



## **The Central Valley Winegrape Industry and the World Market for Wine**

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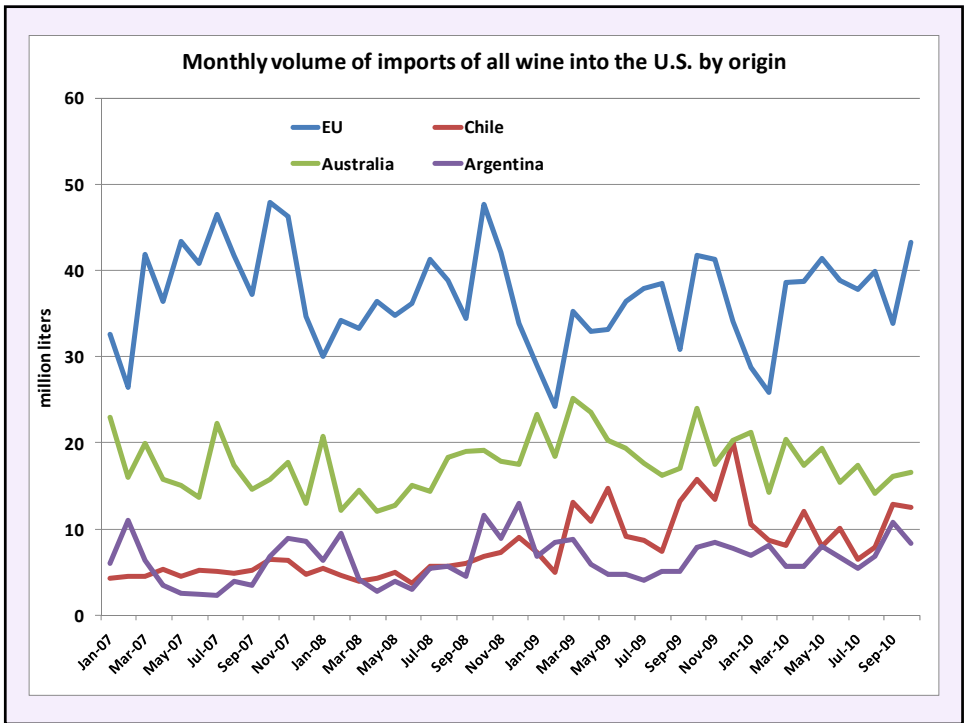
**University of California Agricultural Issues Center**

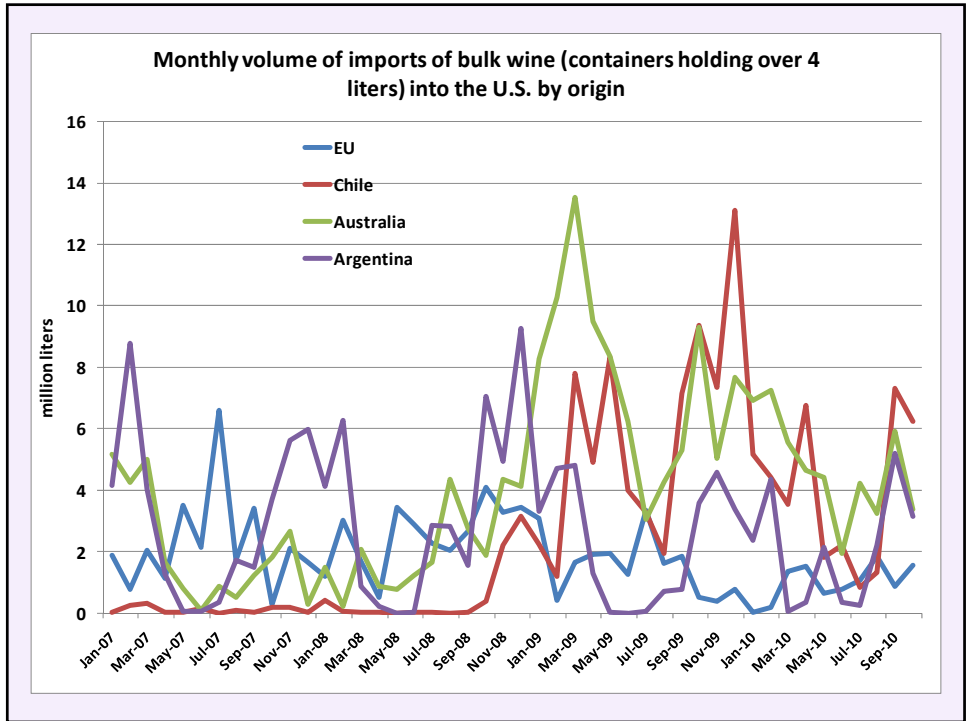
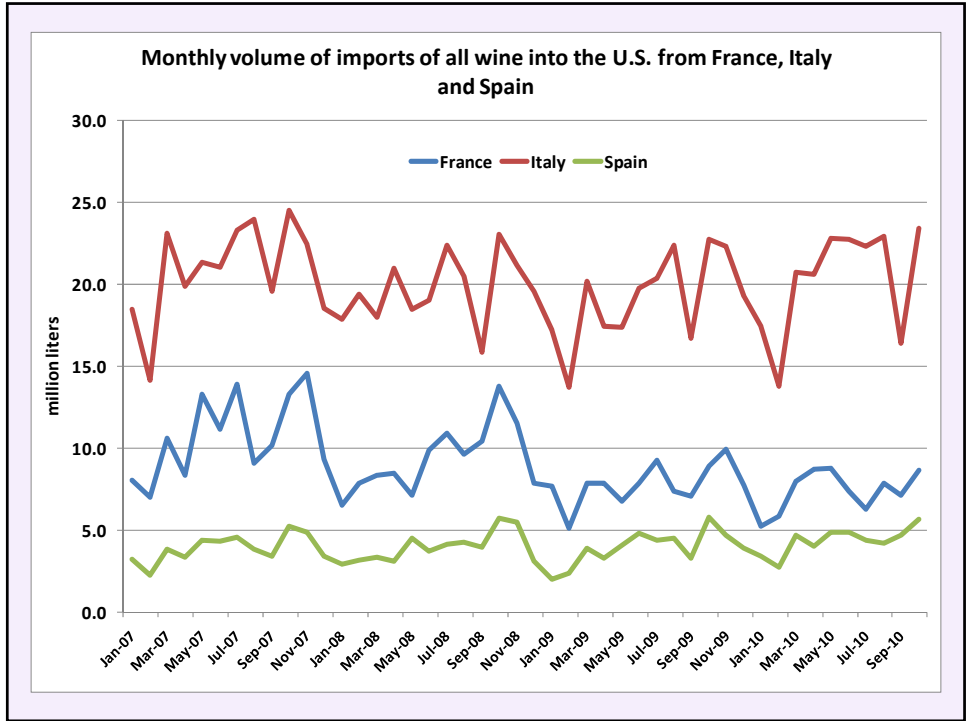
**January 5, 2011**

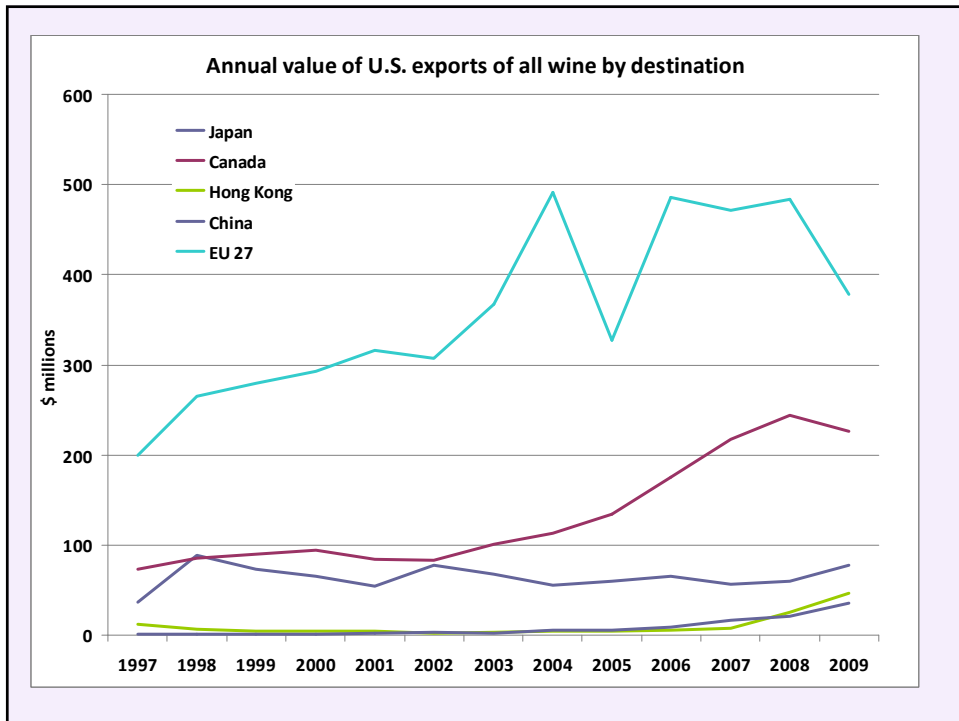
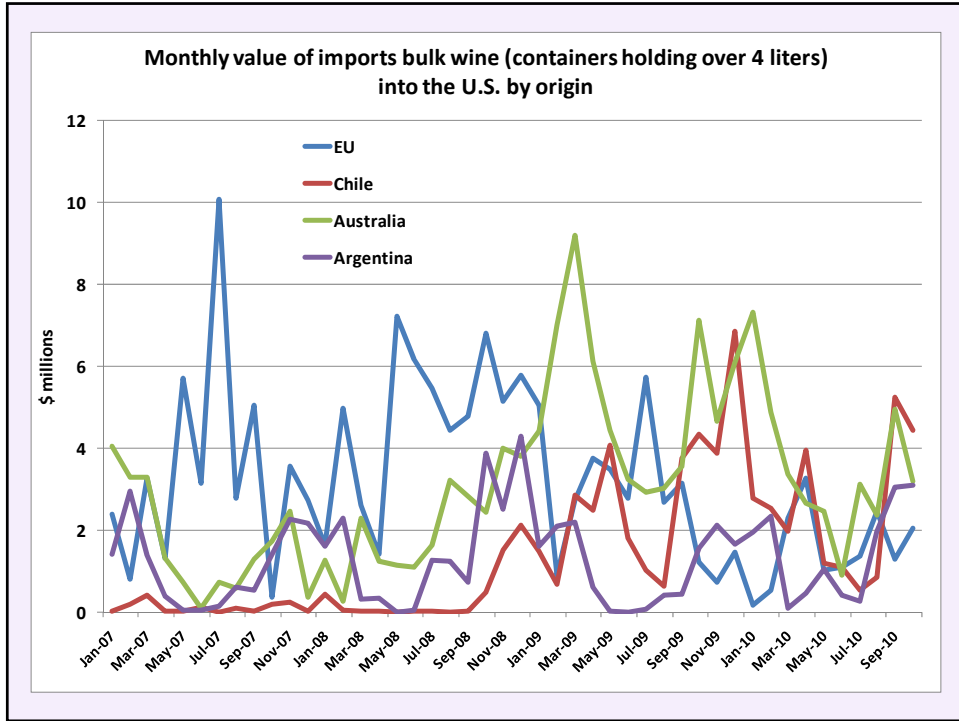
### **The Central Valley is a Central Part of the Competitive World of Wine**

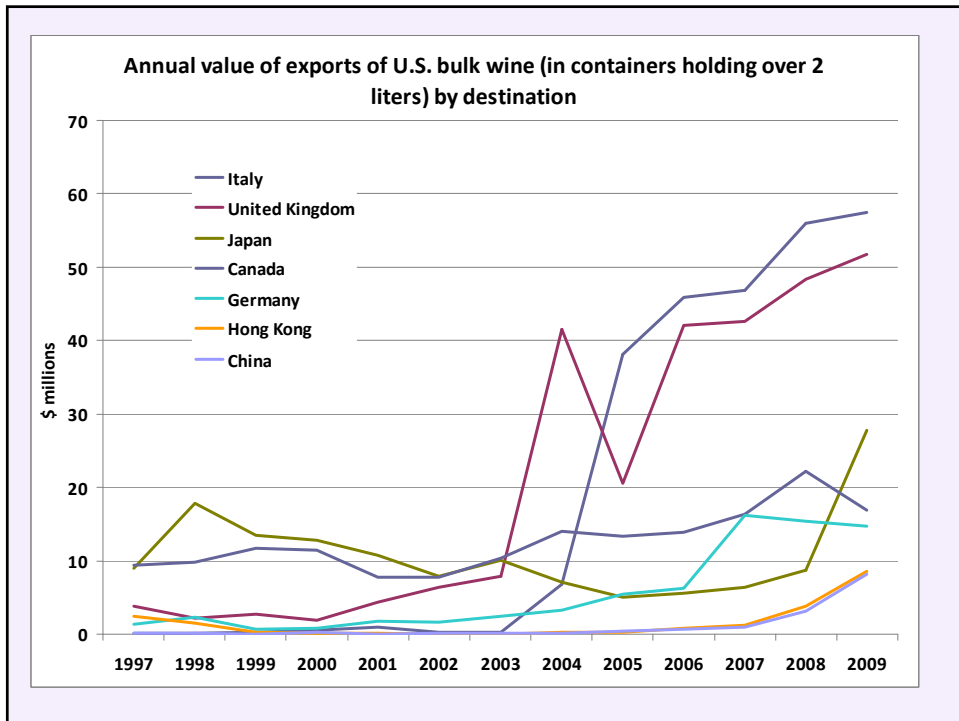
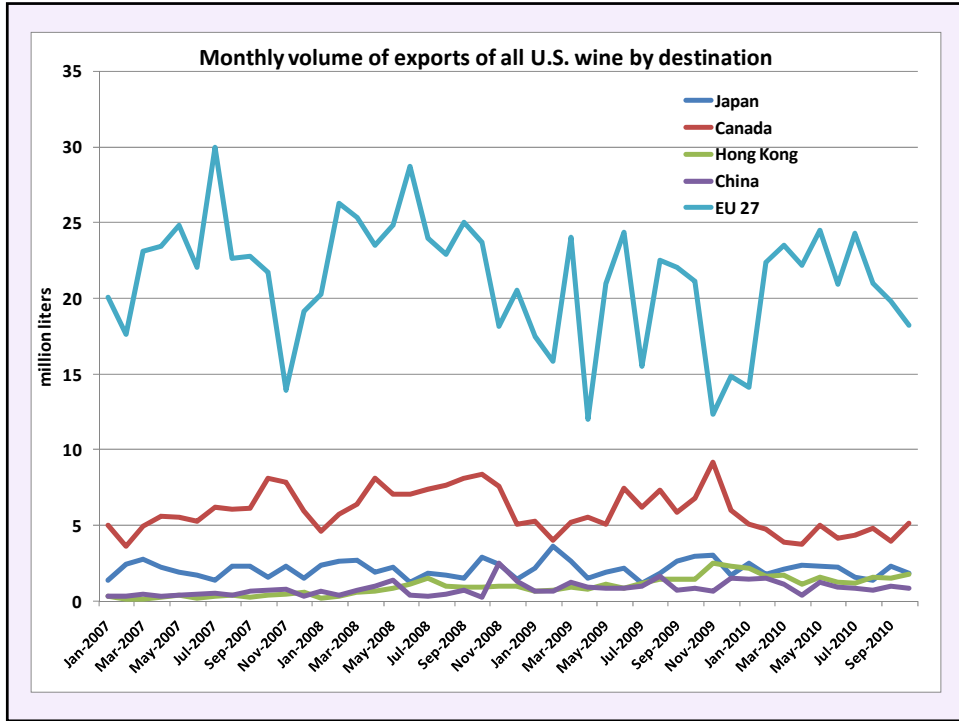
- **What is happening in the world of wine?**
  - Where in the world is the competition and what are they doing?
- **What are the drivers of changes in global demand and costs of competitors?**
  - Where and why is demand growing or not growing and who benefits?
  - What are the cost conditions elsewhere?
- **What are the current policy developments?**
  - Especially what is the EU doing and what in the world does it mean for the competitive position of Europe?
- **What is the competitive position of the Central Valley?**

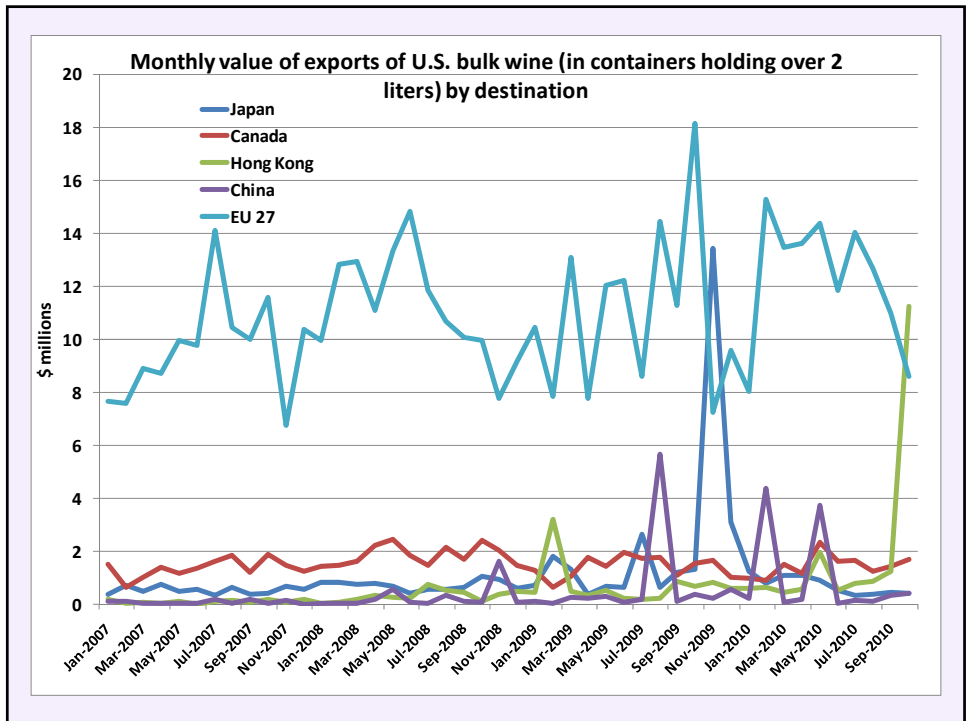
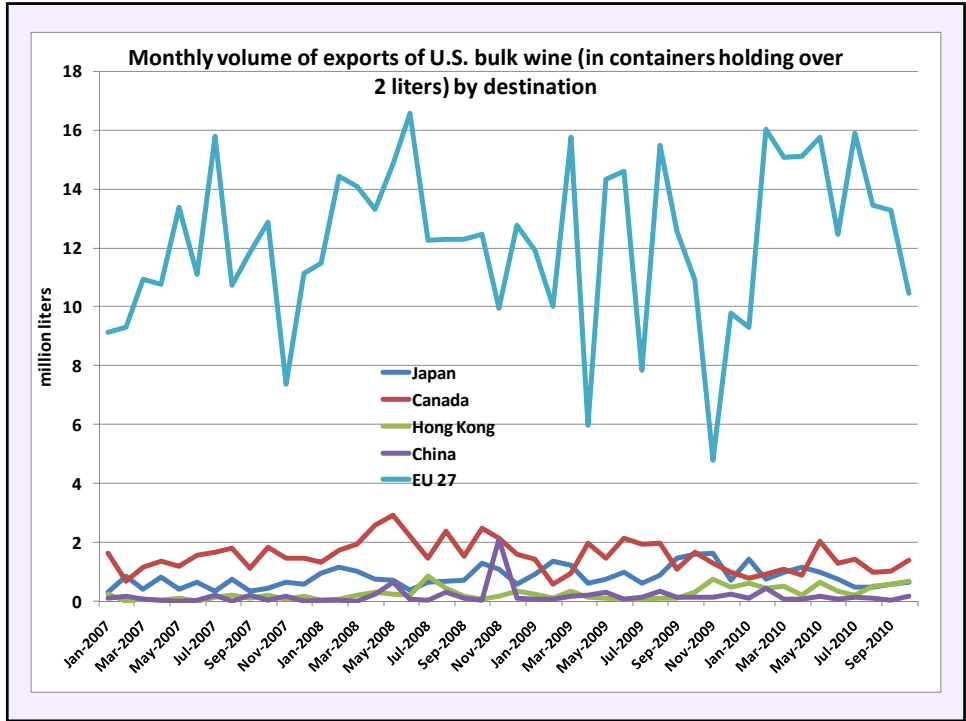
# International Wine Markets: Imports and Exports









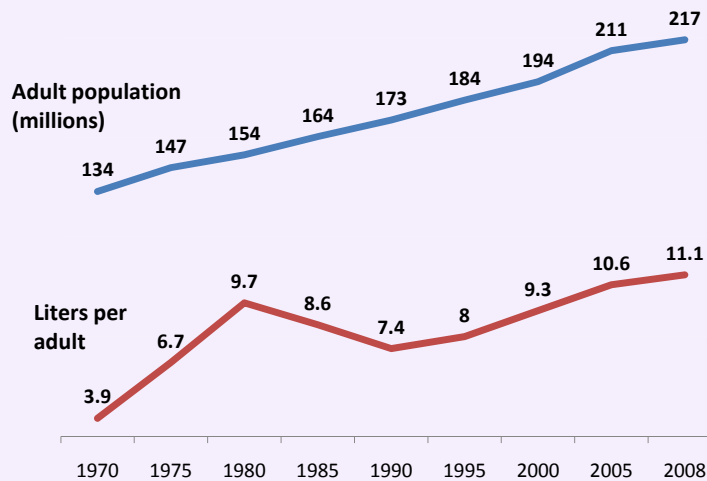


## The wine world is continuing to expand outside Europe

- Production has stopped falling in Europe and is growing in the rest of the world
- Consumption continues to fall in traditional big wine producing European countries
- Much of world trade is within the EU South to North
- These patterns continue to change as the rest of the world grows in importance on both sides of the supply and demand balance
- Consumption growth in Northern Europe and the world outside Europe is accompanied by production growth outside Europe

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## U.S. adult population and per capita consumption of wine, 1970-2008

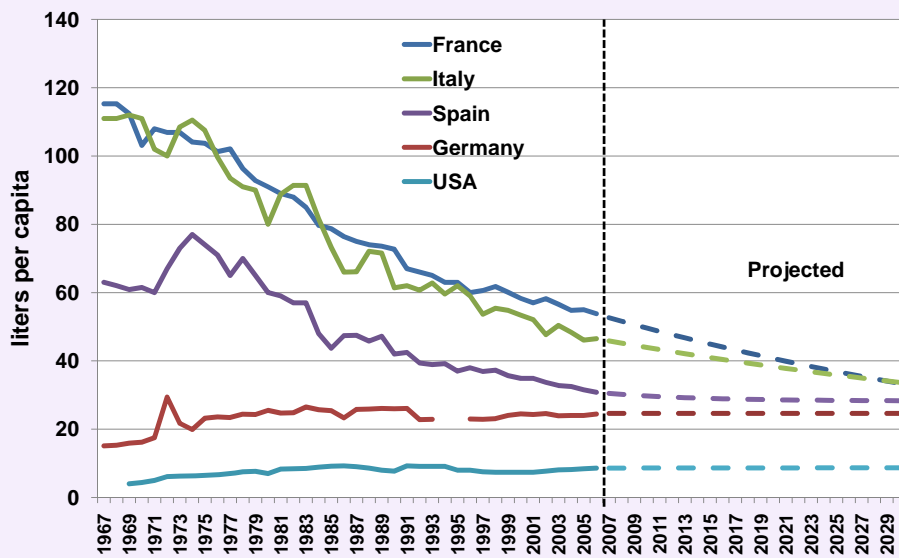


### Consider simple statistical projections from the historical data

- We use past 50 years of consumption data in each place to project forward 20 years using recent patterns to forecast subsequent years, smoothing out big movements.
- This time series forecast approach is more sensible than just a linear or other trend line because it puts more weight on recent years, but it does not really do any economic or industry analysis.
- Consider this a straw man. We use no real information other than that the future will be like the past in relatively simple ways.
- But, if we think the future will be different we need some good reasons.

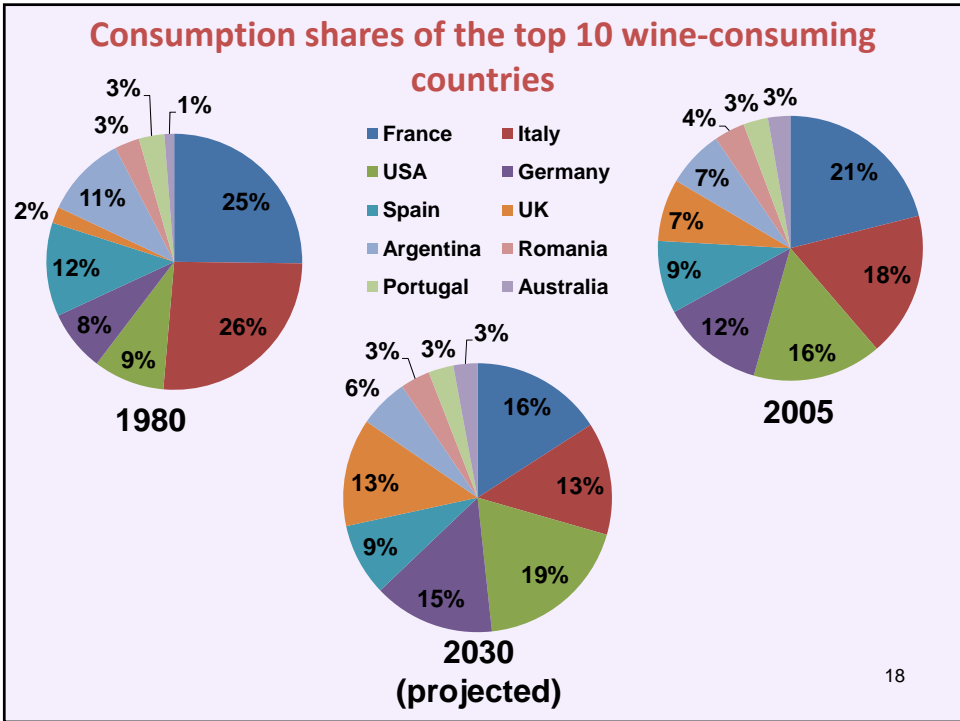
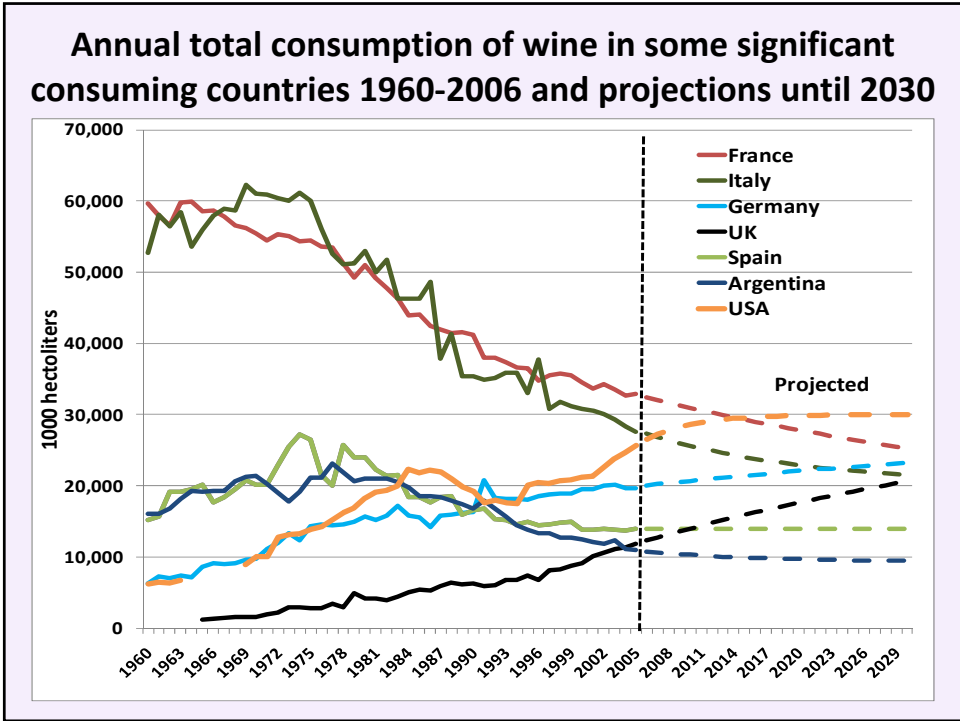
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### Annual per capita consumption of wine



Note: projections estimated using exponential smoothing with a damped trend

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### **What does population and income growth mean for the wine markets of the future?**

- The wine consuming markets are **NOT** in the fastest growing parts of the globe.
- The Middle East, south Asia and Africa are growing and none have much of a history of wine or, probably, much future.
- The rich world is a shrinking share of the global consumption of most food and consumer products.
- These demographics mean that the overall wine market is not like food and agricultural markets generally.

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### **Plant or Pull?**

#### **One simple equation**

Compare across potential crops:

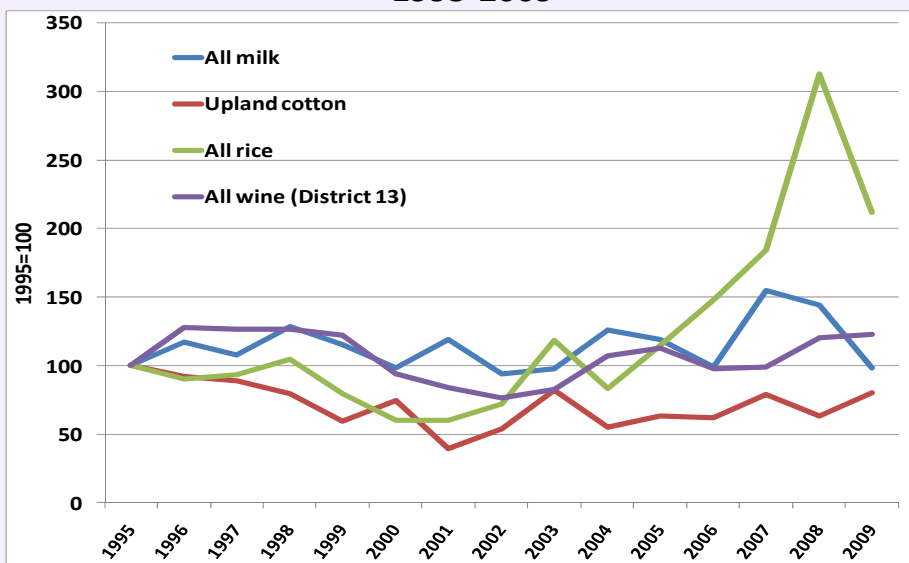
$$\mathbf{Profit = Price \times Quantity - Costs}$$

- **But, we must look far into the future and consider the interest rates and expectations**
- **So the equation is really a little less simple**
- **Variability causes complications too**
- **Adds to risk**

## Expected prices

- Expected prices hinge on the interaction of expected long run crop supply conditions in competitive regions and long run demand conditions in relevant markets.
- Expected future demand includes the US market and potential export markets.
- In all markets, expected future demand depends on expectations about prices of substitutes, new product developments, nutritional benefits, income growth, demographic trends such as age distributions, ethnicity and etc.
- In export markets, tariffs and other barriers to access also determine relevant demands.

## Indexed prices for milk, cotton, rice and winegrapes, 1995-2009



Source: NASS. *Agricultural Prices and Grape Crush Reports*. All Milk and all rice prices are for California. Upland Cotton price is national.

**Measures of volatility in average annual price changes,  
1995-2009**

|  | All Milk  | Upland Cotton | All Rice | Winegrapes |
|--|-----------|---------------|----------|------------|
|  | (percent) |               |          |            |
| Averaged absolute values of annual percent price changes                     | 18.66     | 23.56         | 27.21    | 11.22      |
| Averaged absolute values of annual percent deviation from trendline (linear) | 12.01     | 16.52         | 35.70    | 14.13      |

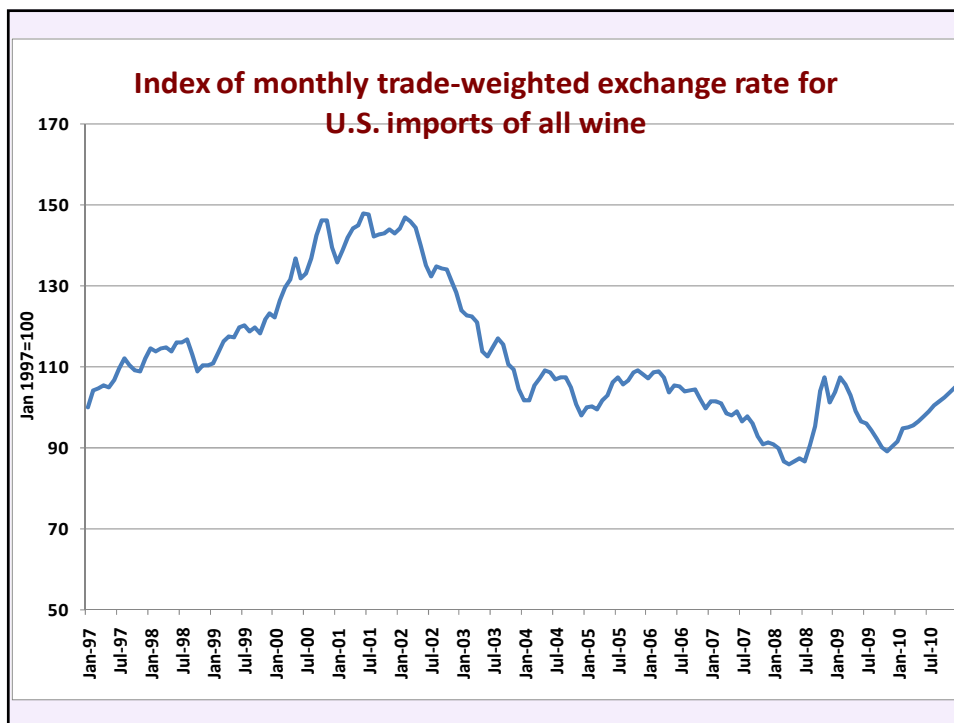
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**Korean Free Trade Agreement:  
Competition with other exporters in crucial**

- **The best opportunities are to expand in the Korean market for products where Korean production is small or potential for Korean supply expansion is limited**
- **One emphasis to use lower barriers to compete with other who already have trade deals (Chile) or may develop deals (Australia and the EU)**

## Wine and tree nuts have significant potential

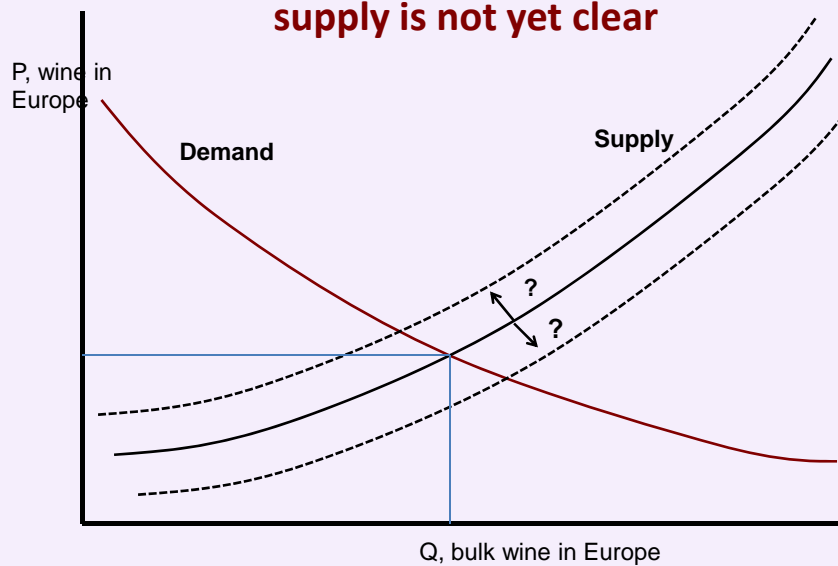
- Wine must build stronger Korean demand to compete with Chile, EU and Australia
- Korean consumption of tree nuts is low and has a huge upside for taste and health reasons



## EU Wine Policy has changed

- Policy to remove bulk wine from the market is being phased out
- Some relaxation of intrusive regulations
- Paying growers to remove vineyards
- Paying growers for “environmental” services even if they do not grow winegrapes
- Some of these shift out the supply of bulk wine from Europe some of them shift back the supply.
- The next result is not yet clear.

## The effect of EU subsidy changes on EU wine supply is not yet clear



### **Other issues for changes within the industry**

- **Bulk commodity wine vs. expensive packaged wine**
- **Branded commodities**
  - Easy to reproduce product hard to reproduce the brand
  - high profit margin
  - Colas, shampoos, beers
- **Branded wine**
  - different model than wines with unique *terroir* or practices
  - produced by distributors who capture benefits
  - Australian wine in the US has partially achieved this and others are attempting to use commodity grapes
- **Traceability, location and labeling what is the role for policy and industry practice**

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### **Country of origin other labeling issues as the industry evolves to global sourcing without appellations of importance**

- **Traceability for products of mixed origin**
  - Potential for blending wines from different regions of the world
- **To what extent does *terroir* matter for bulk wine?**
  - Issue that wine industry doesn't necessarily face but the food industry does
- **Effects of regulation and policy: will governments mandate added labeling for wines with multiple international sources**

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**Thank you! [www.aic.ucdavis.edu](http://www.aic.ucdavis.edu)**

