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## Ongoing Casualties in the Trade War

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Food & Agribusiness  
far.rabobank.com

#### [Stephen Rannekleiv](#)

Global Strategist –  
Beverages  
+1 212 808 6823

#### [Maria Castroviejo](#)

Senior Analyst – Beverages  
+31 30 712 3811

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### US Tariffs Hit European Wines

Wines exported from Spain, France, Germany, and the UK to the US are now subject to a 25% ad valorem tax. Some players may set up mitigating strategies, like exporting in bulk or notching up the ABV. However, for many, there is no way around increasing prices or absorbing the extra cost, meaning revenues and margins will be dented.

### Bulk Wine Prices Stable

Bulk wine prices have been broadly stable recently. With the last European Commission estimates pointing to a 2019 harvest 15% shorter than a year earlier in the region, bulk wine prices for the near future are more likely to move up than to decline, though predictability is lower than ever due to the ongoing trade and political interferences.

### Trade Flows Reflect a Sum of Specific Situations

The EU-Japan trade agreement (effective since February) has boosted wine exports from Spain, Italy, and France to the country. Elsewhere, very competitively priced bulk wine from Chile and Argentina resulted in strong export volume increases, while the opposite was the case in South Africa and Australia, where exports in value performed better.

### US Imports Recovering After a Slow Start

After a negative start of the year, activity recovered, and in Q2, imports increased by 7% in volume and 5% in value compared to the same period of the previous year. The outlook is very unpredictable, in particular with respect to Q4.

## Trade Wars

On Wednesday, October 2<sup>nd</sup>, the WTO ruled in favor of the US in a long-running trade dispute over illegal government support to European aircraft builder Airbus. It allowed the US to impose tariffs on USD 7.5bn worth of EU-28 products. The proposed tariffs target specific product categories of which the EU-28 is an important source of imports for the US (for more information on the impact on food & agri products, please see Rabobank's recently published report [A Hard Landing for Some: US Trade Tariffs on EU Agricultural Products](#)).

Under the new regime, a 25% ad valorem tariff will be imposed on wines from France, Spain, Germany, and the UK. Considering average import prices, if the entire impact of the tariffs were passed on to retail prices, the retail price increase for French imported wines would be, on average, in the region of USD 2.42/liter (or USD 1.80/750ml bottle), while retail prices for Spanish and German wines would increase USD 1.30/liter (or about USD 1/750ml bottle). Given that this is an ad valorem tariff, the actual increase will be higher for higher-priced wines. In most cases, we estimate that this can represent a retail price increase in the region of 10% to 15%, definitely significant enough to encourage some buyers to consider other options, in particular at the lower end of the price range.

Wine imports coming from the UK have a clear focus on super-premium wines and represent a very small amount in volume terms (15,700 cases in 1H 2019, compared to over 8m cases coming from France and 2.2m from Spain for the same period). For these, the price increase could be in the region of USD 15.70/liter.

### New Tariffs Hit Some More Than Others

The US accounts for around 18% of French and 12% of Spanish wine exports in value terms. Under the current terms of the tariffs (which aren't affecting sparkling wine or wines with over 14% alcohol content), around 60% of those wine sales to the US by value will be affected by the tariffs. In addition, we would expect some of the UK premium wine exports to the US to be re-exports, some of which could possibly originate from France or Spain. The US also represents around 10% of total German wine exports by value, and around 90% of these exports will be affected by the tariffs. However, Germany exports a much smaller proportion of its wine production than Spain and France.

### Smaller Producers Are More Vulnerable

Large European wineries exporting to the US may suffer a short-term setback in their profitability. However, these players tend to have sufficient diversification to eventually reshuffle their portfolios and business mix and minimize the impact.

This may not be the case for certain smaller suppliers. Given the highly fragmented structure of the wine industry in Europe and the appeal of the US market as a buyer of higher-priced wines, some wineries are likely to sell a disproportionately high share of their product to the US. If their market position doesn't allow them to transfer the impact of the tariffs and maintain volumes, their viability may come under pressure.

### Potential Beneficiaries

Higher prices may trigger a substitution effect, and other wine suppliers may benefit from transferred demand. Domestic wines, as the broadest category in the market (circa 70% of total volumes), and Italian wines (for those seeking Old World wines) may be the most obvious beneficiaries of this change.

### Limited Impact for the US Consumer

According to our estimates, the affected wines represent around 13% of the total annual wine volumes consumed in the US. Given the abundance of alternatives in the market, the average consumer will have enough choice if unprepared to pay the extra fee.

### Suppliers Need to Take Action

The tariffs will force wineries to make difficult choices between sacrificing margins by absorbing the increase or passing on the costs and losing hard-won market share that can be difficult to regain. Given the size of the tariffs imposed, wine exporters will likely be forced to pass on at least part of the extra tariff to their importers and ultimately to the consumer. As a result of the price increases, some buyers may switch to other alternatives. For suppliers, it means that their volumes and their margins will be affected, though the exact impact will depend on their individual decisions and the price-elasticity of each product. Higher-priced wines are likely to be less sensitive to price increases.

Exporters supplying wines with alcohol content close to 14% may consider changing their product to offer higher-ABV wines. And in certain cases, producers may be able to mitigate the impact by just legally changing their labels. Some wines that are now labeled as 14% in alcohol content may be legally re-labeled as 14.5% to elude the tariffs, but they will have to pay import taxes related to higher alcohol content. Regulation accepts errors of up to 0.5%, though rounding downwards is more common than upwards. This possibility is limited to red wines that were already near 14% alcohol but not yet labeled as over 14% (such as some Rioja, Ribera del Duero, Bordeaux, or Burgundy wines). It is unlikely to be applicable to white wines or rosés, due to their naturally lower alcohol content.

Finally, we believe that the new tariffs could potentially drive a reassessment of business models for some wineries. Shipping in bulk and bottling in market could now potentially become more attractive for some lower-priced, non-appellation wines.

## Export Trends of Major Producers

The benefits of the EU-Japan trade agreement that entered into effect on February 1<sup>st</sup> this year have become visible in export numbers, with sales to Japan from Spain, Italy, and France increasing by double digits.

### France

Exports of French wine in the first eight months of 2019 increased by 5.8% in value terms. The US (+13.7% YOY) accounted for 45% of the growth in the period and the UK (+12.5%) for an additional 25%. Exports to Japan increased by 16%.

On the negative side, exports to China declined by 14%, and sales to Hong Kong were down by 1.1%.

### Spain

In 1H 2019, Spanish wine exports showed a 7.4% increase in volume but an 8.7% decline in value terms. These numbers reflect the sharp reduction that bulk wine prices have experienced (-24.8%), with average export prices for bottled wines down by 3.9%. Bulk volumes were up 12.6%, while bottled wine sales rose only 1.3%. Price-sensitive buyers, such as Africa and Russia, explain the increase in bulk volumes. As with other European wine producers, sales of Spanish wine to Japan had a strong performance during the period.

### Italy

In 1H 2019, Italian wine exports increased by 8.8% YOY in volume and by 3.1% in value, with bottled wine exports (+3.9% in value) outperforming bulk wine exports.

The US (+1.9% in value and -0.3% in volume) and Germany (+3.7% in value and +15.4% in volume) remain the two largest buyers of Italian wines. Exports to the UK and Switzerland, the next two largest buyers, saw a modest decline. It is worth highlighting the strong performance of wine exports to two Asian countries. Exports to Japan increased by 20.8% in volume and 15% in value. Sales to China increased by 11.9% in volume and 4.9% in value.

### US

In the first six months of 2019, total US wine exports declined by 2% in volume and 4% in value. After a strong performance in Q1 (+20% in volume and +9% in value compared to the previous year), bulk wine exports slowed down, closing 1H up by 4% in volume and down by 1% in value. Although exports of bulk wine to the EU remained strong (+38% in volume and +22% in value), bulk sales to Japan (-6% in volume) and Canada (-15%), as well as to other destinations, were sharply down.

On the other hand, bottled wine exports in 1H declined by 10% in volume and 5% in value terms. After declining in Q1, bottled wine exports to the EU increased in Q2, along with exports to Japan and South Korea. However, sales to other relevant markets, such as Canada, Hong Kong, China, and Mexico, remained in negative territory.

**Table 1: Change in wine exports for selected countries**

Country	Volume change (%)	Value change* (%)	Period of measure
France	N/A	5.8	Jan-Aug 2019
Spain	+7.4	-8.7	Jan-Jun 2019
Italy	+8.8	3.1	Jan-Jun 2019
US	-2.0	-4.0	Jan-Jun 2019
Argentina	17.9	-0.2	Jan-Aug 2019
Chile	4.4	-1.3	Jan-Aug 2019
South Africa	-26	-7	Oct 2018-Sep 2019
Australia	-6.0	4.0	Jul 2018-Jun 2019
New Zealand	6.0	6.0	Sep 2018-Aug 2019

\*Value changes in local currencies, Argentina and Chile in USD. Source: Osservatorio Qualivita Wine, OEMV, Iekiosque.finances.gouv.fr, Wine Australia, SAWIS, ODEPA, Stats NZ, Osservatorio Vitivinicola Argentino, the Gomberg Fredrikson Report, Rabobank 2019

## Argentina

Argentine wine exports in the first eight months of 2019 saw a further increase in volumes (+17.9%), with exports in value virtually stagnant. The numbers partially reflect a mix effect, as bulk wine exports increased by 67% YOY and bottled wine exports were up by just 2.6%. At the same time, there was a shift in price categories within the bottled wine segment. Wines sold between USD 15/box and USD 26/box experienced a significant increase, while those sold above USD 26/box declined in volume.

However, the situation is changing. In August alone, exports were down by 15.3% in volume and 6.1% in value, reflecting a comparative base impact (Argentine wine exports started to accelerate in August 2018, when exports were up by 49% in volume and 5% in value compared to the previous year).

## Chile

In the period from January to August, exports of Chilean wine increased by 4.4% YOY in volume terms, reflecting predominantly larger bulk wine exports (+16%). Sparkling wine exports were also up (+15.4%), but their volumes are still marginal. Meanwhile, all bottled wine exports contracted by 2.5% in volume terms. Average export prices declined for all product segments.

Exports to China were up by 7% in volume and 4% in value terms, with bulk wine export growth (+12.3% in volume and +7.9% in value) exceeding growth for bottled wine (+2.1% and +3.3%, respectively).

Other relevant buyers of Chilean wine, like the UK and US, imported more bulk wine at the expense of bottled wine, with the resulting adverse mix impact in value terms.

## South Africa

In the 12 months to the end of September 2019, South African wine exports declined 26% in volume terms and 7% in value, reflecting predominantly the adverse impact of drought on availability. Bulk wine exports were down 34% in volume and 19% in value, with bottled wine sales down 13% in volume and 2% in value. Scarcity and quality supported prices.

Exports to the UK – the largest buyer of South African wine – declined by 23% in volume and 8% in value. By volume, bulk wine sales to the UK were down by 35% and bottled by 17%. Export volumes were down for virtually all destinations. Among the relevant buyers, only Belgium, Tanzania, and Nigeria increased their imports of South African wine during the period.

## Australia

In the 12 months to June 2019, Australian wine exports reduced by around 6% in volume (-50m liters) but rose by 4% in value YOY, in a continuation of recent trends of value growth. Both bulk and bottled exports experienced a decline in volumes, but both recorded value increases per liter in local currency terms. Australia's top five export markets by value remain China, the US, the UK, Canada, and New Zealand, with China now accounting for around 42% of all Australian export values. China continues to be the most significant market for Australian wine exports, importing less Australian wine by volume over the period (-16%), but, importantly, increasing its imports of premium wines from Australia, with total value lifting by 7% to AUD 1.2bn.

## New Zealand

In the 12 months to August 2019, New Zealand wine exports rose by 6% in total volume (+14.3m liters), to 268m liters, with the majority of the growth coming from Sauvignon Blanc exports. The value of exports also lifted by 6% (+NZD 104m), to NZD 1.8bn. Australia was the only one of New Zealand's three key export markets to record a flat-to-slightly-negative change in value and volume (-1% individually). Exports in terms of value to the UK, the largest market by volume, increased by 18% (+NZD 67m), with volumes up by 12%, primarily related to pre-Brexit stockpiling. In the US, New Zealand's number one market by value, exports rose by 5% in volume, with value lifting by 8% (+NZD 40m).

## US Import Trends

In 1H 2019, US wine imports increased by 1% in value and 7% in volume (see Table 2). After a negative start of the year, activity recovered from March onward, and in Q2, imports increased by 7% in volume and 5% in value compared to the same period of the previous year.

Among the largest suppliers, imports from France and New Zealand saw the largest YOY increases in value terms. Imports from Argentina increased significantly in volume terms, reflecting a 334% increase in bulk wine volumes bought at much lower prices than a year earlier (USD 4.89/9-liter case vs. USD 20.34). As a result, imports of Argentine wine in value terms were virtually unchanged compared to 1H 2018.

Imports from Australia (-8% in volume and -1% in value) reflect a gradual improvement in average import prices, a development more relevant for bulk wine than bottled. This trend is consistent with the overall shift in Australian wine exports towards higher price points. In the case of the US, higher import prices go hand in hand with the performance of Australian wine in retail sales, where prices are also edging up as the category repositions after years of negative trends.

Imports of sparkling wines increased by 8% in value and 11% in volume, predominantly from Italy, France, and Spain.

Imports of sangria and coolers increased by 41% in volume and 29% in value. Although almost 60% of the total is supplied by Canada, other exporters, such as Spain, Germany, and Italy, also benefited from the increased demand.

**Table 2: US imports by country of origin, Jan-Jun 2019**

	Value (USD million)	Change (%)	Volume (thousand cases)	Change (%)
Italy	1,015.1	-3	20,490.5	3
France	1,047.4	5	10,542.4	6
Spain	196.4	0	4,949.1	3
Australia	164.7	-1	7,442.8	-8
New Zealand	240.6	5	4512.0	7
Chile	117.8	-9	7,080.3	-2
Argentina	141.3	0	4,566.0	39
Portugal	50.7	0	1,181.7	3
World total	3,246.5	1	75,664.0	7

Source: Gomberg-Fredrikson Report, Rabobank 2019

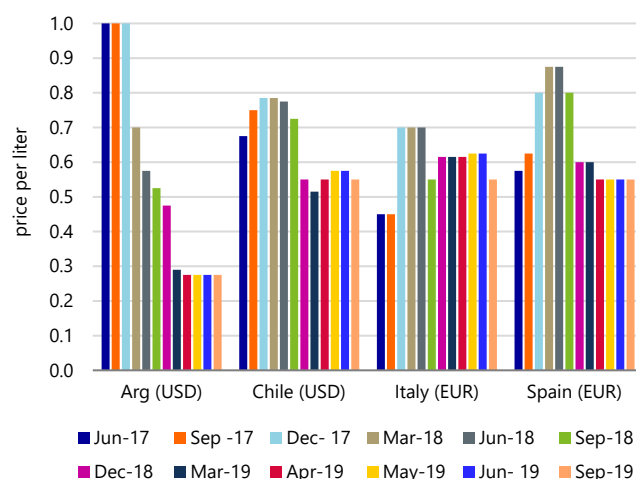
## Bulk Wine Pricing

Although final figures for the 2019 harvest in the northern hemisphere are not yet available, the latest estimates provided by the European Commission point to a 15% contraction in volume for the region, with smaller harvests expected for all major producing countries. Only Portugal is likely to see an increase in production compared to its 2018 weak output. Once again, regional and even local differences within each country can be significant, due to the varying impacts of weather events. In the southern hemisphere, the Australian 2019 vintage came in around the ten-year average, despite drought. Now all eyes are on the potential further downside for the

2020 vintage, as the Australian Bureau of Meteorology forecasted less than a 30% chance of median rainfall for the summer period for a large area of Australia, including key wine-growing regions.

In recent months, bulk wine prices have been broadly stable (see Figures 1 and 2). Considering availability, bulk wine prices for the near future are more likely to move up than to decline, though predictability is lower than ever. In addition to the usual crop size and quality drivers, political issues such as Brexit and US tariffs may impact global trade flows. Furthermore, in the US, the hold-up in the Gallo-Constellation deal is creating a lot of uncertainty in the market, which is weighing on bulk wine pricing.

**Figure 1: Prices for generic red bulk wine by country of origin and currency, Jun 2017-Sep 2019**

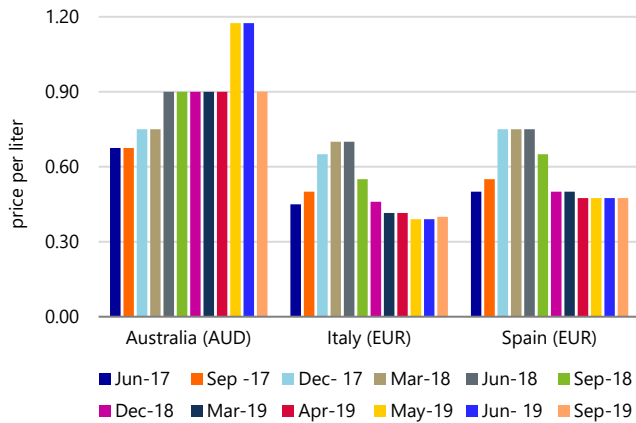


Source: Ciatti Company, Rabobank 2019

Chilean bulk wine prices have been somewhat softer recently, reflecting in part the tougher competition that Chilean wines have suffered this year in China (now their largest buyer), due to the removal of tariffs for Australian wines. Similarly, the EU-Japan trade agreement has increased competition from EU wines in Japan, another major buyer of Chilean wines.

Meanwhile, Argentine bulk wine prices remain low, reflecting the country's ample inventories and sluggish domestic demand (see Figure 2). A weak currency means that export prices in US dollars remain very attractive, a situation that is likely to continue in the near future.

**Figure 2: Prices for generic white bulk wine by country of origin and currency, Jun 2017-Sep 2019**

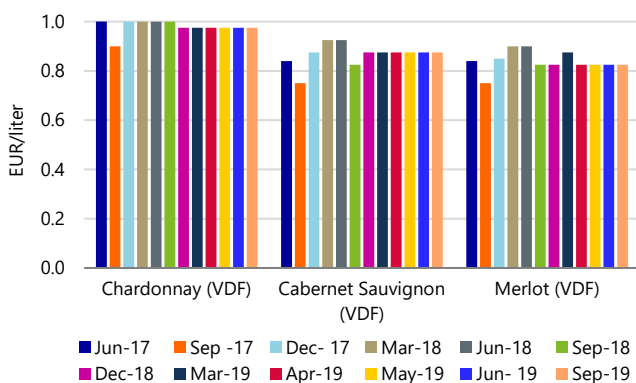


Source: Ciatti Company, Rabobank 2019

According to the latest information provided by the French Ministry of Agriculture on October 3<sup>rd</sup>, 2019, wine production in 2019 is estimated to reach around 4.22bn liters. This is 14% below last year’s output and 7% lower than the five-year average, although still above 2017 levels (3.67bn liters). It also represents a downward revision compared to the previous estimate of 4.34bn liters provided on August 27<sup>th</sup> and reflects the impact of various adverse weather events. Although prices have been stable in recent months (see Figure 3), some price increases may take place given the news.

For other parts of Europe, production estimates vary significantly by region. Among the largest producing areas, Bourgogne and Beaujolais were among the most affected by adverse weather events, with estimated output 32% below 2018 and 19% below the five-year average. Loire and Languedoc-Roussillon are also likely to close with double-digit declines compared to the previous year. Production in Corsica and the southeast is expected to be slightly higher than in 2018 (+6% and +4%, respectively) and broadly in line with their five-year averages (+4% and -1%).

**Figure 3: Prices for French bulk wine by varietal, Jun 2017-Sep 2019**

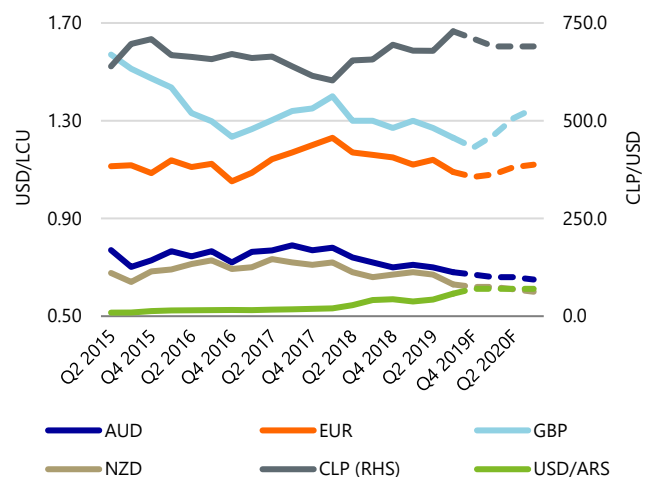


Source: Ciatti Company, Rabobank 2019

## Currency Outlook

The strength of the US dollar was very much in evidence in the third quarter. Against the backdrop of the US-China trade war and a slowdown in global growth, the US economy remains a relatively good performer. The Fed has cut interest rates twice this year, but many other central banks have been both more aggressive and more pre-emptive than US policymakers, which has ensured rate differentials remain generally supportive of the greenback. Additionally, the dominance of the US dollar in the international payments system has meant that demand for dollars has remained firm in spite of the dwindling risk appetite. While the euro was pressured both by a dovish European Central Bank and the fear of a German recession, the Australian dollar was under pressure from a weakening China and from talk that the Reserve Bank of Australia may have to resort to extraordinary monetary policy, such as quantitative easing, in the foreseeable future. The British pound remained hostage to news regarding Brexit, with new prime minister Boris Johnson’s hard line on leaving without a deal spooking investors. The Argentine peso has had a shockingly weak quarter following the August 11<sup>th</sup> primary election, which indicated that President Macri is likely to lose the presidency to Peronist Fernandez. The shift comes after a second consecutive year of recession, rising poverty, and a USD 57bn IMF bailout, but for the markets, it means a fall in hope for coherent reforms (see Figure 4).

**Figure 4: Wine currency movements and forecasts, Q2 2015-Q3 2020f**



Source: Bloomberg, Rabobank 2019

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far.rabobank.com

Stephen Rannekleiv	Global Strategist – Beverages	stephen.rannekleiv@rabobank.com +1 212 808 6823
Maria Castroviejo	Senior Analyst – Beverages	maria.castroviejo@rabobank.com +31 30 712 3811

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