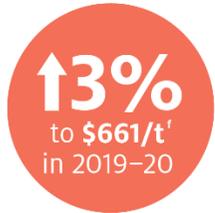


Wine and wine grapes

Charley Xia



¹ Australian average farmgate price of wine grapes.

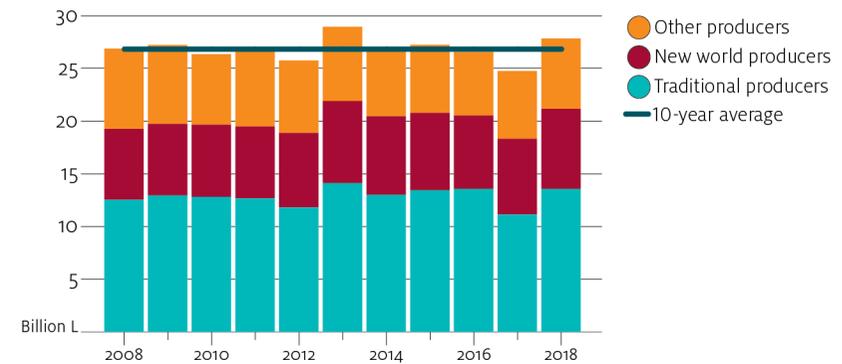
Wine

Demand from China for Australian wine to support wine grape prices.

Bumper global harvest increases wine inventories

In 2018 bumper grape harvests in Europe, South America and the United States substantially increased global wine inventories. These inventories were low due to a limited 2017 vintage and rising consumption from China and the United States. However, demand in these major markets is expected to moderate in the short term due to lower income growth and greater economic uncertainty. Clearance of the 2018 vintage is expected to be slow, with intense price competition between exporters.

World wine production, 2008 to 2018



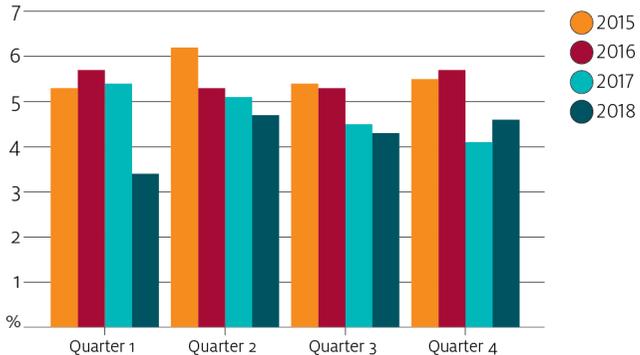
Note: New wine-producing countries include Argentina, Australia, Chile, New Zealand, South Africa and the United States. Traditional wine-producing countries include France, Italy and Spain.

Source: International Organisation of Vine and Wine

Wine imports in China to contract in the short term

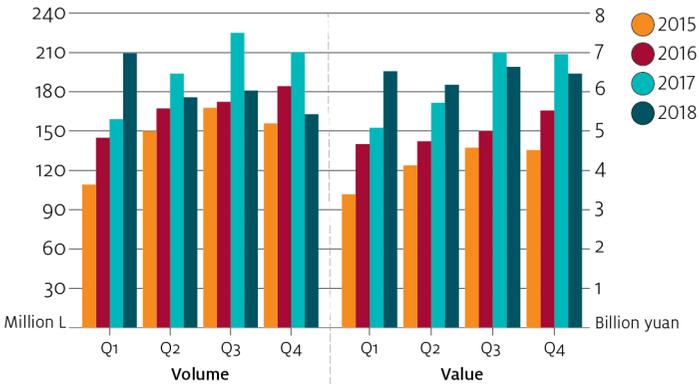
In 2018 the expenditure of urban households in China grew at a slower rate in real terms than in previous years. Tightening household budgets led to a reduction in wine imports at the start of the second quarter of 2018.

Per person expenditure of urban households, quarterly growth rates, China, 2015 to 2018



Note: Growth rate is in real terms and calculated relative to the same quarter in the previous year.
 Source: National Bureau of Statistics of China

Value and volume of Chinese wine imports, quarterly, 2015 to 2018



Source: General Administration of Customs, People's Republic of China

In 2018 Australia increased its wine exports to China despite falling Chinese imports. Australia's competitiveness was improved by favourable exchange rates, tariff reductions under the China–Australia Free Trade Agreement and marketing campaigns in China. In 2019 assumptions of slower economic growth are expected to further reduce Chinese wine imports. However, prices of Australian wines in China are expected to strengthen as a result of the smaller 2019 Australian vintage, favourable exchange rates and the elimination of Chinese tariffs on Australian wines.

Over the medium term to 2023–24, growth in the value of Australian wine exports to China is expected to be slower compared with the last 4 years. This is expected to result from slower growth in Chinese wine consumption and greater competition from Chile and France. Growth in the domestic wine industry in China also poses significant risks to Australia's market share.

Challenging conditions in US and UK markets

Estimates by the [Silicon Valley Bank](#) show wine consumption in the United States increased only slightly in 2017 and remained flat in 2018. The trend follows declining retail sales of commercial wines and slower growth of premium wines. US wine imports are expected to fall in 2019 due to stagnant consumption and increasing supply of quality Californian wines following the record 2018 harvest. Prices of Australian wines in the US market are expected to fall as competition from domestically produced wine and wine from Argentina, Chile and Spain increases.

In the UK market, wine consumption is expected to fall because of economic uncertainty and rising taxes on wine relative to other

alcohols. The value of Australian wine exports to the United Kingdom is expected to fall in 2019–20.

UK consumption will also be affected by the price of imported wine, which could rise quickly depending on the impact of Brexit on the country's exchange rate, logistic networks and market access. The bilateral Wine Agreement between Australia and the United Kingdom will ensure continued access for Australian wines into the UK market post-Brexit. The agreement is expected to preserve Australia's dominant market share in the UK retail market. The UK Government has yet to reach similar agreements with Australia's European competitors, potentially providing capacity for Australian producers to expand their sales in the UK restaurant market.

Over the medium term, demand for wine in the United States and the United Kingdom is expected to remain subdued. Despite relatively poor growth prospects in these major markets, quality, strongly branded and competitively priced Australian wines are expected to capture additional market share from North American and European wine producers.

Outlook for Australian wine grape production

Adverse seasonal conditions to reduce Australia's 2019 harvest

Australian wine grape production for the 2019 vintage is estimated to be around 1.5 million tonnes, the smallest harvest since 2013–14. Shortages of irrigation water, spring frosts and extreme summer heatwaves in Australia's major wine-growing regions are forecast to significantly reduce grapevine yields.

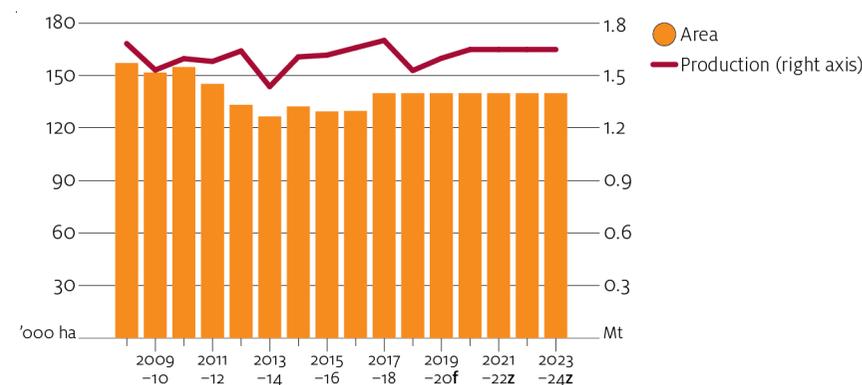
The difficult seasonal conditions of 2018–19 are likely to have affected fruit set for the 2019–20 harvest, which will lower potential

production. The price and availability of irrigation water are also expected to affect production decisions.

Wine grape planting to remain low over the medium term

Total vineyard area in Australia is expected to remain stable over the medium term. Increasing competition for resources, including land, water and labour from other perennial crops is expected to limit new vineyard plantings. Existing vineyards are expected to optimise their varieties and replace ageing vines to cater for increasing demand from China for red varieties.

Australian vineyard areas and wine grape production, 2008–09 to 2023–24



f ABARES forecast. z ABARES projection.

Moderate increase in wine grape prices over medium term

Over the medium term, Australian wine grape prices are expected to rise more moderately compared with the last 4 years. Slower growth in Chinese demand for Australian wines is expected to reduce the potential for strong increases in wine grape prices.

The short-term tightening of global wine demand is expected to cause wineries to prioritise the long-term development of premium markets. This is likely to increase bonuses and penalties paid for fruit based on quality parameters. Growers will increasingly have to choose between producing greater quantities of lower-quality fruit or reducing yields to achieve higher prices.

Opportunities and challenges

China's economic slowdown

In 2018 the value of Australian wine exports to China totalled just over \$1 billion, exceeding the sum of exports to its 3 other largest markets, Canada, the United Kingdom and the United States.

China's economic growth is expected to slow but remain above 6% per year to 2020. Rising disposable income is expected to continue to drive growing Chinese consumption. However, economic uncertainty affecting consumer confidence is a significant downside risks to Australian wine exports.

Impact of Brexit on distribution networks into Europe

The United Kingdom is the largest market for Australian wines by volume. The UK Wine and Spirit Trade Association estimated that around a quarter of Australian bulk wines sent to the United Kingdom are bottled in the country for re-export to the European Union, Norway, Russia and Ukraine.

In 2018 Australia increased exports of bulk wines to the United Kingdom in preparation for potential trade disruptions caused by Brexit. The Wine Agreement between Australia and the United Kingdom will ensure continued access for Australian wines into the UK market. However, it is unclear whether trade arrangements

between the United Kingdom and the European Union post-Brexit will retain the current distribution networks for Australian wines.

Trans-Pacific Partnership Agreement opens new opportunities

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership will improve market access for Australian wine into Canada, Malaysia, Mexico and Vietnam. The elimination of Canada's tariffs on Australian wines is expected to improve their competitiveness, with benefits expected throughout the industry.

Reforming the Wine Equalisation Tax

Most alcohols in Australia are taxed based on alcoholic content, but wine is taxed based on value through the Wine Equalisation Tax. This taxation arrangement creates price distortions that affect consumers' choice of wine versus other alcohols, and choice of commercial wines versus premium wines. Several government reviews have recommended overhauling the wine taxation system. In 2009 a review of [Australia's future tax system](#) called for a transition to a volumetric tax on alcohol that would converge over time to a single tax rate.

On 1 July 2018 eligibility criteria for the Wine Equalisation Tax rebate were tightened to better ensure its recipients were small and regional wine producers. The change follows a [2015 Senate committee inquiry into the Australian grape and wine industry](#) that heard evidence that the rebate was being exploited through eligibility loopholes. This worked against the profitability of the wine industry by creating a disincentive for mergers, and subsidised unprofitable grape production. The committee recommended that the government phase out the current Wine Equalisation Tax rebate over 5 years.