

# WORLD MARKETS AND TRADE

May 2008

## WINE

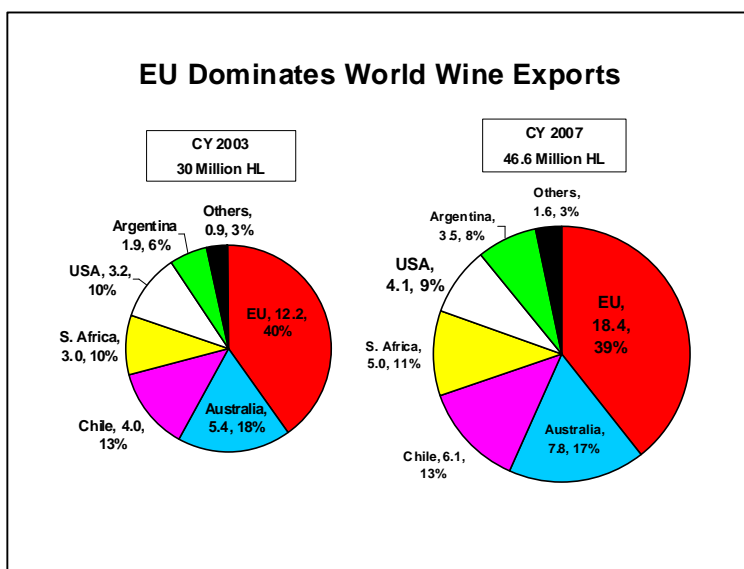
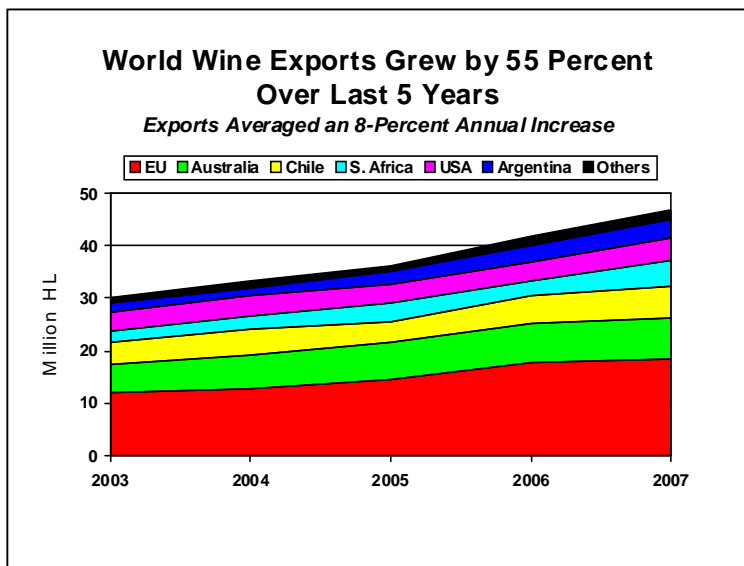
### SUMMARY

World wine trade has enjoyed explosive growth over the last decade, with exports averaging an 11-percent annual increase and topping off at 46.6 million hectoliters (HL) in 2007. Despite intense competition and surging unit prices in key markets, world wine trade is forecast to continue to expand due to increased interest in wine, ample global supplies at all price points, reductions in tariffs and other trade barriers, and aggressive promotion.

The EU-27 is the dominant exporter, importer, consumer, and producer. The United States is also a significant player, and is the fifth largest exporter, second largest importer, and second largest producer. The situation and outlook for key countries is highlighted below.

### U.S. Exports Forecast Up 12 Percent

Aided by a weak dollar, good supplies of quality wine, greater awareness of the health benefits associated with wine, increased



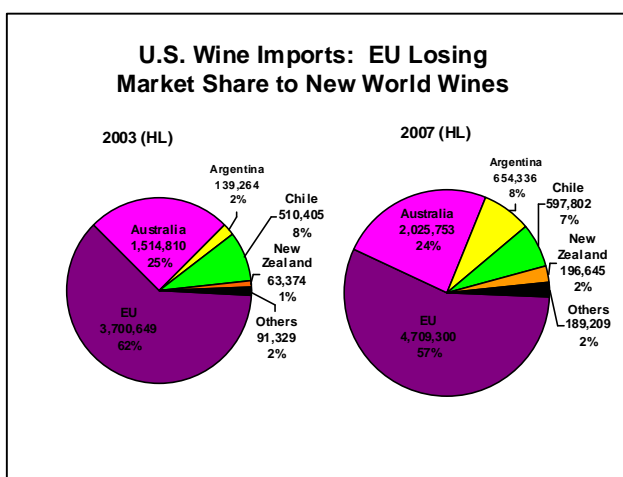
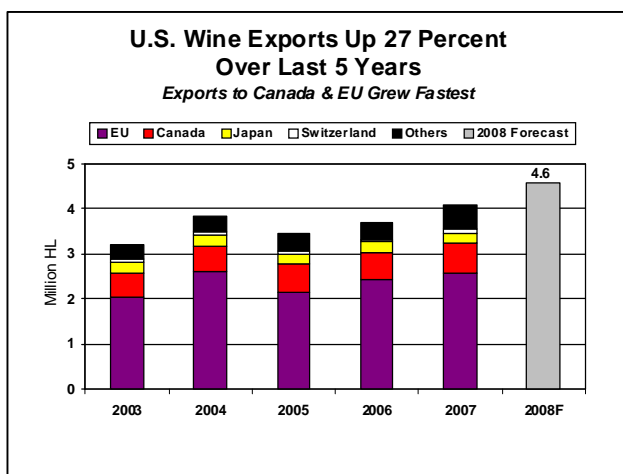
export promotion, and interest in trying new products, exports reached 4.1 million HL in 2007, up 10 percent over the previous year. Exports for the first two months of 2008 were strong, particularly to some of our largest markets (up 25 percent to EU and up 20 percent to Canada). Competition is intensifying, but the continued depreciation of the dollar is expected to further boost overall exports to 4.6 million HL in 2008 (up 12 percent).

As demand for high quality premium wines continues to soar, imports continue to fill the gap. Imports rose faster than exports over the last five years, rising 40 percent to almost 9 million HL in 2007. EU was the dominant supplier with 57 percent share last year. However, EU's share has been slowly eroding as Argentina's (although from a smaller base) has been climbing. However, analysts predict that there will be shortages of Chardonnay, Cabernet Sauvignon, and certain other varietals in coming years, which may have an effect on trade. There is increasing interest in organic wine domestically and internationally, but the market size is unclear since reliable statistics do not exist.

### EU Continues to Dominate

Total EU wine production in 2007/08 (August-July) dropped 9 percent to 162 million HL due to adverse weather, particularly in France and Italy. However, EU's external exports are expected to grow 8 percent to 21 million HL in 2007/08. Russia and the United States are the top markets.

EU imports have risen steadily over the last several years, and they are forecast to rise 4 percent to 13 million HL in 2007/08. Shipments



from the U.S. are increasingly represented by bulk wine bottled locally for distribution within the EU.

Last December, the EU passed major reforms of the wine sector, which are aimed at reducing the large overproduction and phasing out expensive market intervention measures. EU wine producers are smaller than their major competitors', which contributes to higher EU production costs and inadequate production needs for large-scale retailers. Marketing strategies appears to lack dynamism and there are too many regulatory constraints. These handicaps have contributed to a large loss of market share for EU wines relative to competing wines, both in the domestic and export markets. The reforms include maintaining a better market balance between supply and demand, addressing increasing production and competition from the New World, allocating national funds to turn vineyards over to other uses, reducing crisis distillation, and addressing confusing labeling rules and rigid oenological practices. On August 1, 2008, major reforms will come into force.

### **Australian Exports Forecast at Record Levels Despite Drought**

The Australian industry has continued to grapple with drought, low prices, and high stock levels. Production for 2007/08 is forecast at 10.5 million HL. This will represent an average size vintage but will be 19 percent greater than the historically low level of the previous year. Wine grape growers are concerned with the low prices being received, and may continue dropping for four more years.

Exports are forecast at a record 8.4 million HL, up over 5 percent from the previous year's record level of 8 million HL. The EU is Australia's largest export market, followed by the United States and Canada.

Due to the relatively high per capita consumption level and a sharply stronger Australian dollar, wine imports are forecast up 25 percent to 438,000 HL. New Zealand supplies over half of its imports by volume, followed by the EU with 40 percent and Chile (15 percent). The United States only supplies about 1 percent, so opportunities exist to expand our exports, particularly with the weak U.S. dollar.

### **Chilean Wine Supply & Exports Expected to Remain Steady**

Production for 2008 is forecast to remain about the same at 8.3 million HL. As new areas come into production, supplies will keep expanding and wineries will have to invest in new processing and storage facilities to absorb the additional output.

Exports are forecast to rise slightly to 6.2 million HL. The EU is Chile's largest export market, accounting for approximately 40 percent, followed by China (12 percent) and the United States (10 percent). China and other developing markets, as well as quality improvements, will play an important role in further expansion.

The U.S.-Chile Free Trade Agreement had no effect on Chilean wine export volumes to the United States, as the duty for most wine is 6.3 cents per liter and will be phased out over a total of 12 years (2016). In the case of U.S. wine exports to Chile, the 6-percent tariff will remain at base rate until 2010 and phased out until it becomes duty free in 2016. In agreements signed with other trading partners, Chilean exports will have a zero tariff in 2011 in all Mercosur member countries and a zero tariff in 2009 with South Korea. It has already free access in Canada, Mexico, and the EU. The current duty of 11 percent in China will be reduced to zero in 2015. The recent agreement signed with Japan calls for a 12-year phase out period from the current 15-percent duty.

### **Argentina Expects Robust Exports**

Exports are forecast at 4.4 million HL in 2008, up 25 percent, spurred by strong demand in the EU and the United States. These two countries are its largest export markets, accounting for about 20 percent each. In comparison, wine production in 2008 is expected to rise moderately by 3 percent to 15.4 HL. The government caps production at around 15 million HL.

Argentine wine consumption is among the highest in the world at 30 liters per capita annually. Previously, consumption in Argentina had been falling for the last 20 years at an annual rate ranging between one and two liters per person per year. However, that trend changed in 2006 when, for the first time in 20 years, domestic consumption increased compared with the previous season. The reversal in consumption is due to the domestic wine association's effective marketing efforts. Despite the positive consumption patterns, imports of wine have remained insignificant since the massive peso devaluation in February 2002.

Land prices reached a plateau in mid-2007. Foreign investors are still interested in buying vineyards but are hampered by high land prices as well as the political and economic environment.

### **South African Production and Exports to Remain Flat**

Wine production is expected to remain unchanged at 7.4 million HL in 2007/08 due to cool weather. Exports are also expected to remain the same at 3.1 million HL. Red wine exports are rising three times faster than white, and a shortage of red wine is expected by 2010. The EU is South Africa's largest export market, accounting for over 80 percent by volume. Most of the shipments to the United Kingdom are made up of bottled wine. The majority of the wine shipped to the Netherlands, the next top EU destination, is characterized by bulk wine.

### **New Zealand's Rapid Growth Expected to Continue**

The industry is growing rapidly and is predicted to continue adding 2,000 to 3,000 hectares of production vineyard for the next three years. Production in 2008 is forecast at 1.7 million HL, up 17 percent from the previous year.

Exports of wine are expected to continue to grow rapidly, and are forecast up 18 percent to almost 1 million HL. Domestic consumption of New Zealand wine is likely to increase slightly, however, the huge increases in production will dwarf any domestic consumption increases. Sauvignon Blanc will continue to be the flag bearer for New Zealand exports but Pinot Noir is growing in significance. The industry as a whole is still striving to maintain a very high quality level and sell its wines into the premium end of the world market.

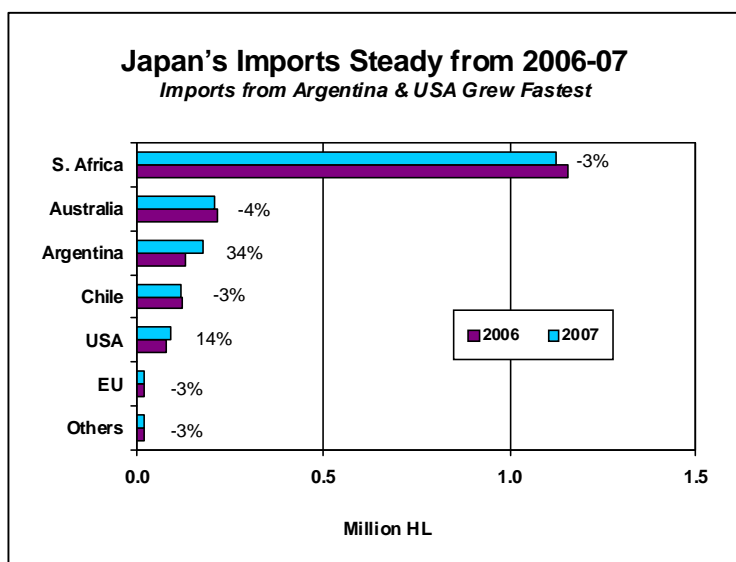
### Japan's Market Continues to Be Very Competitive

Japan wine imports were stable for the second consecutive year after several years of declines that ended in 2005. Overall, the value of wines increased due to marketing efforts to increase the \$15 per 750 ml bottle or higher priced market and the strong yen.

Total imports for bottled wine remained stable at approximately 1,310 hectoliters for the second year in a row, which confirms that the Japanese wine market has recovered. U.S. wine import volumes were stable for 2007, but the total value increased 10 percent above 2006 figures to reach \$71 million. The strong yen forced importers to raise prices, but this was not the only reason for the higher value. There was

also an increase in consumption of middle level priced wines, which are \$15/bottle or higher. Unit values of imports from the EU showed a 10-percent increase from the previous year, and U.S. imports showed a 23-percent increase. The value increase of U.S. wines can be attributed to the "Wine by the Glass" and other marketing programs implemented by The Wine Institute, and the wine associations of the States of Washington and Oregon.

The Japanese wine market is very competitive. Over 30 countries export to Japan, led by the EU and the United States. Import volumes in 2007 were about the same as 2006. Imports rose from Chile, Australia, and New Zealand in 2007, whereas U.S. wines fell 5 percent.



### **China's Market Continues to Surge**

The volume of U.S. wine exports to China rose tri-fold over the last five years, ending at 50,000 HL. Despite this, due to their late entry, U.S. winemakers have yet to gain a significant market share relative to their European counterparts, or relative to other latecomers such as Australia and Chile. In fact, the United States rose to fourth place by volume among the top wine importers to China, following Chile, the EU, and Australia.

Due in part to low disposable incomes, mid-priced domestic wines still dominate the market, ranging from about \$3 to \$8 per liter. Imported wine is believed to be healthy and implies a certain social status and cultural sophistication. It is considered a fashionable alternative to traditional Chinese rice wines and alcohol.

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