



**Australian Government**

**Australian Wine and  
Brandy Corporation**

Our Ref.

30 June 2005

Senate Rural and Regional Affairs and  
Transport References Committee  
SG62  
Parliament House  
CANBERRA ACT 2600

Dear Sir or Madam

**Re: Inquiry into the Wine Industry**

Thank you for inviting the Australian Wine and Brandy Corporation to make a submission to the Senate Rural and Regional Affairs and Transport References Committee – Inquiry into the Wine Industry, a copy of which is attached.

Should you have any queries regarding the issues raised in the submission, please do not hesitate to contact Mr Lawrie Stanford, Manager Information and Analysis for the Corporation, on (08) 8228 2004 or email: [lawrie.stanford@awbc.com.au](mailto:lawrie.stanford@awbc.com.au).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Sam Tolley', written over a white background.

Sam Tolley  
Chief Executive

**State Rural and Regional Affairs and Transport References Committee**  
**Inquiry into the wine industry**

Submission made by the  
Australian Wine and Brandy Corporation

Industry House  
cnr Botanic and Hackney roads  
ADELAIDE SA 5001

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## 1. Summary

The Australian Wine and Brandy Corporation (AWBC) has a mission to enhance the operating environment of the wine sector. It does this by playing a leading role in wine sector regulation; information collection and analysis; and collaborative marketing initiatives with industry in overseas markets.

As an Australian Government statutory authority, the Corporation is separate from commercial operations which are principally responsible for the growth of the sector.

In the submission that follows, the point is made that the sector is market-driven and solutions to problems will also emphasize market-based actions. As such, the Corporation's primary comments on the inquiry's terms of reference will concern the role of information in facilitating effective market decisions and the role of collaborative marketing.

The Corporation's specific advice on the current oversupply issue is as follows: while double digit export growth for Australian wine cannot be expected to continue in the medium-term, any reasonable assessment of the future will still place sales growth potential above anticipated supply growth. **The medium-term problem is therefore more about shortages than oversupply.**

Main points:

- The wine sector has grown and thrived in the modern era on market-based principles and incentives.
- Current oversupply is being sustained by seasonal influences.
  - ... - The two immediate past seasons have been above-average yielding.
  - ... - Moreover, in the warm inland districts three out of four of the last seasons have been above-average yielding.
- Falling prices are not solely because of oversupply. Other factors influencing the current downward trend in winegrape prices include unfavourable exchange rates, a consolidating retail sector and a consumer shift to lower price points in Australia's major overseas markets.
- In a market-driven industry like the wine sector, business plans need to incorporate an understanding of these influences on price. In an agriculturally-based sector, like wine, this will include seasonal factors.
- In the current trading environment, the retail sector has growing market power through consolidation and exerts price pressures on the producer sector. In response, wine producers are consolidating. In this environment, consolidation in the grape growing sector is inevitable in order to deal with price pressures.

- The market is resolving the current oversupply in the Australian wine sector.
  - ... Structural oversupply is non-existent – plantings have been at low levels for what is anticipated to be five years.
  - ... Export sales have been spectacular for at least a decade and double digit growth continues.
- Sales success rests with the commercial acumen of producers. From time to time, they collaborate with the Corporation to fund united marketing of the Australian wine image and to facilitate market opportunities. The most recent example was the launch in May 2005 of the refreshed Wine Brand Australia positioning to highlight the diversity in style, variety, regionality and price points of Australian wine.
- The requirement for collaborative action by independent grapegrowers is equally apparent. Hence, there is a need for a national grape grower’s representative body. Such a representative body will also assist in the flow of information between the Corporation and individual grapegrowers.
- Integration of vineyard and winemaking practices are critical to wine sector success. Integration needs to emphasise market-based solutions, not regulatory.

2.

## **Overall assessment of the wine sector's supply and demand balance**

- **The nature of wine contributing to the winegrape oversupply**
  - The major category of wine in oversupply is red wine sourced from the higher-cost production districts located outside what are commonly referred to as warm inland districts (the Riverland, Murray Darling and Swan Hill and the Riverina).
  - Independent grapegrowers, the subject of this submission, are concentrated in the warm inland districts and are not as directly influenced by the current oversupply as are growers in the east of Australia.
  - Independent grapegrowers in warm inland districts are nevertheless indirectly affected by flow-on effects of oversupply in other areas. An opportunistic nature to demand for warm inland fruit means the flow-on effects lead to greater volatility of warm inland prices (see later section).
  - There are indications that in addition to the oversupply of red winegrapes that has existed for some time, white winegrapes also went into oversupply in season 2005.
- **Evidence for oversupply**
  - Falling prices are not solely because of oversupply. Other factors influencing the current downward trend in winegrape prices include unfavourable exchange rates, a consolidating retail sector and a consumer shift to lower price points in Australia's major overseas markets.
  - Winegrapes left on the vine or dropped on the ground are a tangible sign that winegrapes are in oversupply.
  - Tonnages left on the vine in 2005 are hard to determine because there is no rigorous method in place for quantifying the tonnage.
    - ... Anecdotally, the tonnage left or dropped in 2005 was of the order of 40 000 tonnes Australia-wide. This amount would represent about 2% of the national crush in that year.
  - This is not the first time in recent history that grapes have been left on the vine.
    - ... In 2002, winegrapes were left on the vine. The reasons, at that point in time, were largely short-term influences to do with failed arrangements for

contracted fruit – namely, the collapse of a major winemaker and a drastic overhaul of another’s contract arrangements.

... In 2002, the tonnages left on the vine were thought to represent about 4% of the national harvest.

... In contrast to 2002, winegrapes left on the vine or dropped on the ground in 2005 have been due to oversupply issues.

- **Seasonal influences are the major driver of the current winegrape oversupply.**

- A recent planting boom kicked-off the current cycle of oversupply. Some of the current surplus inventory is production from this boom.

- ... The planting boom peaked in 1998. Seasons 2004 and 2005 saw the last of this new planting coming on-stream.

- The current oversupply, kicked off by planting, is being sustained by two immediate past above-average yielding seasons. Moreover, three out the last four seasons have been above-average yielding.

- **Market-based factors are leading to balance**

- Demand-side prospects remain strong (in volume terms).

- ... The volume of exports grew at 14% in the year-ended May 2005.

- ... The volume of domestic sales in the year-ended May 2005 grew at 3% (representing an expected rate of growth in domestic sales).

- ... The combined rate of volume growth in sales across export and domestic markets was 11% in the year-ended May 2005

- Prices are under pressure and are influencing lower plantings that will allow current surpluses to be drawn down.

- ... Wine export prices fell 5% in the year-ended May 2005.

- ... Domestic wine prices and the derived price for winegrapes can be expected to undergo the same fate.

- ... Factors influencing the downward trend in wine export prices include oversupply, unfavourable exchange rates, a consolidating retail sector and a shift to lower price points in Australia’s major overseas markets.

### **3. What are the prospects of balance being achieved in the Australian wine sector?**

- **It is a matter of time before supply and demand comes back into balance.**
  - Market forces are driving the passage to balance.
  - The structural underpinnings to the current oversupply have been dealt with.
    - ... Plantings in the four seasons ended 2003, and almost certainly in 2004, have been at rates that are estimated to grow supply at marginally more than 2% per annum.
    - ... On the basis of price outcomes in 2005, it is very likely that plantings in 2005 will also be low – making five successive seasons of relatively low planting rates.
  - While price adjustments in the industry are painful, they have nevertheless mediated the required structural adjustment in supply.
  - Combining the expected growth in supply at around 2% per annum in the next five years with the rate of volume growth in sales, currently running at 11% per annum, it is apparent that the current stock overhang will be drawn down in the near future and balance will be achieved.
- **There are data problems in determining when balance will be achieved**
  - While it is possible to estimate when balance will occur, the usual uncertainties attached to any forecasting exercise are currently exacerbated by inaccurate inventory statistics available to the industry.
  - Since 2000-01, the reported industry inventories have under-numerated actual stock.
    - ... The ABS Wine Statistics Unit (WSU), in Adelaide, collects wine stock numbers.
    - ... An apparent break in the series in 2000-01, was brought to the attention of the WSU by the wine sector and has been a topic of discussion between the two parties since then.
    - ... There is agreement between the WSU and the wine sector that the reported stock numbers understate reality. A cause and solution has been hard to find although a course of action that promises a solution has been recently agreed.

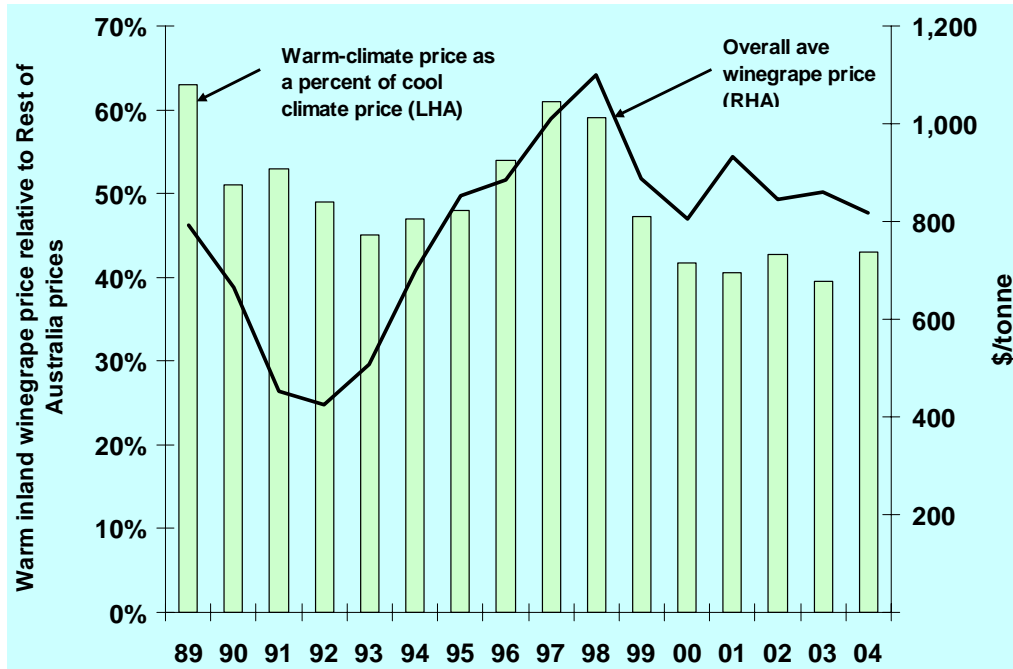
... Implementing a solution is subject to resourcing. A direct action the government could take to facilitate a solution to the existing situation could be to resource the currently identified Australian Bureau of Statistics solution to inaccurate stock numbers.

- The current understatement of the stock overhang understates the extent of the oversupply problem.
- Another implication of under-numerated stocks is that they hamper attempts to estimate when balance will occur.
- Until more accurate stocks are reported, the Australian wine sector cannot be entirely confident about forecasts of balance.
- **Subject to the uncertainty raised in the previous section, overall balance in the sector is expected by around 2008-09**
  - Based on reasonable assumptions about sales prospects, and an anticipated urgent drawn-down of stocks in the next few years, discomfort due to high stock levels will dissipate more rapidly in the early part of the period leading to balance, than in the latter part.
  - Winegrapes from warm inland districts will be in balance sooner while winegrapes from the rest of Australia, and particularly red winegrapes, will take longer to come into balance.

#### **4. Growers in warm inland districts generally face more volatile winegrape prices compared to growers in the rest of Australia.**

- **There is an opportunistic nature to warm inland fruit that leads to greater price volatility.**
  - The accompanying figure illustrates that when winegrapes are in overall shortage (indicated by rising prices), warm-climate prices increase at a relatively stronger rate than prices for fruit from the rest of Australia.
    - ... Warm inland winegrape prices are closer to the prices achieved in the rest of Australia when shortages exist. The converse relationship is also true, completing the picture of greater volatility.





– The explanation for this rests in the fact that warm inland fruit is, to some extent, an option of last resort.

... In 2004, 86% of the crush sourced from warm inland districts was purchased from independent growers at an average price that represented 42% of the average price achieved in the rest of Australia. By contrast, a smaller share of the crush sourced from other parts of Australia (at 64%) was purchased from independent growers.

... Winemakers tend to reduce the costs of inputs by integrating the growing of higher-cost fruit into their businesses. Conversely, they are more likely to outsource the growing of cheaper fruit by purchasing it from independent growers.

... Winemakers will attempt to optimise quality. In times of oversupply, greater tonnages can be sourced at higher quality levels. In this scenario, lesser quality grapes that are traditionally sourced from warm inland districts, will be in relatively less demand and greater oversupply as this fruit is ‘abandoned’ for the more available higher quality fruit (at relatively lower prices). The price for warm inland fruit will therefore be driven down further than for fruit from the rest of Australia.

... Conversely, in times of shortage, warm inland fruit will be sought to fill gaps in supply of higher quality fruit from the 'rest of Australia'. In this way, shortages will be greater in the fixed reserve available from warm inland districts and the price rises in these districts will be relatively stronger.

- **If price volatility for warm inland fruit is greater than for fruit from the rest of Australia, warm inland growers need to be aware that this is the nature of their market and appropriate business plans are needed to accommodate forward price volatility.**
  - The factor that will facilitate such awareness is accurate, timely and accessible information and interpretation.
  - Traditionally, most independent grapegrowers do not seek such information and interpretation as individuals. Rather, they rely on their representative organisations to procure and disseminate interpretation on their behalf.
- **Information and analysis plays a key role in facilitating effective supply and purchase arrangements between independent grapegrowers and winemakers.**
  - The Australian wine sector is rooted in agricultural enterprise and will always be subject to cycles of over- and under-supply. The desired outcome in terms of orderly industry planning is for the cyclic troughs and peaks to be minimised.
  - A well informed wine sector, which is sophisticated enough to interpret and apply available information, is key to ensuring sustainability and profitability in the sector.
  - The Australian wine sector is widely acknowledged as having “excellent data which allows us to monitor risks and trends in a timely manner” (B Searle, Horticulture Agribusiness Specialist, ANZ at the 2004 WA Wine Industry Outlook Conference).
  - The AWBC plays a central role in gathering and organising data as well as in disseminating it - together with industry-level interpretation.
  - A principle vehicle for making this material highly accessible to industry, in a timely manner, has been a recent innovation called WINEFACTS Statistics.

- WINEFACTS Statistics is an on-line facility that delivers both public-domain and higher value-adding fee-for-service data and interpretation.
  - ... WINEFACTS Statistics is a recent innovation and is in a phase of promotion and marketing to potential clients.
- The uptake of WINEFACTS Statistics among independent grapegrowers and their representative organisations has thus far been low.
  - ... The reasons offered include resources (financial and human capital) and problems with the Copyright Act.
- The independent grapegrower sector nevertheless acknowledges both the importance and usefulness of the industry's information services and in particular, those offered by the AWBC.
- Lack of utilisation in the wine sector of information initiatives such as WINEFACTS Statistics, suggests possible market failure.
- If market failure exists, there is an important government role in facilitating independent grower's access to initiatives such as WINEFACTS Statistics.

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29 June 2005

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