Wine Industry Insights

Key Emerging Issues – April 2024

China's wine tariff repeal a relief, but industry remains vulnerable to global macroeconomic, trend changes.

While the lifting of China's tariff on Australian wine will help restore exports, it doesn't solve the greater macroeconomic and sectoral headwinds that threatens the Australian wine industry's sustainability and resilience.

After several years of challenging global and domestic trading conditions, the Australian wine industry has welcomed the recent news that the punitive China tariffs that were imposed 2020 have been removed.

These duties on Australian wine made it unviable for Australian producers to export bottled wine to the Chinese market, which was worth $1.1 billion in 2019.

Although an immediate bounce back to those export levels is not expected given the changing market dynamics in play, the strength of the Australian wine brand in China remains strong despite the extended absence from the market and customers have been keenly awaiting the tariff decision so they can restart relations with key Australian partners.

This optimism, however, needs to be tempered in light of ongoing global macroeconomic and sectoral headwinds and does not alter the fact that a much overdue and significant industry restructure needs to occur to ensure the sectors remains sustainable and can be resilient in the face of future market shocks.

We explore these themes in further detail.

PART 1 SUPPLY

Although Vintage 2024 is still yet to wrap up in a number of regions across Australia, the general readout is that yields are down.

This is in part due to seasonal factors as well as the pricing on offer notably for mainstream red varietals in the inland regions which has made it commercially unviable for certain growers to harvest and deliver the fruit.

Constrained vintages in other key Southern Hemisphere producers – following a similarly challenging vintage in the heavyweight producers of the USA, France, Italy, and Spain – will partially assist to arrest the global supply-demand imbalance and improve pricing.

Even so, there is a long way to go given that the approximately three billion litres of wine made each year is above current drinking rates (OIV as published by Wine Australia).

Wine Australia estimates that current commercial red wine grape production exceeds current demand by 200,000 tonnes, which underscores the pressing need for large scale reform to ensure pricing can return to sustainable levels compared to what the market is currently delivering, which is well below cost of production.

That said, the industry is grappling with how to engineer this change with government funded measures, such as vine pull schemes which were recently implemented in Bordeaux, France, that has not been in favour in Australia since the 1980s.

Given, however, the dire and pressing circumstances facing independent grape growers in the inland regions, advocacy is building for governments at a State and Federal level to intervene to facilitate an orderly exit strategy for those who wish to leave.

On the flipside, a number of other cool climate regions are struggling to meet demand given successive short vintages.

Still oversupplied despite 10 year average shortfall

The production of wine across Australia in 2022-23 was the lowest total volume produced nationally since 2006-07, being an estimated **1.32 million tonnes.**

The **465,000 tonne** reduction in crush is the equivalent of approximately **325 million litres** of wine. It is forecast that trend in supply will continue with the 2024 Vintage tonnage likely to mirror 2023.

Despite the fall in production levels in Australia, wine inventory is still **2.2 billion litres** which is c.15 percent (288 million litres) above the 10-year average of **1.9 billion litres.**

Given that current inventory levels exceed consumer demand, this steady decline in production is indicative of inventory being well in excess of consumption taking into account current domestic and export volumes.

Production of red wine has seen a significant decrease in in the 2022-23 harvest, whilst white wine also saw a marginal decline in harvest when considering total volume produced [source: Wine Australia].

Supply issues impacting domestic commercial vineyard values

The ongoing pressure on commercial wine producers has led to grape prices as low as $100 per tonne or no home for their grapes, some for multiple vintages.

Consequently, 2023 was a year where was little to no activity across major wine regions with respect to vineyard transactions.

Since the sale of the over 7,000ha of vineyards by Casella Wines to Southern Premium Vineyards, there has been minimal large scale vineyard transactions.

TWE have been the only notable major seller of their commercial vineyards as they continue on their premiumisation strategy.

> Recent commercial vineyard sales are well below historical levels of over $30,000 - $40,000 p/ha and recent market evidence suggest recent transactions range between $25,000 p/ha and going as low as $8,500 p/ha.

Given the recent China tariffs announcement, astute investors may see medium- to long-term opportunities for the right vineyard asset.

PART 2 DEMAND

The global wine industry is also grappling with a decrease in demand in both bulk wine and, to a lesser extent, premium wine categories *[source: Wine Australia].*

Global wine consumption has decreased by 4 percent over the past 10 years, whilst consumption in Australia is trending at a 1.8 percent decline annually, based on a 5-year compound annual growth rate.

At this current rate, forecasts predict volumes of Australian wine produced to decrease

FROM **946 M** Litres in 2023

TO **774 M** Litres in 2033

Out of **112 markets** that received Australian wine, **68 of these markets** imported less in total value than the previous year.

67 percent of the current decline in wine consumption in Australia is attributable to wine exports to China being wiped out from

FROM **175 M** Litres in 2018

TO JUST **1 M** Litres in 2023

Whilst we do not expect 2018's export volumes of 175 million litres of wine will return, there will certainly be exports of Australian wine to China occurring, which will improve sentiment and start to chip away at addressing the oversupply of bulk wine (in particular red varietals).

Anecdotally we are aware that many producers have been immediately approached with sale inquiries.

However, it is important to note that China market for wine imports is now a third of what it was five years ago.

Other factors contributing to this decrease include a reduction in the general consumption of alcohol both globally and domestically due to a variety of macroeconomic conditions.

These macroeconomic conditions include cost-of-living pressures reducing consumer spending in Europe, change in consumer tastes in China, and domestic changes in consumer interests towards less alcoholic beverages marketed as a 'healthier' alternative based on alcohol content.

Reports from Prowein 2024 indicated that Northern hemisphere have seen declines in their 'medium' and 'premium' wine categories, whereas sales in the 'basic' categories have stayed constant.

This is different from the Australian market trends whereby reports from Wine Australia have indicated that consumers are drinking less in total volume but at higher price points.

PART 3 CONCLUSION

The prevailing sentiment is that it's now or never for the Australian wine industry as urgent and large-scale restructuring is required to address the corrosive and enduring supply/demand imbalance, however, it's not entirely clear who will lead the charge.

Historically, reform has always been muted with growers staying the course against a backdrop of inconsistent signals from producers who have persisted with ongoing wine production in the hope of eventually finding a sale to justify the decision and taking volume to ensure optimal utilisation of production facilities.

Though the tide is turning with early indications that the current uneconomic pricing is leaving growers with no other option other than to exit and winemakers holding firm on their required intake.

The key question is what the new steady state for the industry will be – particularly the commercial wine sector – and at what price levels on the retail shelf can Australia sustainably compete which allows all players in the value chain to receive a reasonable return to keep them in the game for the long term.

The Australian wine industry is resilient and needs to address the factors leading to a decrease in consumption, with a key market being to focus on adapting to the times and innovate including for 'health conscious' trends that has resulted in an increase in consumption of other categories such as the 'Ready to Drink' category in shrinking alcohol markets.

Australia will evidently need to rely on innovation and continue to cultivate a broad spread of markets beyond China if it is to thrive in the long term.

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