

2008 post-vintage bulk wine review

The wedding at Cana: Turning water into wine¹



Australian wine has been short for some time. This shortage is due to extremely limited water availability resulting from drought. But the 2008 vintage came in well above expectations at 1.83m tonnes, 31% higher than 2007, despite some of the strictest water restrictions ever seen. So how did we produce so much wine with so little water? **Jim Moularadellis** from Australia's bulk wine specialists, Austwine,

analyses the 2008 vintage and the resultant likely outcomes in the bulk wine market.

2008 vintage overview

The 2008 vintage was about 300 million litres larger than 2007. To put this into context, 300ML represents about two-thirds of current domestic sales² of Australian wine of around 449ML, or just over 40% of current exports³ of around 724ML.

In South East Australia, west of the Great Dividing Range, relatively benign weather conditions persisted during vintage prior to a very long heatwave⁴. The heatwave began in early March and lasted until late in the month. 2008 was a generally early vintage and most of the crop from the warm inland⁵ regions was harvested before the heatwave began. The relatively benign weather conditions until then delivered generally excellent quality.

Many cooler climate regions, with later harvests, felt the full brunt of the heatwave: rapid fruit ripening resulted in production bottlenecks and a lot of (mostly red) grapes were picked at extremely high Baumé. The Hunter Valley and nearby districts also experienced an extremely difficult year for red grapes, and in many instances reds were not picked at all. However, the reason was very different there, namely, excessive vintage rainfall. The Hunter experienced almost 10 times the rainfall that regions west of the Great Dividing Range experienced. Selected vintage weather statistics⁶ for various regions are detailed in Table 1, with extreme weather observations in red.

A lot like 2002

Vintage 2008 has a number of similarities to the 2002 vintage and there are three main characteristics that stand out:

- *larger than expected crop*: 2008 vintage was 31% higher than last year. The 2002 grape crush, at 1.6 million tonnes, was a relatively modest 13% higher than the 2001 crush, but 2001 was already up 24% on 2000. So in both 2002 and 2008 a lot more bulk wine was suddenly in inventory
- *excellent quality outcomes in the warm inland regions and abundant cooler climate crops*: The Murray Darling and Riverland regions, in particular, reported good quality fruit flavours with good acids. These areas produced white wines with fragrant

complexity and red wines with great colour, and have shrunk the traditional quality gap that cooler climate regions achieve over the warm inland regions in most years. Together with abundant crops in the cooler climate regions, the price gap between wines from warm inland and cooler climate regions may diminish in 2008, as it did after the 2002 vintage when both these factors were also features

- *the price of grapes was high compared with the actual crop size*: A lot of wineries posted their 2008 grape prices about five months early (in September 2007) rather than in January 2008, which is usually the case. They did this in anticipation of a disastrously small crop and in the expectation that growers would have to pay over \$1000 per megalitre for irrigation water. However, many growers bought water later and they paid only a fraction of this price⁷. In 2002, a number of large wineries paid for red grapes based on colour, and 2002 was an extraordinarily high colour year. That one event led to very high bulk wine costs and contributed significantly to later bulk inventory writedowns. Similarly, bulk wine writedowns may well occur during 2008, as wineries come to terms with their high cost bulk wine.

Upward trend of vintage forecasts

With the great benefit of hindsight, the larger than expected 2008 vintage was simply a continuation of the trend of upward revisions of vintage size. Various bodies⁸ produce forecasts and estimates on the size of each Australian vintage in the months leading to harvest, and 2008 was no exception. An interesting analysis is to compare these forecasts and estimates, against Austwine bulk wine inventory at the time of their publication. This data, together with Austwine bulk inventory in the intervening months, is set out in the table below:

Date	Forecaster/Estimator	2008 Crush Estimate (Million Tonnes)	Austwine Bulk Wine Inventory (Million Litres)
14 Dec 07	AWBC	1.22	62.2
31 Jan 08	-	-	76.2
28 Feb 08	AWBC	1.55-1.65	89.0
31 Mar 08	-	-	97.8
30 Apr 08	-	-	117.0
20 May 08	ABARE	1.67	122.7
13 Jun 08	WFA	1.83	122.8

It can be seen from the above table that Austwine bulk wine inventory grew rapidly during the first five months of 2008. This occurred as more and more producers came to the conclusion that bulk wine was not going to be as scarce as previously thought, and so released bulk inventory for sale.

Bulk wine inventory round-up: top four varieties

The top four varieties represent 69% of the total 2008 vintage tonnes crushed. Austwine's bulk wine inventory as at June each year ▶

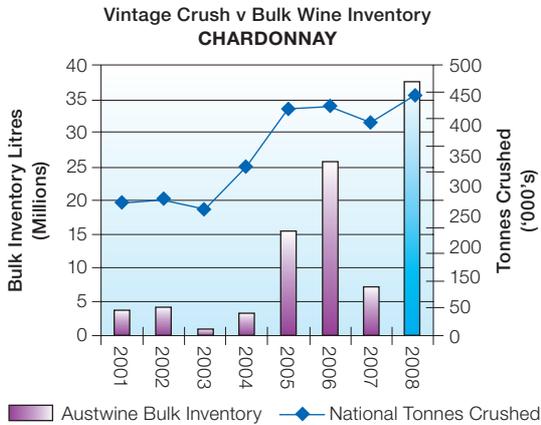
Table 1.

2008 Vintage Weather	Mt Barker, WA	Nuriootpa, SA	Padthaway, SA	Renmark, SA	Mildura, Vic	Griffith, NSW	Cessnock, NSW
Rainfall: Jan – Apr 08 (mm)	199	59	55	29	36	59	524
No of Days over 35° C: Mar 08	NIL	13	10	15	14	11	NIL

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is plotted as a percentage against vintage tonnes crushed in the graphs below. Interestingly, Austwine bulk wine inventory of the top four varieties currently totals 90ML, which is around the same as it was at this time in 2006, when the total was 89ML.

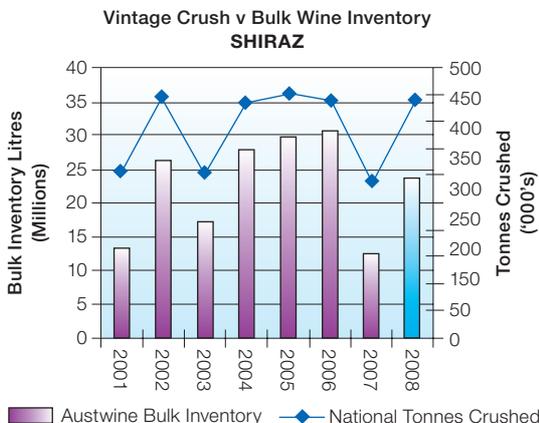
Chardonnay



National tonnes crushed rose a relatively modest 13% to 444,000 tonnes this year, but notice the massive rise in Austwine bulk inventory of over 400% from 7ML a year ago to 37ML now. Last year's extraordinarily low Chardonnay inventory was mainly due to wineries withdrawing Chardonnay during 2007 in anticipation of a very small 2008 crop. This year, much of that 2007 wine (plus a lot from 2006), together with fresh 2008 wine, has been released back onto the bulk market, propelling Chardonnay inventory comfortably past its previous high of 26ML in 2006.

Chardonnay continues to be Australia's most prolific grape produced, overtaking Shiraz last vintage. It represents a quarter of all tonnes crushed and 50% of all white grapes crushed. The next largest white grape is Semillon and, at 99,000 tonnes this year, is just over 1/5th the size of the Chardonnay harvest. Accordingly, Chardonnay significantly impacts a big part of the entire Australian white winegrape crush. ABARE forecasts Chardonnay production to rise to 477,000 tonnes by 2010. Current prices for current vintage commercial quality inland irrigated Chardonnay range from \$0.90 to \$1.40 per litre¹⁰.

Shiraz



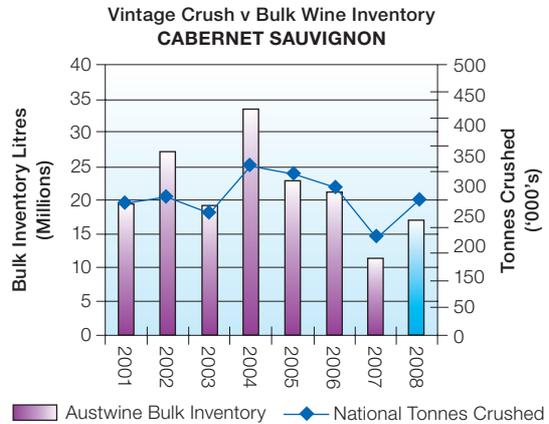
National tonnes crushed rose 53% to 436,000 tonnes this year, compared to a rise in Austwine bulk inventory of 87% to 24ML.

Shiraz is Australia's most popular red grape variety, and more Shiraz is crushed than the next two major red varieties combined, namely Cabernet Sauvignon and Merlot. Shiraz is just behind Chardonnay to be Australia's second most prolific crushed variety

overall, and Shiraz inventory is now significantly off its peak inventory of 31ML recorded in 2006.

ABARE forecasts Shiraz production to rise to 467,000 tonnes by 2010. Current prices for current vintage commercial quality inland irrigated Shiraz range from \$1.20 to \$1.50 per litre.

Cabernet Sauvignon

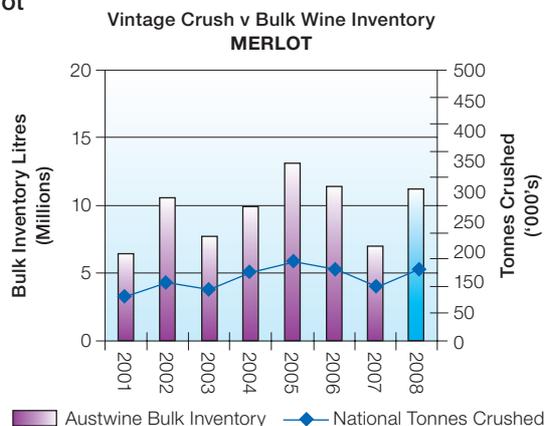


National tonnes crushed rose 40% to 254,000 tonnes this year, compared to a rise in Austwine bulk inventory of 47% to 18ML.

The percentage rise in Cabernet Sauvignon bulk inventory at 47% was the most modest of all the top four varieties, and is just over half of its 2004 peak inventory of 34ML.

ABARE forecasts Cabernet Sauvignon production to rise to 286,000 tonnes by 2010. Current prices for current vintage commercial quality inland irrigated Cabernet Sauvignon range from \$1.20 to \$1.50 per litre.

Merlot



National tonnes crushed rose 39% to 129,000 tonnes this year, compared to a rise in Austwine bulk inventory of 61% to 11ML, which is not far from its peak of 13ML recorded in 2005.

Like Shiraz and Cabernet Sauvignon, but to a much lesser extent, Merlot's inventory levels have fallen from previous peaks, so its outlook is improving.

ABARE forecasts Merlot production to rise to 138,000 tonnes by 2010. Current prices for current vintage commercial quality inland irrigated Merlot range from \$1.20 to \$1.50 per litre.

Water outlook

Figure 1 shows water in store¹¹ throughout the Murray Darling Basin since 2000. The good news is that there is more water in store this year compared to the same time last year. However, the situation remains very critical, with less water in store than the most recent previous major drought year, 2003.

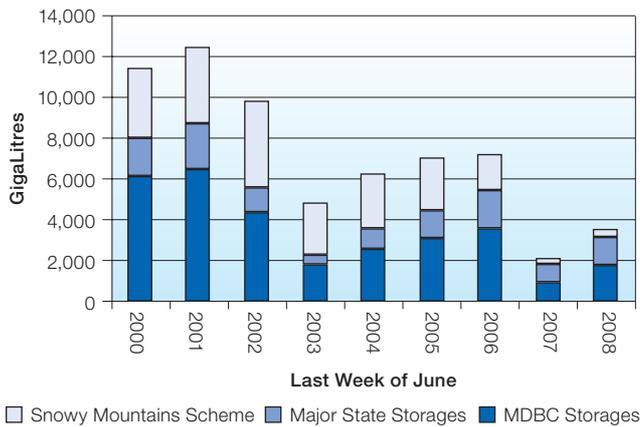


Fig. 1. Water in Storage in the Murray Darling Basin (Excl. Dead Storage)

Significantly, the political situation is now very different to 2003, and this has major ramifications for irrigators: widespread water restrictions in capital cities have been in place for several years, leading to heightened public awareness of Australia's water scarcity. Apart from actual water savings, a possible outcome of capital city water restrictions is to prepare the public for higher water costs in future. Likely metropolitan water supply solutions, such as desalination, are expensive. This is because users will be paying for the *manufacture* and *transport* of water to their door, rather than just the latter, which has been mostly the case until now. The era of cheap water is likely to be over.

With comparatively few votes, the downside for irrigators arising from the current political climate is significant. Any government is going to be extremely anxious to avoid repeating former Prime Minister Howard's announcement¹² on 19 April 2007 to "pray for rain" which (in part) resulted from previously excessive irrigation allocations running down water reserves to critical levels. Therefore, governments are likely to set very low irrigation allocations in order to build up water reserves in dams. This is likely to take several years because the dams are very empty and they are very big. The largest ones (such as Dartmouth, Hume & Eildon) are each about six to seven times the size of Sydney Harbour.

Increased costs of production

The 2007 water scarcity crisis has shown us that the wine industry is capable of surviving, and producing, a reasonably abundant crop in times of extreme water shortages. With a little more water in the storages this year, it augers well that the 2009 vintage has every chance of being reasonably abundant, provided that the economics of grape production can sustain the expected high water costs this year. The wine industry can successfully bid for scarce water resources, but this increases the cost of growing grapes in those regions that need to do so. Therefore, the Australian wine industry's international competitiveness is reduced and inevitably this constrains international demand for our wine.

High exchange rate

A high exchange rate also hurts our international competitiveness and constrains export demand. Consider Table 2¹³, which shows selected data for the A\$ against the US\$ and the UK£:

The appreciation of the A\$ against these two currencies can be clearly seen during the last four years (for the US\$) and the last two years (for the UK£). This is quite bad news, since these two markets alone represent over 60% of our wine exports by both volume and value¹⁴. These two markets are big: combined, they imported 462ML

Table 2. The Australian dollar against the US\$ and UK£.

Average for June	A\$1.00	
	US\$	UK£
1998	0.604	0.366
2000	0.595	0.394
2002	0.568	0.383
2004	0.694	0.379
2006	0.740	0.401
2008	0.951	0.483

of Australian wine in the last 12 months, which is greater than the domestic market for Australian wine at 449ML¹⁵.

The high A\$ also makes imports into Australia cheaper, but import volumes for domestic bag-in-box products (which broadly occupy the cheapest 45% of Australian domestic wine sales) will be curtailed due to the larger than expected crop in 2008. The exception is likely to be New Zealand Sauvignon Blanc, resulting from a large 2008 vintage in New Zealand also. A possible outcome is that significant volumes of 2008 New Zealand Sauvignon Blanc are likely to be promoted in Australian domestic retail outlets at a consumer price of less than \$10 per bottle.

Where are we in the wine industry cycle?

With water scarcity and a high exchange rate leading to reduced competitiveness, it is instructive to take a step back and assess where we are in the wine industry cycle. A useful tool for such an assessment is measuring bulk wine prices. Figure 2 shows weighted average domestic bulk wine prices for all Austwine domestic sales¹⁶, since 2000. Figure 2 clearly shows the rapidly declining prices from 2000 to 2005, a result of the massive grape production increase due to the planting boom of the late 1990's.



Fig. 2. Domestic Bulk Wine Press All Transactions

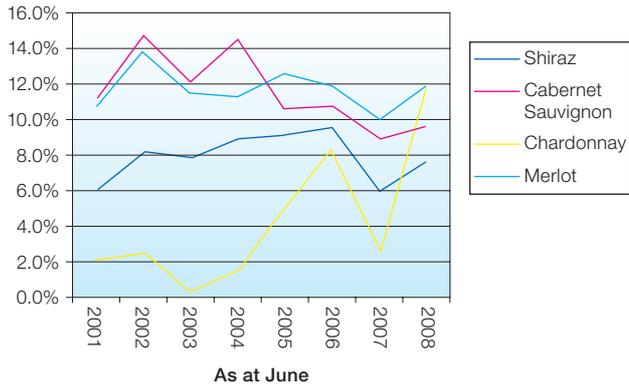
During 2005 there were a number of forced bulk wine sales in circumstances where sellers were either in administration or receivership, significantly depressing the average sales values for that year. The 2006 vintage was also very large, further depressing bulk wine prices, and anecdotally was the Australian wine industry's emotional nadir.

However, in late 2006, prices started rising as a short crop in 2007 became evident and market participants moved rapidly to cover their positions. Large volumes transacted by the major companies at that time lifted the average price for the year above the 2005 price nadir.

Prices increased again during 2007, in response to the low vintage that year and the (then) poor outlook for 2008. But it appears ▶

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Fig. 3. Bulk Wine Inventory As a Percentage of Current Vintage Year Crush



that we have passed the drought induced spike, as prices for 2008 appear to be sagging¹⁷.

Figure 3 neatly summarises the relative supply position of the top four varieties. It shows that Shiraz, Cabernet Sauvignon & Merlot are at the middle, or possibly nearer the end, of their over-supply cycle, and Chardonnay is clearly nearer the beginning of its over-supply cycle.

2008 is a full decade after the peak planting year of 1998, when approximately 16,000 hectares of wine grapes were planted, and we are still feeling the effects of the late 1990's planting boom. In 1998 Australian wine export volumes were growing strongly but, at 199m litres, were just over one quarter of volumes today, and the vintage was 0.976m tonnes, a bit over half the size of 2008.

I think it is reasonable to predict that the next decade promises less dramatic change than the last in terms of export growth and vintage size, and therefore greater stability in terms of bulk wine prices. Hopefully, price levels will be somewhere above the cost of production.

2009 Vintage outlook

ABARE forecasts a 2009 crop of 1.78m tonnes, up on their 2008 forecast of 1.67m tonnes, and similar to the 2008 outcome of 1.83m tonnes.

Winery bulk wine inventories are higher than preferred following the larger than expected 2008 crop, and the great demand for grapes that existed 12 months ago has largely disappeared. So this year, it is unlikely that grape prices will be posted by wineries five months early (in September) as they were last year. The exception is probably Chardonnay, and wineries are already talking about 2009 grape prices being in the vicinity of \$250-\$350 per tonne for warm inland grapes. By publicising such low prices for Chardonnay, (about half the level of 2008 prices) wineries are clearly signaling to growers not to use precious water resources on this variety.

In the absence of pricing information for the coming vintage, growers will be carrying additional risk when deciding whether to purchase sufficient water to keep their vines alive: the price of grapes may not be high enough to cover the cost of water.

Top six likely outcomes:

So what does all this mean? Set out below are the top six likely outcomes in the bulk wine market arising from the 2008 vintage:

- 2008 was 300ML higher than 2007, which was larger than expected and there are a number of similarities to 2002. This has led to a reduction in the quality differential associated with cooler climate bulk wine, and the possibility of wineries writing down bulk wine generally

- bulk wine inventories are higher than last year, and near 2006 levels. Shiraz, Cabernet Sauvignon and Merlot bulk wine inventories are all down from their record peaks. Chardonnay is the longest variety, despite experiencing the smallest increase from 2007. This will put downward pricing pressure on most other white varieties, particularly Semillon, Colombard and Neutral Dry White
- reduced winery profitability arising out of 2008 vintage. Bulk wine prices will not rise but will stabilise and fall towards or even below the cost of production
- 2009 grape prices are likely to be lower than 2008. Wineries are carrying larger than expected inventories at high costs, and the 2009 vintage is likely to be at least as abundant as 2008. (The usual proviso applies that it is still a very long time until next vintage and many events could significantly influence the crop size)
- continued water scarcity and high water cost. This will increase grape (and hence wine) production costs, leading to reduced export volumes exacerbated by a high exchange rate
- a significant curtailment of bulk wine imports. With the possible exception of New Zealand Sauvignon Blanc, bulk wine import activity will be significantly curtailed and will likely cease as a major influence on the Australian bulk wine market.

In conclusion, the Wedding at Cana¹⁸ did not run out of wine¹⁹, and nor did Australia. Turning water into wine during the wedding was the first of seven miracles, and the Australian wine industry may need one or two more to deal with the likely outcomes of the miracle 2008 harvest.

Jim Moularadellis is Chief Enthusiasm Officer (CEO) of Austwine, Australia's Bulk Wine Specialists. He was named 2007 Entrepreneur of the Year, Services, for South Australia and is currently in the top 25 Fast Movers for South Australia, an index of South Australia's fastest-growing companies. Established in 1993, Austwine celebrates 15 years of service to the wine industry during 2008.

References

- ¹The Wedding at Cana is where Jesus Christ turned water into wine in the Gospel according to St John. (John 2, 1:12.)
- ²AWBC Annual Report 2006/7. Domestic Sales of Australian wine for 2006/7 was 449m litres.
- ³May 2008 AWBC Wine Export Approval Report. MAT Export volume was 724m litres.
- ⁴There is no universal definition of heatwave, the term is relative to the usual weather in the area. For the purposes of this article, I have simply measured the number of days over 35°C.
- ⁵I have used the same classification and nomenclature employed by AWBC. "Warm inland" is defined as the grape growing districts along Australia's major rivers (Australian Geographical Indications Zones SA Lower Murray, NSW Big Rivers, Vic North West Victoria and these regions all have a Mean January Temperature of at least 23.0°C. "Cooler climate(s)" is defined as all other regions.
- ⁶Australian Government, Bureau of Meteorology.
- ⁷Not all regions had to pay for water. For example, Griffith enjoyed adequate water, with allocations closing at near 100%.
- ⁸Australian Wine & Brandy Corporation (AWBC), Winemakers Federation of Australia (WFA), and the Australian Bureau of Agricultural and Resource Economics (ABARE).
- ⁹Australian wine grape production projections to 2009-10, ABARE, 2008.
- ¹⁰All price range indications are ex works for spot domestic sale of commercial quality wine, for immediate delivery with short payment terms.
- ¹¹Murray Darling Basin Commission (MDBC) storages: Dartmouth Reservoir, Hume Reservoir, Lake Victoria & Menindee Lakes. Major State Storages included are Burrinjuck Reservoir, Blowering Reservoir & Eildon Reservoir. Snowy Mountains Scheme: Lake Eucumbene & Snowy Murray Component. Dead Storage excludes NSW Menindee Lakes Reserve.
- ¹²Prime Minister's Media Alert Service: Media Release, 19 April 2007, Murray Darling Basin Irrigation Allocations & associated press conference.
- ¹³www.x-rates.com
- ¹⁴AWBC, May 2008 Wine Export Approval Report. Combined, the UK and USA markets represent 63.8% of volume and 61.6% of value of Australia's wine exports.
- ¹⁵See Footnotes 2 and 8.
- ¹⁶Austwine database. Data includes all domestic bulk wine sales: All contract types (long term contracts, pre-harvest orders, sale-by-sample and distressed sales), all vintages, regions, all varieties.
- ¹⁷2008 year to date.
- ¹⁸The Wedding at Cana is where Jesus Christ turned water into wine in the Gospel according to St John. (John 2, 1:12.)
- ¹⁹When the hosts ran out of wine, Jesus ordered servants to fill the empty containers with water, then draw out some of it and take it to the chief waiter, whereupon it had turned into wine. ■