Wine and the economic recession

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The issue, beginning in 2008

- Shock of GFC and North Atlantic recession
- Coincident with, and reinforced by:
  - primary product price spikes, and
  - rapid growth & taste change in emerging Asia
- Those, and the associated exchange rate changes, are affecting various segments of the global wine market differently
<table>
<thead>
<tr>
<th>Real GDP growth:</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-income (OECD)</td>
<td>0</td>
<td>-4</td>
<td>3</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>7</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>World export vol.</td>
<td>3</td>
<td>-12</td>
<td>11</td>
</tr>
</tbody>
</table>
Int’l agric and energy raw material price indexes, 2000 to Feb 2011 (nominal, WB)
<table>
<thead>
<tr>
<th></th>
<th>GDP share (%)</th>
<th>Pop’n share (%)</th>
<th>GDP per capita (rel. to world)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
<td>2030</td>
<td>2004</td>
</tr>
<tr>
<td>High-income</td>
<td>80</td>
<td>65</td>
<td>20</td>
</tr>
<tr>
<td>Developing</td>
<td>20</td>
<td>35</td>
<td>80</td>
</tr>
<tr>
<td>of which Asia:</td>
<td>11</td>
<td>22</td>
<td>55</td>
</tr>
<tr>
<td>World</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Currency</td>
<td>2001</td>
<td>2007</td>
<td>06/11</td>
</tr>
<tr>
<td>---------------</td>
<td>-------</td>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>Euro</td>
<td>1.12</td>
<td>0.73</td>
<td>0.70</td>
</tr>
<tr>
<td>UK Pound</td>
<td>0.69</td>
<td>0.50</td>
<td>0.63</td>
</tr>
<tr>
<td>Arg. Peso</td>
<td>1.00</td>
<td>3.10</td>
<td>4.30</td>
</tr>
<tr>
<td>Au. Dollar</td>
<td>1.93</td>
<td>1.20</td>
<td>0.95</td>
</tr>
<tr>
<td>NZ Dollar</td>
<td>2.38</td>
<td>1.36</td>
<td>1.23</td>
</tr>
<tr>
<td>S Afr Rand</td>
<td>8.61</td>
<td>7.05</td>
<td>6.86</td>
</tr>
</tbody>
</table>
Segments on global wine market, 2007-09

Non-premium (NP), commercial-premium (CP), super-premium (SP), and iconic wines

- By volume: 45%, 40%, 15%, and 1%

Old World (EU27), New World (8), and Rest-of-world

- By prod’n volume: 61%, 27%, and 12% (but was only 8% in 1995-99)
- By cons’n volume: 68%, 24%, and 8%
Basic direct influences of GFC

-hit NYC and London financial markets most, with flow-on adverse effects to US, UK and European economies

⇒ Reduced demand for SP wines, as people dined out less & tightened spending

⇒ Perhaps smaller proportional declines in CP and NP wine sales, esp. as beer prices have risen with increased price of grain
Influences of exchange rate changes

- Declines in value of UK pound and US$ further lowered demand there.
- Strengthening of Australian (and NZ & Canadian) $, due to China-driven boom, made their wineries less competitive in US, UK and Europe, so cushioning slightly the impact of GFC on US and EU wine producers, and allowing Argentina to take advantage of its major devaluation.
Contributions of coincident trends

1. Rapid income growth & taste changes in emerging Asia, esp. China, plus removal of wine import taxes in Hong Kong

=> Large increase in demand for iconic wines (which in any case are less affected by recession because they’re storable)
Contributions of coincident trends

2. *Supermarket* dominance in especially UK led to severe discounting at expense of wineries and, in turn, grapegrowers -- and winery profits are being further eroded by expanding share of supermarkets’ *own-brands*

3. Bottlers, shippers, importers and distributors also losing out by growth in *bulk* share of New World’s wine exports
Rising share of New World exports in bulk (%)
Researchable questions re. 2008-11

- Who bore the brunt of recession: Grapegrowers, input suppliers, winemakers, distributors, retailers?
- Which types of wine demand fell most: Domestic or imported? NP, CP, SP, iconic wines? Sparkling?
- What share of impact was due to exchange rate changes? Shift to bulk?
- How low are elasticities of grape and wine supply response to a fall in wine price?
Current challenges in Australia’s wine industry: more than the GFC

- **Profits of wineries** have nose-dived
  - => fire sales (<1/2 price) of some winery and vineyard assets
- **Winegrape prices** in irrigated areas fell 30% in 2009, a further 25% in 2010, & no better in 2011
- **Import share of domestic wine sales** has risen five-fold, from 3% in 2001 to 15%
  - NZ (68% of vol.), but also from France (13%) and Italy (10%)
- **Export sales prices and volume are declining**
- **48% of exports sold in bulk** in 12 months to 04/11, compared with 15% in 1996-2003
Why a wine crisis in Australia now?

- Excessive exuberance of investors, fueled by tax incentives, led to 30-year targets (1995-2025) being achieved in $\frac{1}{4}$th of that time
  - Too much fruit from young vines for marketers to sell
- Other New World producers copied Australia
  - grew their exports even faster in 2000s than Aust did in 1990s (due to fall in cons’n, not acreage expansion, in Arg, SA & CEE)
- Exchange rate appreciation, due to mining boom
  - in contrast to, e.g., Argentina
- Fashion swing against Oz wine abroad
  - and at home, from NZ esp. (which has its own surpluses, exacerbated by 23% higher crop in 2011)
- Cool wet summer, following 10-year drought
Aust AUD export price peaked in 2001, volume plateaued from 2006
Aust. exports: slowing in all but lowest prices

<table>
<thead>
<tr>
<th>Price Range</th>
<th>Million Litres</th>
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<tbody>
<tr>
<td>$2.49 and under</td>
<td></td>
</tr>
<tr>
<td>$2.50 to $4.99</td>
<td></td>
</tr>
<tr>
<td>$5.00 to $7.49</td>
<td></td>
</tr>
<tr>
<td>$7.50 to $9.99</td>
<td></td>
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<tr>
<td>$10.00 and over</td>
<td></td>
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</tbody>
</table>

Graph showing the million litres of exports across different price ranges from 1999-00 to 2009-10.
How quickly will Oz wine industry recover?

- China boom could continue for 20+ years, so strong AUD will persist
- Very slow vine pull; supply adjustment will require new ownership to raise efficiency
  - Big listed firms aren’t attractive to smaller family firms, but may be to Chinese investors?
- R&D spending growth has stalled
  - tied to size of crush, unlikely rate will be raised
How quickly will EU recovery occur?

- For Bordeaux iconic wines, not an issue
  - Demand growth from HK/China (now Bordeaux’s No. 1 market) means continuing high prices
    - Asset prices also kept high by China’s interest in acquiring chateaux (but will new owners by-pass negotiants?)

- For EU’s producers of NP wines, chronic surplus continues (and removing restrictions on planting in 2015 may worsen it?)
  - Requires them to upgrade quality of prod’n AND marketing, to at least CP wine standard

- US/EU demand for SP wines now rising again?
Despite export growth, Old World prodn. continues to exceed sales (ML)
Two promising signs

(a) In EU’s wine-importing countries, consumption per adult continues to grow.

And young adults are beginning to return to wine in some EU wine-exporting countries?

• But will health lobbies’ influence choke it off?
Consumption in Europe’s wine-importing countries (litres of alcohol)
Two promising signs (continued)

(b) In Emerging Asia, middle class is rising very rapidly (extra 2.5m expected by 2030, compared with just 900m middle-class today globally)

Is Asian demand growth enough to arrest LR decline in wine’s share of global alcohol cons’n?

Will Asia’s domestic wine prod’n rise as rapidly as/faster than their domestic cons’n?
Shares of wine, beer, spirits in global recorded alcohol consumption (%)

- **Spirits**
- **Beer**
- **Wine**

<table>
<thead>
<tr>
<th>Decade</th>
<th>Spirits</th>
<th>Beer</th>
<th>Wine</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960s</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970s</td>
<td></td>
<td></td>
<td></td>
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<td>1980s</td>
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<tr>
<td>2000s</td>
<td></td>
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</tbody>
</table>
Total wine sales in Asia (ML)

- China
- Japan
- Hong Kong, Korea, Taiwan
- Other Asia

Sales data from 2000 to 2009
Consumption/adult in Asia (litres of alcohol)

Hong Kong

Japan

Singapore

China

Korea

Malaysia

2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
China’s wine production & consumption (ML)
Exporting to China is a challenge though

France, the leading wine exporter to and foreign investor in China’s wine industry, has been there for decades
### Whose exporting to China (2009)?

<table>
<thead>
<tr>
<th>Country</th>
<th>Volume, ML (and share, %)</th>
<th>Value, US$m (and %)</th>
<th>Unit value (US$/litre)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>48 (24)</td>
<td>206 (38)</td>
<td>4.29</td>
</tr>
<tr>
<td>Australia</td>
<td>44 (22)</td>
<td>102 (19)</td>
<td>2.34</td>
</tr>
<tr>
<td>Chile</td>
<td>56 (28)</td>
<td>54 (10)</td>
<td>0.97</td>
</tr>
<tr>
<td>United States</td>
<td>12 (6)</td>
<td>35 (7)</td>
<td>3.08</td>
</tr>
<tr>
<td>Italy</td>
<td>8 (4)</td>
<td>27 (5)</td>
<td>3.42</td>
</tr>
<tr>
<td>South Africa</td>
<td>8 (4)</td>
<td>7 (1)</td>
<td>0.88</td>
</tr>
<tr>
<td><strong>All exporters</strong></td>
<td><strong>202 (100)</strong></td>
<td><strong>538 (100)</strong></td>
<td><strong>2.66</strong></td>
</tr>
</tbody>
</table>
Final word: this week’s news on the challenges of exporting to China

How easily can others catch up with France?

1/3rd of China’s upper middle class drinkers of imported wine do not know Australia produces wine, and

2/3rds have never heard of Napa Valley (according to Wine Intelligence)
Thanks!

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www.adelaide.edu.au/wine-econ