quality is to be maintained.

  The gradual rise in global temperatures will affect viticulture all over the world. In doing so, it will have both positive and negative effects on the various wine regions of the world. Growers will have to adapt to climate change using various mitigation strategies. In some instances, grape varieties will need to change. Breeding programs (and perhaps genetic engineering) may also be needed to develop grape varieties better able to tolerate changing environmental conditions.

- **Tendency towards globalisation and localisation**

  At one end of the continuum from large-scale to small-scale producers are the big, multi brand, transnational corporate players. The ten largest of these corporations are listed in Table 1. Together they account for 12.62% of world production.

  Such corporations typically operate at a global scale. They are profit driven and their wines are often produced on an industrial scale using industrial processes. Economic factors dominate and the wines produced are 'generic' in terms of locality. Brands tend to be well known and are often widely available.

Table 1: The world's 10 largest wine corporations, 2016

Company and place of origin	Percentage of world production
E & J Gallo (USA)	2.70%
Constellation Brands (USA)	1.70%
The Wine Group (USA)	1.50%
Treasury Wine Estate (Australia)*	1.12%
Viña Concha y Toro (Chile)	1.03%
Castel Frères (France)	1.02%
Accolade Wines (Australia)#	0.97%
Pernod Ricard (France)	0.97%
Grupo Peñaflor (Argentina)	0.90%
FeCoVitA Coop (Argentina)	0.70%

*** Treasury Wine Estate's** *41 brands include: Acacia, Belcreme De Lys, Beaulieu, Beringer, Blossom Hill and Chateau St Jean in the USA; Secret Stone and Matua Valley in NZ; Castello de Gabbianno in Italy; and Heemskerk, Leo Buring, Penfolds, Pepperjack, Rosemount, Saltram, Seppelt, Wolf Blass and Wynns in Australia.*

 # Accolade Wine's *56 brands include: Atlas Peak, Echo Falls, Geyser Peak, Paul Masson, Ravenswood, Robert Mondavy and Turner Road in North America; Drylands, Monkey Bay, Mud House, Ta Ku and Waipara Hills in New Omni, Zealand; Anakena and Gran Tierra in Chile; Da Luca and Mezzomondo in Italy; Fish Hoek, Flagstone, Kumala in South America; and Banrock Station, Berri Estates, Eddystone Point, Grant Burg, Hardys, Houghton, Knappstein, Leasingham, Petaluma, Stanley Wines, St Hallett, Tatachilla and Yarra Burn in Australia.*

At the other end of the continuum are the small-scale estate wine producers. Often these are family owned and operated and have a strong association, culturally and geographically, with the place in which they area located. The producers are typically small (boutique) wineries and the owners are often lifestyle driven. The wines tend to be innovative and are made using 'traditional' processes. Cultural influences are strong and the wines are often distinctive in terms of locality (or *terroir*). Wines are typically sold via the cellar door or online using email mailing lists. Where wines are sold through retail outlets these tend to be small independent wine retailers rather than the large outlets controlled by Woolworths and Coles.