



The Central Valley Winegrape Industry and the World Market for Wine

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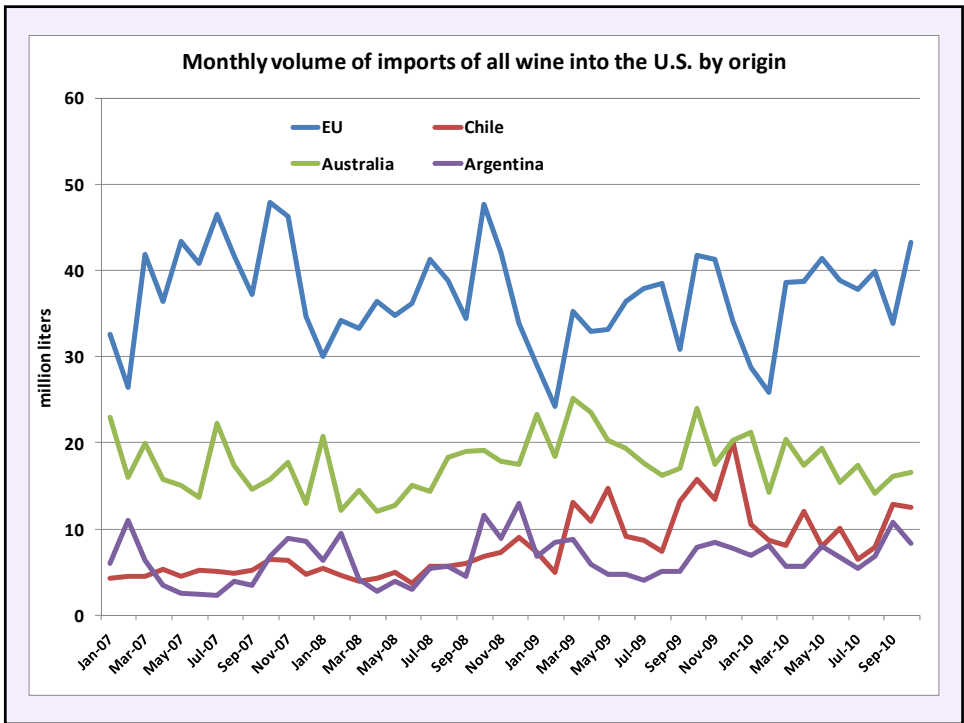
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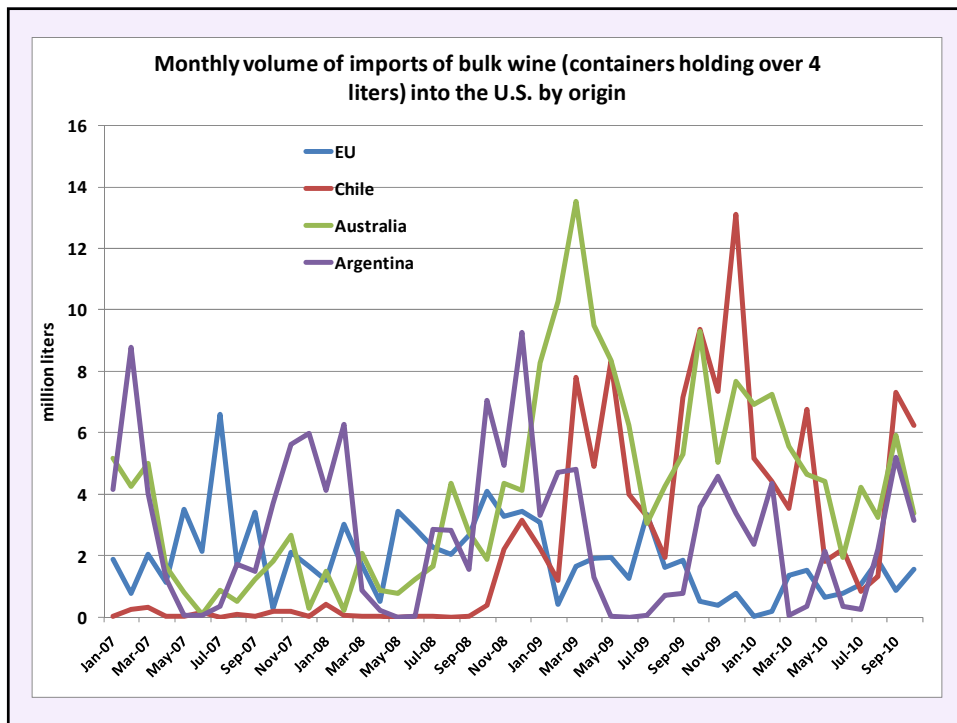
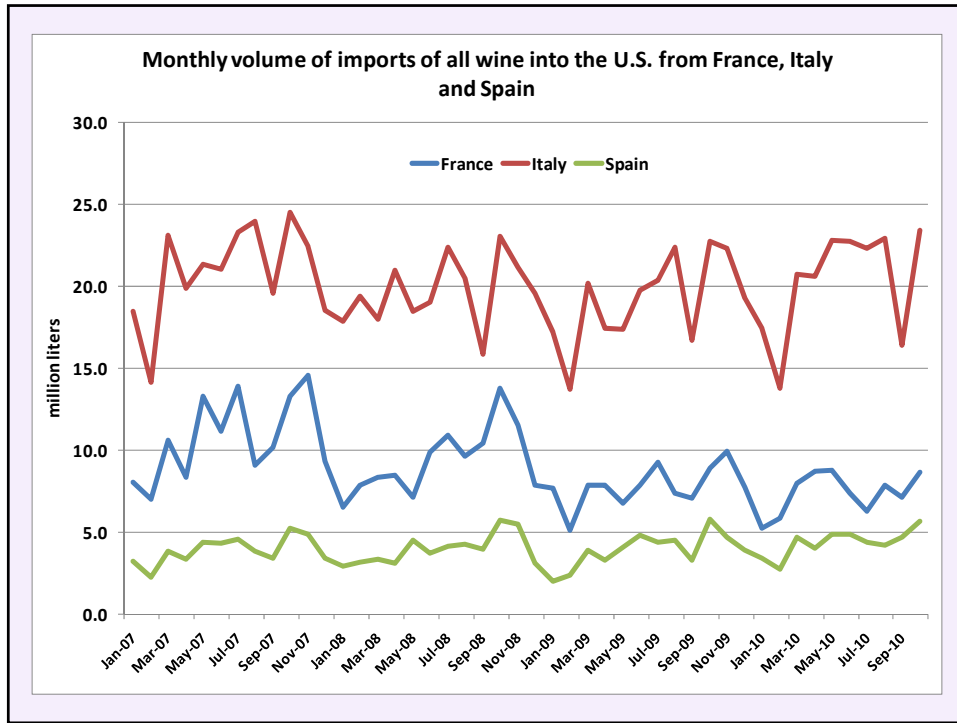
January 5, 2011

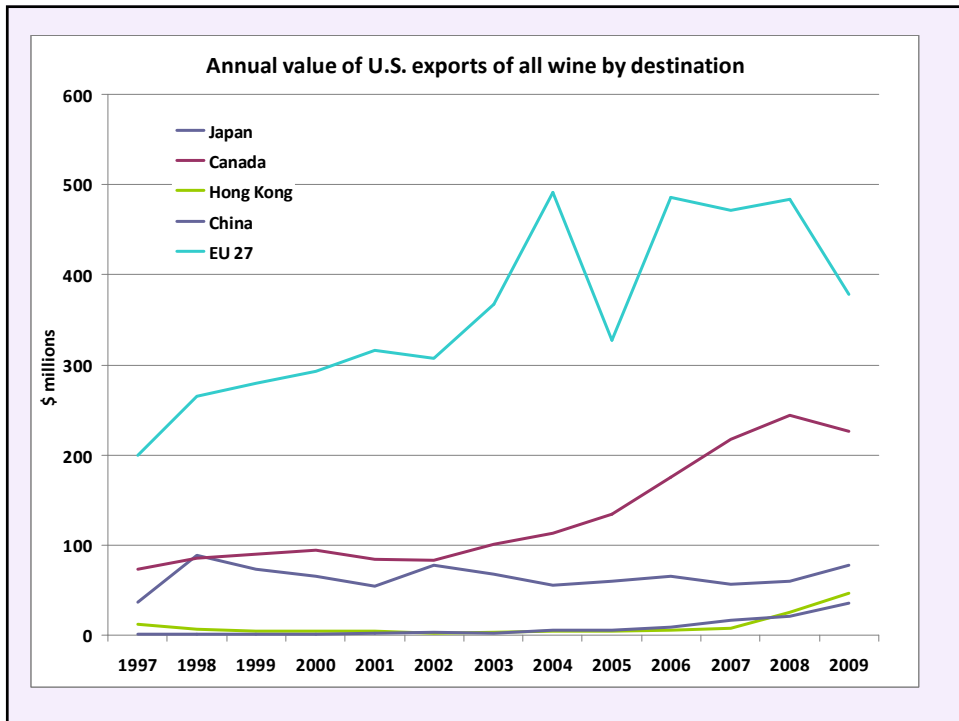
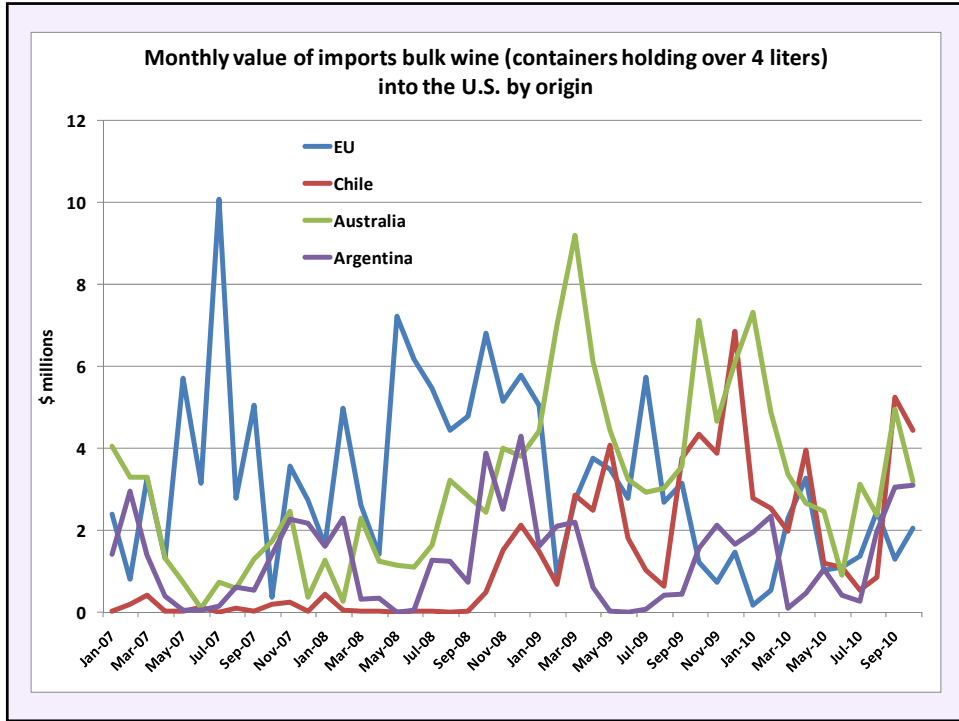
The Central Valley is a Central Part of the Competitive World of Wine

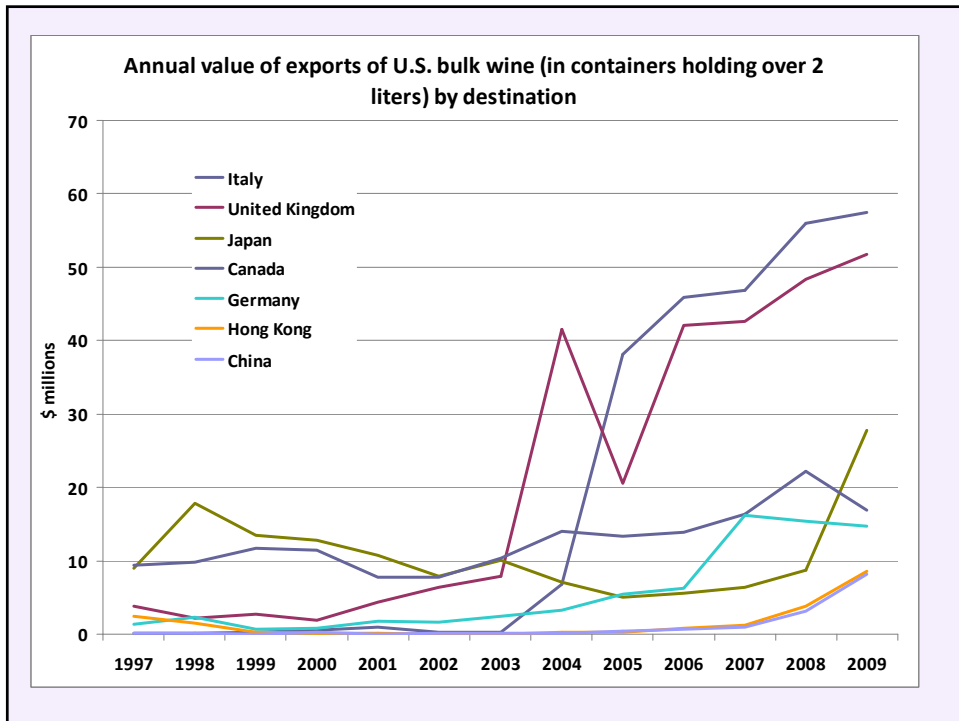
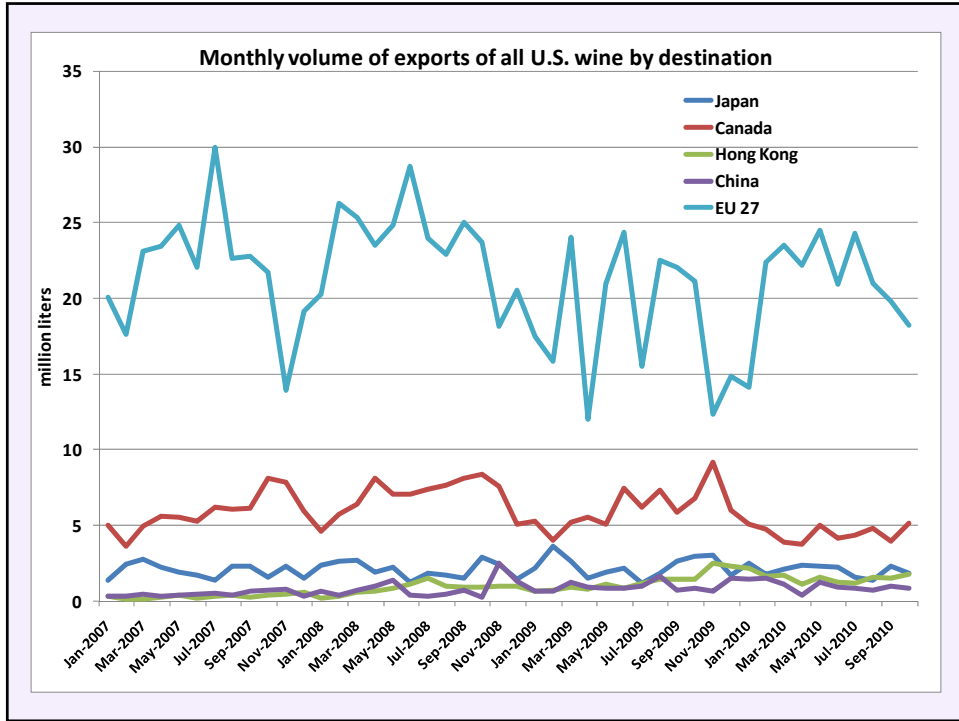
- **What is happening in the world of wine?**
 - Where in the world is the competition and what are they doing?
- **What are the drivers of changes in global demand and costs of competitors?**
 - Where and why is demand growing or not growing and who benefits?
 - What are the cost conditions elsewhere?
- **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?**

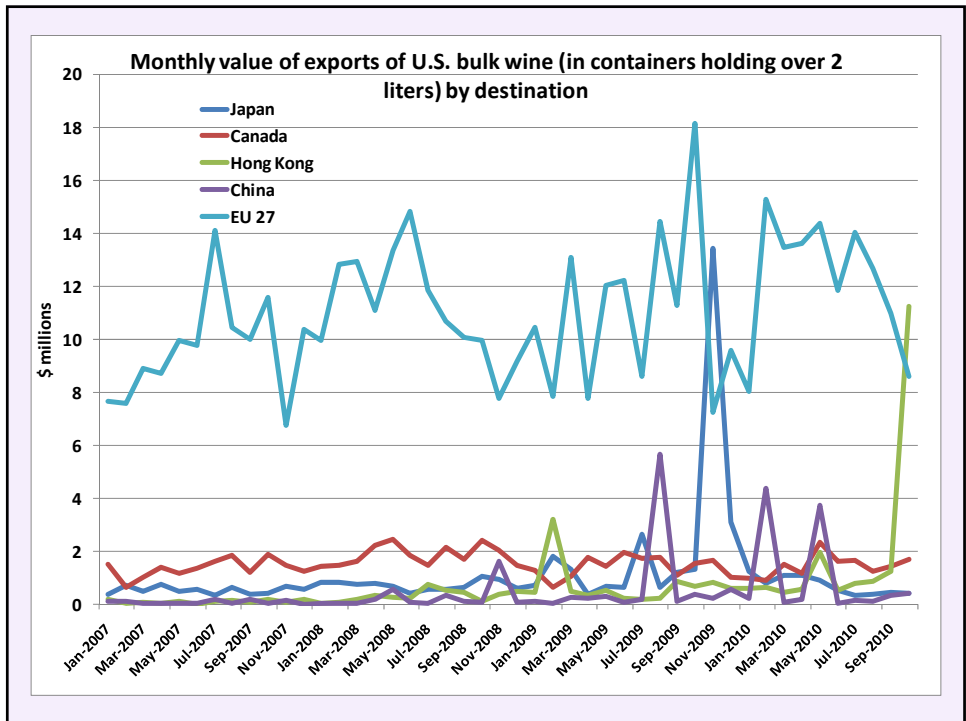
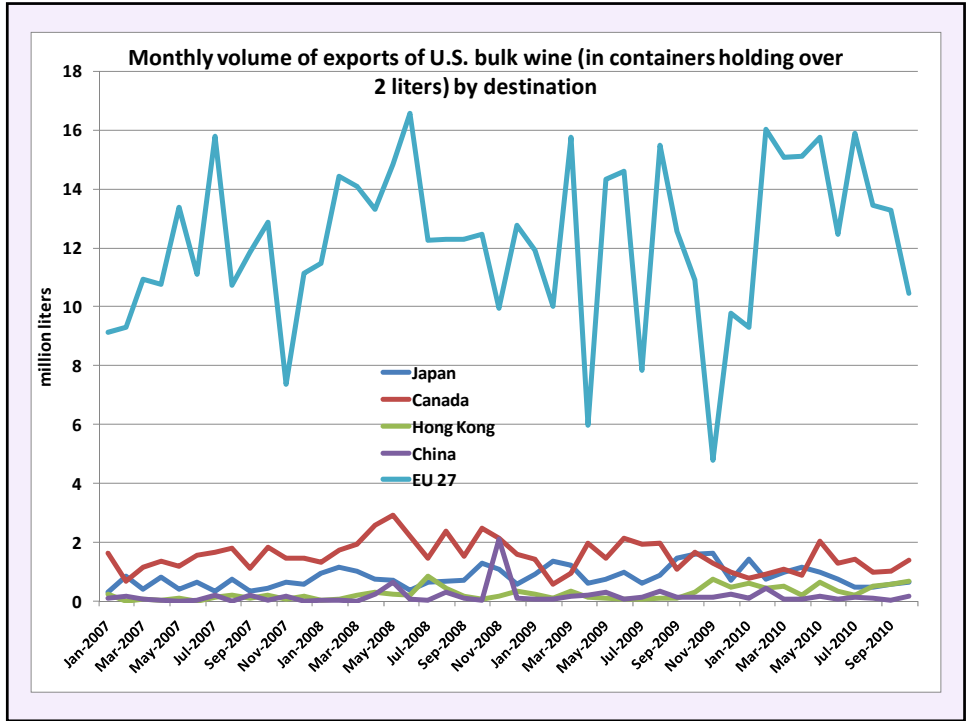
International Wine Markets: Imports and Exports









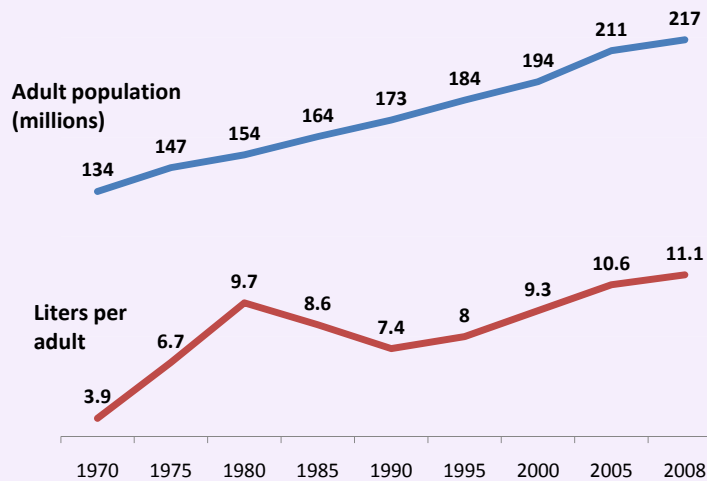


The wine world is continuing to expand outside Europe

- 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

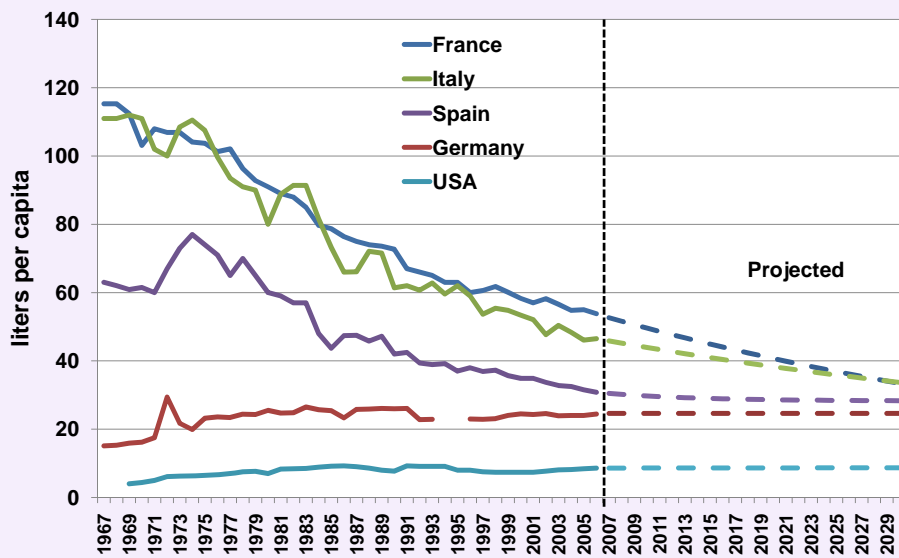


Consider simple statistical projections from the historical data

- 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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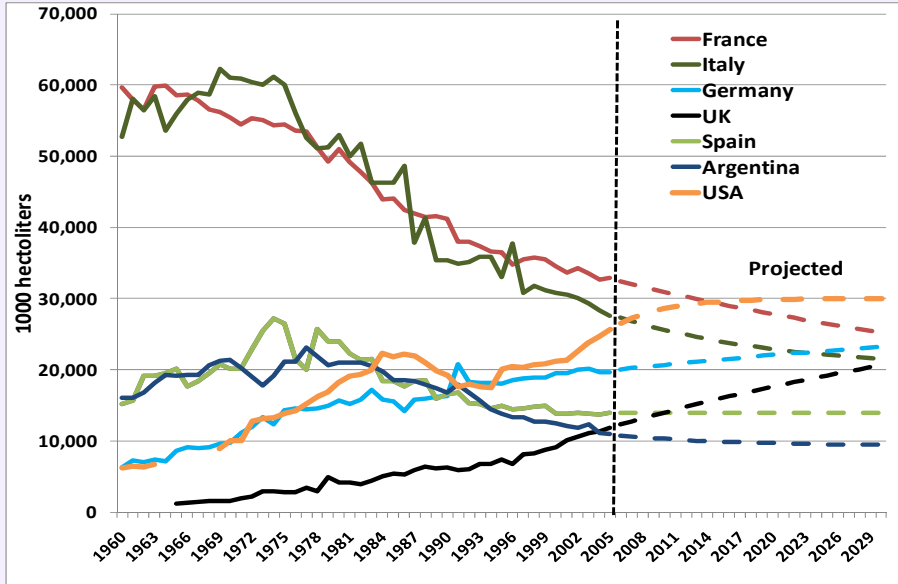
Annual per capita consumption of wine



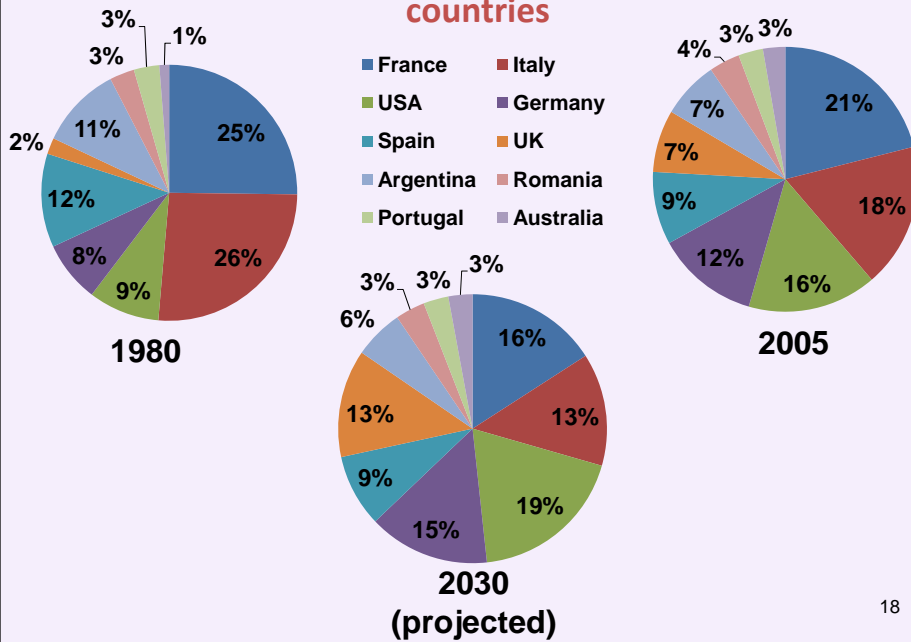
Note: projections estimated using exponential smoothing with a damped trend

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Annual total consumption of wine in some significant consuming countries 1960-2006 and projections until 2030



Consumption shares of the top 10 wine-consuming countries



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:

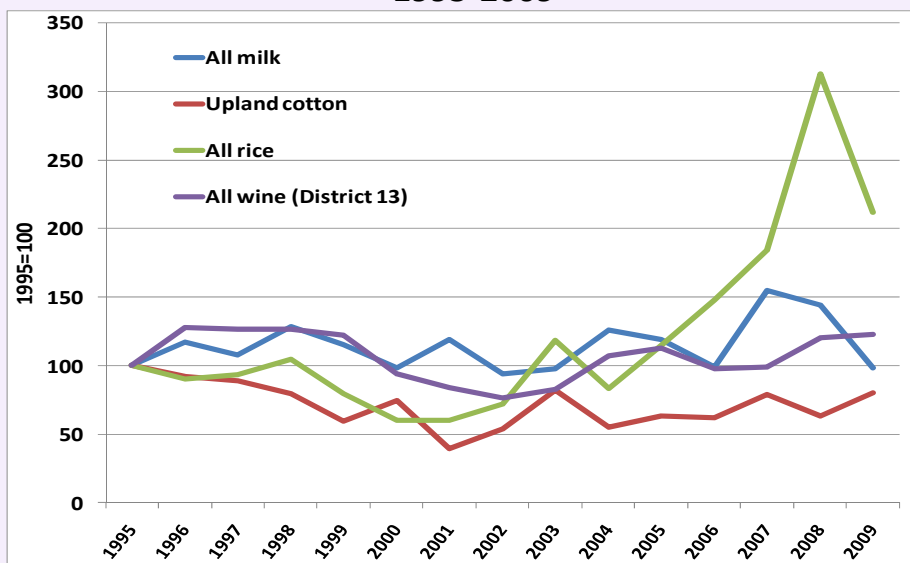
$$\mathbf{Profit = Price \times Quantity - Costs}$$

- **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

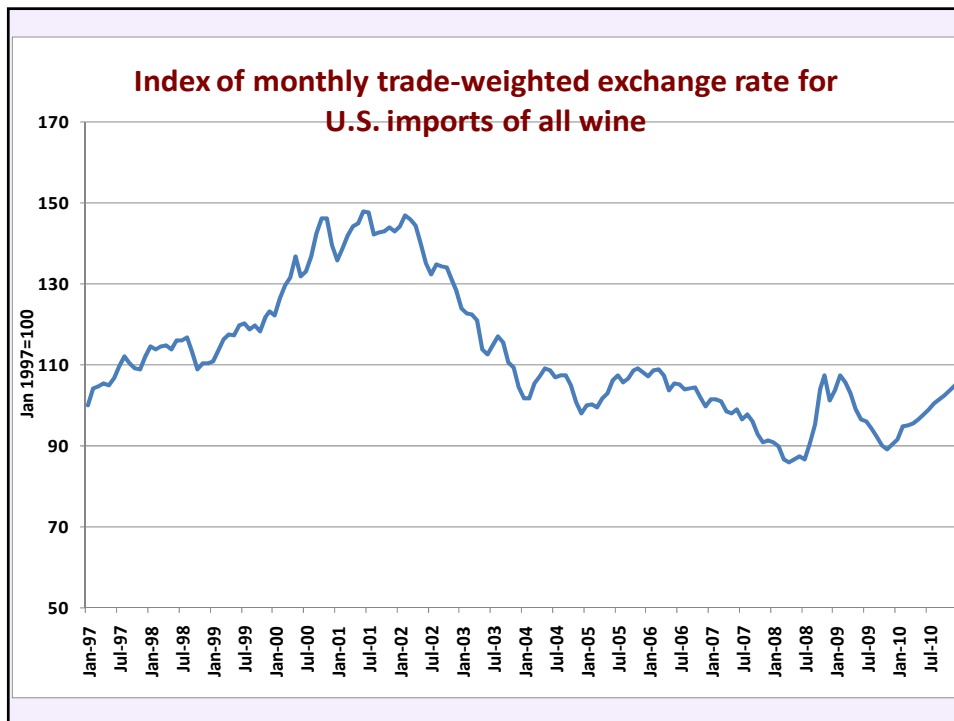
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**Korean Free Trade Agreement:
Competition with other exporters in crucial**

- **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

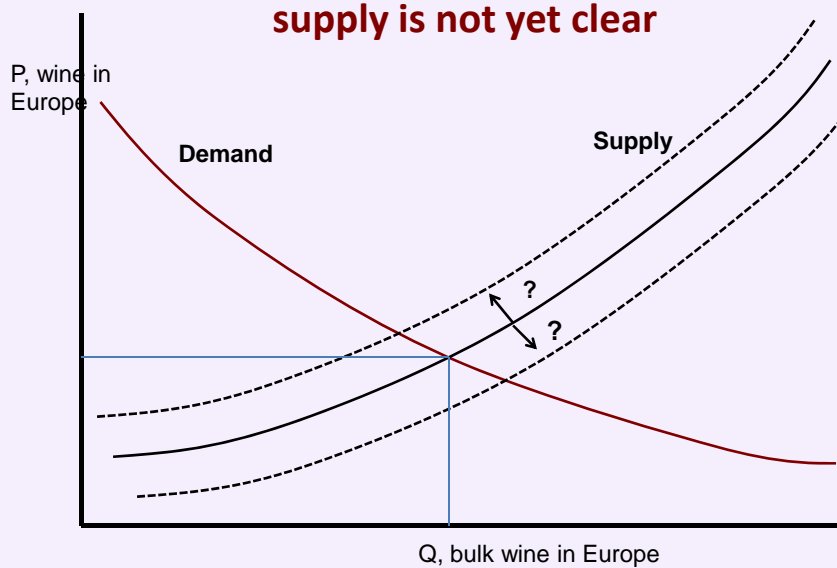
- Wine must build stronger Korean demand to compete with Chile, EU and Australia
- Korean consumption of tree nuts is low and has a huge upside for taste and health reasons



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

