



AUSTRALIAN AGRIBUSINESS GROUP

# MARKET OVERVIEW – THE AUSTRALIAN WINE AND WINE GRAPE INDUSTRY

Independent Assessment – January 2007

## Industry Snapshot

- Due to large plantings of grapes, national vineyard areas grew 145% in the last decade from 64,000 ha in 1995 to just over 157,000 ha in 2006 (Section 1).
- Along with the USA and South Africa, Australia is one of the most influential new world wine countries (Section 1).
- Wine is Australia's fourth largest rural export industry with the value of exports by the industry predicted to reach \$4.3 billion by 2009/10 (Section 3).
- South Australia contributed almost half of the country's national wine grape crush, while combined with NSW, Victoria and WA produced more than 99% of the overall total (Section 2).
- Over the last ten years Australia has recorded a 40% increase in total domestic wine sales with a current total domestic consumption of 431 ML, which is expected to increase by 1L per person by 2010/11 (Section 3).
- Despite the international market becoming increasingly crowded, Australia has the capacity to remain competitive while it has the ability to produce quality-for-value wines following the strong market presence it has built up in many of the worlds leading importing countries (Section 5).

## 1 Introduction

Australia has been described as the perfect wine producing country. The first grapevines arrived in Australia with European settlement in 1788, with the establishment of the first commercial vineyard not long after. As settlement spread throughout the country during the 19<sup>th</sup> century so to did plantings of grapevines. However it wasn't until after the First World War that a sharp increase in production was witnessed due to soldier settlement. With the gradual change in eating patterns due to European migration after the Second World War, Australian wine consumption increased. Innovation within the Australian wine industry, in addition to the culture and expertise brought by new migrants, has forged the Australian wine industry into one that today holds a strong international reputation for quality and value <sup>1</sup>.

Australia's diverse array of climates and soil types has resulted in an extensive range of wine styles produced in Australia <sup>2</sup>. These include full bodied reds and fruity whites to sparkling, dessert and fortified varieties which compete favourably in restaurants around the world with wines from more traditional international producing regions <sup>1</sup>.

Up until the early 1980's, Australia was a net importer of wine <sup>2</sup>. Once domestically focused, the Australian wine industry has seen rapid growth in export volumes and value over the last ten years. Since 1992, the value of Australian wine exports has increased a remarkable 1270% from AU\$200 million to AU\$2.7 billion <sup>2</sup>. Along with the USA and South Africa, Australia is now one of the most influential new world wine countries <sup>3</sup>.

In 2005, the Australian wine industry achieved a record vintage, with an estimated crush of 1.95 million tonnes <sup>4</sup>, up 6% from the previous vintage record in 2004. The wine grape crush for 2005 would have been higher if some grapes had not been left on the vines or harvested onto the ground in response to declining prices and poor returns for some grape growers resulting from an oversupply in the Australian market <sup>4</sup>. 2006 saw a 4% decline on 2005's production. Over the past decade, Australian wine production increased by 125% influenced by the continued growth in Australian exports.

Wine is Australia's fourth largest rural export industry, behind wheat, beef/veal, and wool. It is predicted that wine exports will double to a value of AU\$4,260 million by 2009 <sup>5</sup>.

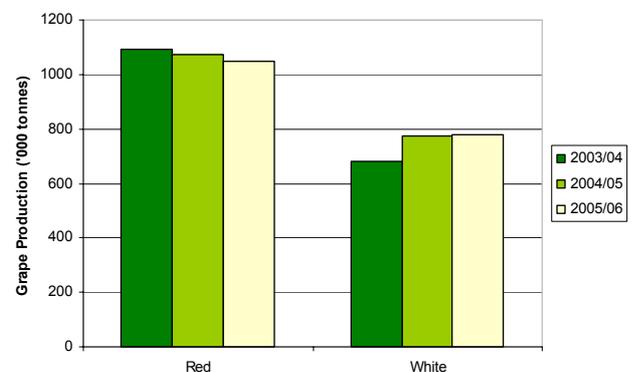


Figure 1 - Australian Red and White grape production 2003/04 to 2005/06 <sup>24</sup>

Due to large plantings of grapes over the last ten years, national vineyard areas grew 145% from 64,000 ha in 1995 to just over 157,000 ha<sup>18</sup> in bearing area in 2006. As is evidenced in Figure 1, red grape production continues to surpass white grape production, reinforcing consumer preferences in recent years for red wine. This is evidenced in 2006 figures showing that Australian vineyards were made up of 54% red grape and the remaining 46% from white grape varieties<sup>21</sup>. The gap between red and white production has however been narrowing over the past few years as indicated by Figure 1. This can largely be attributed to a decline in Shiraz plantings and a 330% increase in vineyards producing Chardonnay between 2000/01 and 2004/05<sup>5</sup>. Changing consumer preferences within these types have also had substantial impact on wine intake with all major red varieties falling and most whites increasing, Sauvignon Blanc was the largest mover with an 8% increase in intake in 2006<sup>21</sup>.

<b>Table 1 - The Australian Wine Industry at a Glance</b>	
Wineries (2005) <sup>22</sup>	1,899
Vineyard Area (bearing vines, 2006) <sup>5</sup>	157,000 ha
Tonnes Crushed (2006 vintage) <sup>21</sup>	1.85 MT
Grapes used for wine production (2004/05) <sup>18</sup>	1.936 kt
Domestic sales (2004/05) <sup>18</sup>	430 ML
Wine exports (2004/05) <sup>18</sup>	661 ML
	A\$2.75 billion
	A\$4.16/litre
Wine imports (2004/05) <sup>18</sup>	22.14ML
	A\$188 million
	A\$8.52/litre

## 2 Grape Growing Regions in Australia

Vineyards and wineries are spread throughout many regions in Australia, with approximately 90 commercial grape varieties grown. Currently Shiraz is the most favoured variety accounting for 24% of production with 2006 harvests resulting in 441,000 tonnes of this grape crushed for wine making purposes. Cabernet Sauvignon, the second most common red grape and Chardonnay, the most popular white grape variety accounted for 15% and 23% of Australia's production respectively<sup>21</sup>.

South Australia (48%) continues to be the dominant state in wine production, with just under half of the country's crush during 2005. NSW and Victoria remain the second and third largest producers accounting for 26% and 22% of the nation's crush respectively, while Western Australia (4.4%) is the only other significant contributor by state (Figure 2)<sup>19</sup>.

Australia has about 60 distinct wine regions, each with unique characteristics. South Australia holds the largest area of vines, with three of the nation's top five winegrape producing zones by volume crushed located in South Australia. Big Rivers Region of NSW and North West Victoria are the exceptions to these ranking's, featuring second and third respectively in terms of volume<sup>22</sup>.

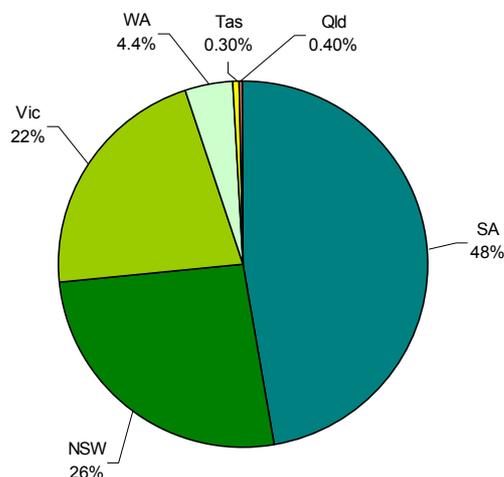


Figure 2 – State Production of Wine grapes, 2005<sup>19</sup>

For the short to middle term South Australia is expected to maintain its position as the leading specialist wine grape producing state. Although NSW has 1,300 ha less vineyards than Victoria, it is expected to remain the second largest producer of specialist wine grapes due to its large area of higher yielding warm climate vineyards compared to that of the cooler climate vineyards in Victoria.

Victoria has the greatest number of wineries and is second only to South Australia in its number of specialist wine grape producers, highlighting the greater number of smaller "boutique" wineries in Victoria<sup>10</sup>.

## 3 Domestic Sales and International Trade

Australia's wine grape production is projected to reach around 1.9 million tonnes by 2010/11. This is 1.5% above predicted 2005/06 production. Over this time it is predicted that white grape production will increase by approximately 10%, while red grape production is forecast to fall 4% by 2010/11<sup>5</sup>.

Domestic wine sales have increased by 24% (imported and domestically produced) over the last eight years with domestic annual wine consumption per person expected to rise slightly from just under 23L to 24L by 2010/11. In line with these figures, sales of Australian wine on the domestic market will increase by 14% to 490,000 tonnes in 2010/11<sup>5</sup>.

Australian imports of wine have fluctuated over the past decade falling dramatically in 2000/01 thereafter rising steadily to 22.14ML in 2004/05<sup>18</sup>. In 2004/05 wine imports accounted for 4.9% of all domestic wine sales in Australia, up from 3.5% in 2001. The average price per litre of imported table wine increased by 4.5% from the previous year to A\$8.50<sup>19</sup>. The majority of Australian wine imports are sourced from Italy, New Zealand and France. New Zealand's contribution to Australian imports has risen significantly over recent years to now account for 27% of Australia's total wine imports<sup>5</sup>.

Germany and the UK dominate global wine imports each accounting for 18% of world imports (Figure 3)<sup>11</sup>. The USA, Russia and France are also large importers of wine. With imported wine constituting 72% of total wine consumed in Germany, it remains crucial to global wine trade. Competition remains intense with imports coming from both 'traditional' wine producers (i.e. France), and 'new world producers' (i.e. Australia and US).

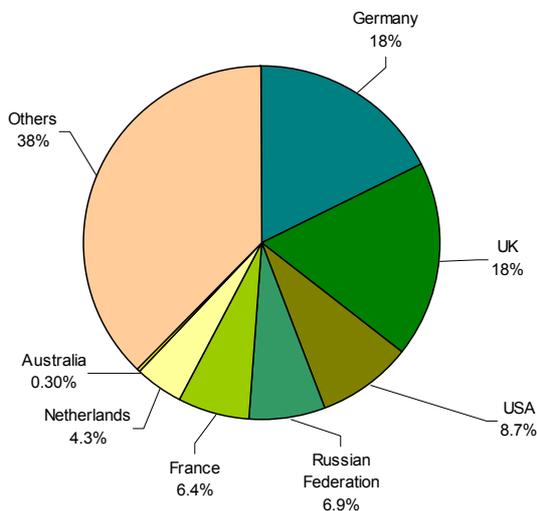


Figure 3 –Volume share of World Wine Imports (%) 2004<sup>20</sup>

Despite price pressures, Australia has managed to grow its exports with Australian export sales surpassing domestic sales for the first time during 2002<sup>6</sup>. Ever since, export sales have continued to grow (Figure 5)<sup>6</sup>. It is currently expected that the volume and value of exports will continue to increase at a greater rate than that of domestic sales.

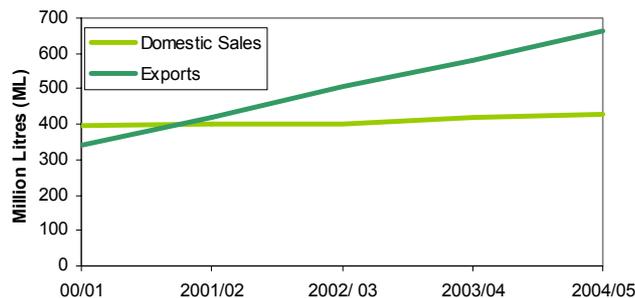


Figure 5 - Domestic vs Export Sales 2000/01 to 2005/04<sup>6</sup>

The UK, with a tiny domestic industry, relies on imported wine for domestic consumption. Demand for wine in the UK has increased by 90% over the past decade to 24 litres per capita<sup>5</sup>. This has resulted in the UK establishing itself alongside Germany in importance as an export market for new world wines.

As Figure 4 suggests, the largest exporters of wine products remain Italy (21%), Spain and France (18%)<sup>23</sup>. Australia is the world's fourth largest exporter of wine products accounting for 9% of the world export market.

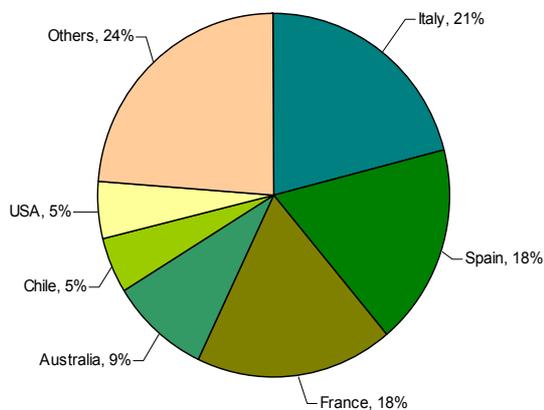


Figure 4 –Volume share of major world wine exporters (%) 2005<sup>23</sup>

While exports from 'traditional' wine producing countries continue to fall due to decreased production, exports from 'new world markets' continue to increase dramatically. The increased volumes from countries such as Australia, Chile, South Africa and the US have generated fierce competition. This competition has resulted in downward pressure on the price of wine.

As Figure 6 indicates, the UK and the US are the key export markets for the Australian wine industry each individually accounting for 40% of the total value of Australian wine exports. Together they are worth over \$1.8 billion of the \$2.3 billion market<sup>6</sup>. There is also growth in the Canadian and German markets<sup>8</sup> and emerging opportunities in Eastern Europe and Scandinavia.

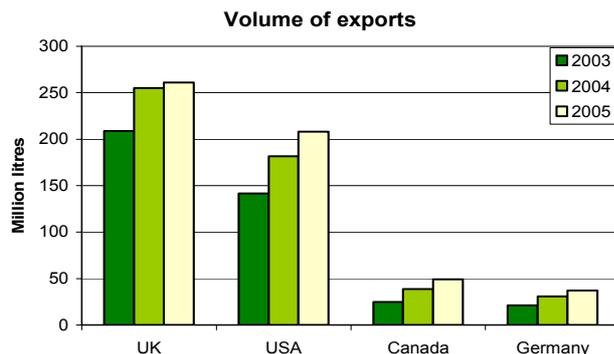


Figure 6 - Volume of Exports 2003 – 2005<sup>22</sup>

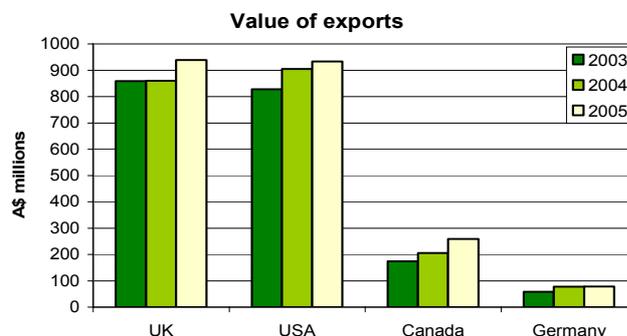


Figure 7 – Value of Exports 2003 - 2005<sup>22</sup>



Although the international market is becoming increasingly competitive, forecasts suggest that further growth opportunities exist for the Australian wine industry. In the medium term, Australian exports are well positioned to take advantage of consumer preferences for premium wine consumption, with Australian wine exports projected to reach 1.2 billion litres, with a value of \$4.3 billion by 2009/10<sup>5</sup>.

Growth of wine consumption is been driven from emerging Asian, Latin American and Eastern European nations. However, current high levels of tariffs associated with potential markets such as South America and Asia provides some restriction to export growth. The recent reductions in tariffs and finalised trade agreements with Singapore, Thailand and the US should allow further growth of wine exports. Negotiations are also currently taking place for Free Trade Agreements with China, Japan and Malaysia<sup>12</sup>.

As Asia becomes a major force in the global economy domestic demand for wine products is expected to increase. Asia, in particular China's economy is booming and with the Beijing Olympics in 2008 and the World Expo located in Shanghai in 2010, there is considerable potential for exporters of wine such as Australia. Within Asia, Japan currently is the largest market, however due to a strong dominance of old world wine "prestige perception" producers, long term marketing campaigns will be needed to entice younger/wealthier consumers to drink new world wines<sup>13</sup>.

Thus it is imperative that the industry continues work to penetrate further into these markets, which will require the development of effective distribution and marketing strategies<sup>14</sup>.

## 4 World and Domestic Prices for Australian Wine and Wine Grapes

After increasing during the early and mid 1990's, domestic wine prices have been declining ever since. This is due to both lower export prices and supply growth significantly outpacing demand for this period<sup>15</sup>.

There has been a global oversupply of wine over the recent period primarily due to an oversupply of old world wine for which demand is easing. It is predicted that this oversupply will cease in 2007 due to increased demand in non-traditional wine consuming countries<sup>3</sup>.

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 wines<sup>5</sup>. Australian wine indicator prices are forecast to fall from 2004/05's levels, 6% for white grapes and 5% for red grapes making the prices for 2005/06 \$522 and \$413 per tonne respectively<sup>24</sup>. With decreased plantings of red grape varieties and improved demand from wineries, it is predicted that average red wine prices will recover in the medium term following a decline in the short term. However, in this time, prices for white grape varieties are predicted to decline as increased supplies of Australian white grapes hit the market<sup>5</sup>.

Australia is likely to see a low yielding 2007 season, possibly to the extent of a 20% reduction in yields, primarily due to drought and frost. However consumers should see virtually no difference in 2007 as current stock overhang can be brought forward a year earlier compared to normal yielding years, balancing supply and demand<sup>25</sup>.

With the wide range of wine producing regions in Australia, it is currently difficult to place a figure on the likely fall in production due to frost and drought. Frost impacts depend heavily on the type of grape grown, individual conditions and the extent of drought within the region. Some of Australia's highest producing regions are predicting minimal losses resulting from frosts and a quick rejuvenation in re-growth.

The drought has been widespread in South East Australia, however efficient irrigation systems, even in regions of water allocation cut-backs, are effectively sustaining crops. The continuation of the drought is likely to have more serious impacts on the industry due to increased water-allocation restrictions and the hindrance this may have on the coming year's secondary buds<sup>26</sup>. The likely prospects for low yielding seasons in 2007 and 2008 along with an easing in national oversupply and a slowing in export growth, present a valuable opportunity to draw down current elevated stock levels towards a balanced position by as early as 2008/09<sup>25</sup>.

Prices are heavily dependent on quality, variety and the region in which they were grown, with significant variations apparent. Export markets are expected to have a large influence on Australian wine and wine grape prices due to the nation's increasing proportion of international sales and reliance on specific markets<sup>7</sup>. New markets opening up such as Asia will have a large bearing on the future price of Australian wine.

## 5 Future Outlook for the Australian Viticulture and Wine Industries

The outlook for the Australian Wine and Viticulture industry is varied with much of the fluctuation being attributed to the current widespread drought in Australia and excess supplies over the past few years. The record 2005 vintage placed further upward pressure on inventory levels forcing prices to fall in 2006. Other challenges such as growth in domestic and international competition, retail consolidation, discounting both in Australia and key export markets and a strong Australian dollar have all contributed to constraints on Australian wine and grape prices greatly affecting margins all along the supply chain<sup>21</sup>.

The outlook over the next 5 years shows white wine grape prices falling by 21% in 2005/06 dollars. The outlook for red grape prices predicts a low in 2006/07 and a steady increase occurring by late 2008<sup>5</sup>. These price movements leading up to 2010/11 reflect an increase in white grape production by 10% over this period and a decline in red grape production by 4%. This shift in production from red to white grape varieties may help to reduce some of the market imbalances occurring, alleviating the build up in supplies and falling prices.

With significant demand for high quality cabernet sauvignon, shiraz and merlot in international markets, Australia's ability to enhance the quality of grape and therefore wine production is imperative to the outlook of the Australian wine industry. The Cooperative Research Centre for Viticulture (CRCV) is developing analytical methods to measure critical grape components such as flavour and vineyard management strategies for the production of grapes to these specifications. Defining grape quality attribute specifications will be of benefit to the grape industries<sup>16</sup>.

Australia is also at the forefront of viticultural science through research into molecular biology, and applying this information to technological changes. Other issues the CRCV is addressing include environmental concerns so that Australia can maintain and enhance its 'clean and green' image, as this is vital for future market growth<sup>16</sup>.

Grape production is expected to increase in all regions, being most evident in the inland warm climate regions of Australia particularly the Swan Hill/Murray Darling and NSW districts<sup>27</sup>. The strongest growth is expected to occur in white grape production<sup>24</sup>. This reflects grape planting activities of recent years with increased white grape production responding to the sustained low prices of red grape varieties and a catch up in the plantings of white varieties<sup>21</sup>.

Industry growth and expansion relies on exports. The continual growth experienced by the Australian wine industry should persist as it is anticipated that by 2009/10, Australian wine exports will have grown by approximately 45% since 2004/05 levels<sup>5</sup>. World wine consumption is predicted to grow 7% by 2010<sup>5</sup>. Ultimately the degree of success by the industry will largely be determined by the economic growth and disposable income levels of countries that consume Australian wine and the relative exchange rates<sup>10</sup>.

Opportunities for the Australian wine industry to expand its export sales will occur through increased open markets and export tools such as FTA's being established. This will provide much needed diversity and flexibility to the current program. In contrast tightening of trade agreements into any of the current key markets would have the reverse effect on the industry<sup>9</sup>. Domestic consumption is expected to rise as a result of population growth in wine consuming age groups, increasing incomes, increasing restaurant patronage and an increase in regional wine tourism and cellar door sales. Although Australia increasingly relies on the export market, the domestic market is also likely to continue to be important to the future growth of the Australian wine industry.

Australia's current reputation for value and quality in wine production is an important factor that will continue to influence the health of this industry. Many wine consumers currently do not exhibit brand loyalty and easily move from one brand to another<sup>17</sup>. It is vital for Australian producers in both the domestic and international markets that they build strong brands to ensure they can capture consumers who will consistently purchase their product.

Risks to the Australian wine industry include fluctuations in exchange rates, increased regulation, variable seasonal conditions leading to variable yields and increased competition from both 'traditional' and 'new world' producers. Changing consumer preferences are a risk to the industry due to the length of time required to establish productive vineyards.

## 6 Conclusions

While the short term outlook for the Australian wine industry will be challenging, the longer term prospects are optimistic. As margins continue to be under pressure, further rationalisation to improve efficiency in the wine industry is likely to occur in the near future.

On the basis of appropriately valued, high quality and branded produce, (which importantly still has room for improvement), good pedigree, genuine market drive, export orientation and sufficient supply, success and further growth should continue in the long term future. Current oversupply issues are an immediate challenge and concern to the industry and will need to be effectively managed in order to ensure the immediate sustainability of the domestic industry. Managing the volatility of the Australian dollar will also remain a critical factor for wine exporters.

With Australia's increasing reputation of producing high valued 'healthy' wine, it should become a stronger force in the global wine and wine grape industries. Australia continues to remain competitive because it is able to produce quality-for-value wines and has built a strong market presence in many of the worlds leading importing countries. With the level of competition increasing, it is imperative that the Australian wine industry continues to work hard to maintain and grow existing and potential markets, whilst maintaining a high quality product.



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