Australian Bulk Wine Market A-B-C

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Here is a brief A-B-C of the Australian Bulk Wine Market to bring you up to date:

A. The main influences driving the Australian bulk wine market today

B. Varietal & Pricing Roundup

C. The Current Outlook

A. The main influences driving the Australian bulk wine market today

2018 Wine Grape Crop

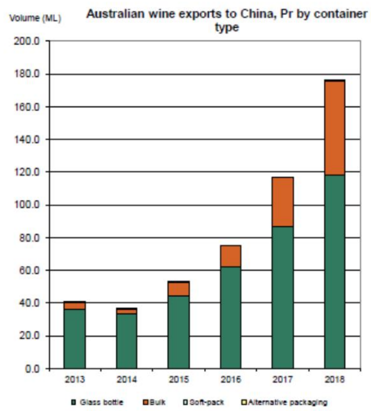
A high quality crop has been reported by most producers, and it is clear to most, if not all, market players that the 2018 wine grape crop has been unable to fully satisfy current demand.

Accordingly, we have continued to witness increasing supply and pricing pressures as buyers try to win their share of wine from this vintage.

The final crop figure is expected later this month, but anecdotally the 2018 wine grape crop was likely 5-10% smaller than last year's record crop of 1.930 million tonnes.

China

Exports to China are growing at a rapid pace, continuing the robust growth of the last several years. See the graph opposite (courtesy AGWA).



The 5-year compound annual growth rate (CAGR) is extremely impressive: 32% CAGR by value and 34% CAGR by volume, for the 5 years ending 30 June 18.

However, the growth rate during the last 12 months is breath-taking: 66.1% by value and 50.3% by volume, for the year to 30 June 18.

China is now the biggest market for Australian wine by value, accounting for over AUD$1.0 Billion of total wine exports of AUD$2.76 Billion.

A market dominated by red wine, China is now equal to the next three markets for Australian wine combined (USA AUD$424m, United Kingdom AUD$384m and Canada AUD$199m).

New Taxation Arrangements

New Wine Equalisation Tax (WET) Rebate eligibility criteria apply from 1 July 2018. Broadly, to now be entitled to the producer rebate, the following key criteria must be met (amongst other, more minor, criteria):

- *the producer must own at least 85 percent of the source product of the wine throughout the wine-making process;*
- *the wine must be packaged in a container less than 5 litres; and*
- *the packaged wine must be branded by a trademark that is owned by the wine producer or its associates.*

The change in the domestic taxation arrangements from 1 July 2018 means that wine producers can now no longer access tax benefits by buying bulk wine domestically, blending, and at some later date, exporting in bulk a derivative blend of a very similar wine. Such schemes could only be described as aggressive interpretations of the tax law and, without the taxation benefits courtesy of the Australian taxpayer, the economics that precipitated such arrangements no longer work. The wineries involved with such schemes cannot supply last year's volumes and a lot of buyers are spilling out into the open spot market trying to secure supply, having been caught short by this change.

This change has been a big invisible hand in the market place, driving up bulk wine and grape prices. Most domestic wineries foresaw this change, however it would be fair to say that they were unsuccessful in convincing their overseas buyers to change their purchasing strategies ahead of the change. Change is now being forced upon many buyers as they witness sudden and breathtaking movements in price and availability across the market place for Australian wine, which are not in their favour.

Domestic Demand Resurgence

Three years ago most domestic wineries were happy to sell to their competitor wineries almost any inventory item. But today most domestic wineries are buyers from their competitors (assuming the price is right). The item in most demand is entry level varietal red wine, often to satisfy Chinese demand, or opportunities in other markets arising from China's demand impact.

During the past couple of years, producers of entry level varietal red wine have almost certainly experienced many more enquiries than they have wine for. Almost all stocks of commercial level varietal red wine of any significant volume are allocated, and most wineries are reporting multiple buyers for the same wine.

It is certainly a very different supply situation compared to say, three years ago.

B. Varietal & Pricing Roundup

Supply/Demand Balance

Critically Short:	*Commercial/Entry level Shiraz, Cabernet Sauvignon, Merlot.*
Short:	*Commercial/Entry Sauvignon Blanc and Chardonnay and Pinot Gris.*
In Balance:	*Dryland/Premium reds.*
Long:	*Dryland/Premium Chardonnay & Sauvignon Blanc.*

Commercial Reds

Commercial/Entry level Shiraz, Cabernet Sauvignon and Merlot are all critically short as demand, mostly from China, outstrips supply. For every litre of Australian white wine exported to China, about 20 litres of red wine are exported.

Commercial Chardonnay

Prior to vintage, Commercial/Entry level Chardonnay was generally assumed by most market players to be in abundant supply. But it is not. Very few wineries have any substantial volume of unallocated commercial Chardonnay and there is limited supply choice. Price increases have been evident, but have been more muted than the price increases witnessed for red wines.

Pricing Roundup

A brief summary of the main varieties is set out below. Prices are for South Eastern Australia wines, unless otherwise indicated, in AUD$, per litre, pre bottling condition, FOB Port, on drawdown.

***Dry Red:** 1.05-1.15. Patchy supply with strong demand.*
***Shiraz:** 1.45-1.60. Very limited supply with strong demand. The largest red variety by volume, also in the greatest demand.*
***Cabernet Sauvignon:** 1.40-1.60. Very limited supply with strong demand. The 2nd largest variety by volume.*
***Merlot:** 1.40-1.60. Very limited supply with strong demand.*

***Dry White:** 0.85-0.95. Patchy supply with moderate demand.*
***Chardonnay:** 1.05-1.15. Patchy supply.*
***Pinot Gris:** 1.35-1.50. Patchy supply, demand not perhaps as hot as 12 months ago.*
***Sauvignon Blanc:** 1.10 - 1.30. Patchy supply.*
***Semillon & Colombard:** 0.90-1.00. Patchy supply*

C. The Current Outlook

Drought

So far, it has been a very dry autumn and winter across much of the wine producing regions of South Eastern Australia. Most of New South Wales is in the grip of a severe drought.

Soil moisture levels are very low in most vineyard areas and, with bud burst just around the corner, will likely reduce potential crop levels. Unless we experience significant rainfall this growing season to compensate, this could lead to a constrained 2019 wine grape crop, all other things being equal.

The price of accessing water resources from the Murray Darling Basin has increased significantly, with prices for permanent water licences (allowing water to be drawn in perpetuity) at record levels.

Prices for temporary water licences (allowing water to be taken for one year only) are increasing in sympathy, and are also very high, although not at record levels.

__Interesting statistic # 1:__

Temporary water prices are now around $300/million litres and at this price, the cost of water alone is about AUD$100 per tonne of grapes, or just under 15 cents per litre of bulk wine.

__Interesting statistic #2:__

In 2018, autumn rainfall in Southern Australian was 57 mm below average, the driest autumn since the 1902 Federation drought.

See the graph below which shows data for Southern Australia for the last 40 years: 1978-2018

The numbers opposite are based on the average autumn rainfall from 1961 to 1990, which was 102.3 mm.

Autumn rainfall (in mm) is shown above or below the long-term average, based on data from 1961-1990 for Southern Australia (everywhere below a line extending along South Australia's northern border).

Few new vineyard plantings

Despite encouraging demand signals, not many wine grape vineyards are being planted in Australia right now.

The reason is that many alternative crops are still much more lucrative than wine grapes, and this has inhibited the development of any significant new wine grape supply. This is reflected neatly in the price of permanent water in the Murray Darling Basin, which is at record highs. A high price for permanent water indicates robust demand across a variety of permanent crops, for example almonds, table grapes and citrus, and all of these crops are now competing with wine grapes for limited water resources.

The overall number of vines propagated remains fairly modest as there are very few, if any, large scale, broad acre vineyard developments underway. Most wine grape development seems to be replacement of aged vineyards to more lucrative varieties or, depending on the region, to other more lucrative crops.

The next 3-5 years

Any increase in supply is likely to be muted over the next 3-5 years, since there are currently only modest levels of planting activity for wine grapes, and China will drive much of the demand for Australia's wine during this time. Should Chinese demand for Australian wine continue unabated, then bulk wine prices will rise in the absence of any significant new supply from Australia or alternative supply from other producing countries.

A large 2018 European wine grape crop will be required to take the edge off any further increases in worldwide bulk wine prices and this is being played out right now.

The Next Phase – Wine Imports Boom & Bust

Historically, when Australian wine prices are high, and supply is short, a lot of wine has been imported into Australia. Such imported wines are used to fill low end bottle and Bag-in-Box programs, as wine origin is less important to consumers of these products, and Australian wines are too expensive to fill them. This phenomenon usually lasts a short time, and has occurred twice in the last 25 years:

- *During the mid-to-late 1990's, at the time of the Australian export boom, supply constraints were exacerbated during the drought affected 1995 vintage, causing widespread importation by most of the then Bag-in-Box brand owners.*
- *During the millennium drought, even at a time of very large surpluses in Australia from 2004-2006, a very short drought-affected 2007 vintage also triggered importation of entry level wines for a short time.*

At this stage, any such wine imports into Australia appear quite limited.

Importation might reasonably be expected to start again soon, should the current trajectory of increasing bulk wine prices continue. It is poignant to note that wine importation usually signals the top of the market for a wine producing nation like Australia: wine imports stop abruptly during subsequent surpluses.

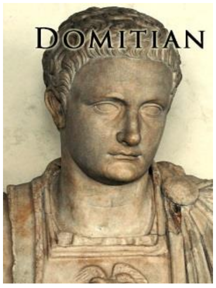
Furthermore, it stands to reason that if Australia can import cheap wines at the bottom end of the market from other wine producing nations, then sooner or later, those same nations might undercut Australia in our key export markets. As grape and wine producers and exporters, we need to ask ourselves: is Australian wine that much better or different to that of our competitors?

Historical Perspective

Things are currently going well for Australian wine producers. Often, when things go well, it is human nature to attribute our success to our own efforts, rather than to the causes and influences outside our control. Naturally there is now increasing confidence amongst Australian wine industry participants along all parts of the supply chain.

But when times are good, events can conspire to throw us off course, and sometimes from the most unlikely quarter.

I draw an example from history:



Many of us would remember high school history lessons about Mt Vesuvius in Italy erupting violently and destroying the thriving city of Pompeii during ancient times. What is less well known is that the massive eruption of Mt Vesuvius also had a devastating effect on the Roman wine industry. The eruption, which occurred in 79 AD, destroyed vineyards, wineries and warehouses storing the most recent 78 AD vintage. Furthermore, it severely damaged local trading ports that hindered the flow of wine from outlying provinces into Rome – a massive wine market at that time. Local wine prices quadrupled and a subsequent planting boom occurred in the areas around Rome, stimulated by the high prices. A few years later, when the new vineyards began to bear fruit, a massive wine surplus resulted. This caused such a depression in wine prices that 13 years later, in 92 AD, the Roman Emperor Domitian banned the planting of new vineyards around Rome, and also ordered the uprooting of half of the vineyards in Roman provinces.

This is a story from nearly 2,000 years ago, and it may be from the ancient world, but does it have a familiarity about it that might resonate with your present day world?