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How much will exchange rates affect wine export prospects?

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WINE ECONOMICS RESEARCH CENTRE

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All industry participants are aware that exchange rate movements affect their bottom line. A high Australian dollar (AUD) makes it more difficult for exporters to compete in overseas markets. It also makes it easier for foreign suppliers to compete in Australia's domestic market .And for those firms that also produce abroad, they get less AUD when they transfer their profits to their Australia base.

No-one knows how exchange rates will move during, say, the next five years. Even if there were good forecasts of the value of the US dollar or UK pound in AUD, they would be insufficient. What matters as well are (a) the bilateral exchange rates relevant to Australia's other key markets (e.g. China) and (b) those relevant to our New World and Old World competitors. Even then, projecting how those different rates affect the world's wine markets is not something that can be done on the back of an envelope.

Projecting market outcomes is thus less prone to avoidable errors if it is done with a formal model of economic behavior in those various markets. To that end we have revised, expanded and updated a global model first developed by Wittwer, Berger and Anderson (2003) to project the wine markets of its 44 countries plus 7 residual country groups. We use the model to analyze the impacts of two alternative sets of changes in real exchange rates (RERs, that is, net of inflation differences) on markets to 2018: no change from the baseline of 2011, and a half-way

return from 2011 to 2009 rates for all but China and India.[1] In both scenarios we also assume there continues to be a gradual trend toward premium wines and away from non-premium wines in traditional markets. The other major development expected to affect the world's wine trade is growth in China's import demand, so we consider two possibilities there as well (high and low import growth). Full details of the model and its various other assumptions are available in Anderson and Wittwer (2013). What follows is a summary of the main findings as they affect Australian producers and exporters.

The projected impacts of those changes on real AUD producer prices in the sector are shown in Table 1. If RERs in 2018 were to be the same as in 2011, Australia's non-premium grape and wine prices would be even lower than in 2011. By contrast, projected super-premium and iconic still wine prices would be more than 40 percent higher.[2]

If, on the other hand, RERs were to return half-way toward what they were in 2009 – which is close to what has happened already since 2011 – and China's imports continued to grow rapidly, real producer prices in Australia would be above 2011 levels for most grape and wine types, especially for super-premium+ wines. The extent of those rises would be somewhat but not substantially less if China's import growth were slower. The lower Chinese import growth scenario assumes the growth in disposable incomes in China is one-quarter less than in the high-growth scenario, its RER ceases to appreciate, and capital investments in domestic grape and wine production grow twice as fast as in the base scenario.

Even if there were no changes in RERs, Australia is projected to expand its output by 2018 for all wine types except non-premium (Table 2). For commercial-premium and super-premium, the increases are 8 percent and 15 percent; but, with a reversal in RER trends, those output increases would be 13 and 18 percent, respectively, unless China's import growth was much slower in which case they would be one percentage point less.

In these scenarios, production grows in both the Northern and Southern hemispheres, thanks to an assumed growth in grape and wine productivity of 1 percent per year in all countries. The income, population and preference changes together mean that global consumption volumes grow over the period to 2018 for all but non-premium wine, but least so for commercial-

[1] The RERs of China and India are assumed to appreciate a further 2 percent per year over the projection period from 2011 to 2018 because of their assumed continuation of strong economic growth.

[2] Commercial-premium still wines are defined to be those between USD2.50 and 7.50 per litre pre-tax at a country's border or wholesale. Non-premium wines are defined as those below USD2.50 per litre and super-premium wines are defined as those greater than 7.50 per litre. The sparkling wine category in the model covers all price points.

premium. The percentage increases in consumption are very similar in the three scenarios for the Old World and Japan, but are somewhat more in the United Kingdom, China and especially the United States in the altered currencies scenarios versus the scenario with no changes in RERs. In all scenarios the consumption growth is concentrated in the US, Brazil and especially China, while there are substantial declines in consumption in the Old World (mostly of non-premium wines).

A picture of what is projected to happen to wine trade emerges when the changes projected in production and consumption are combined. projections for the main wine-trading regions are reported in Table 3. In terms of volumes, world trade would be 6 percent higher in 2018 than in 2011 if RERs were unchanged, and slightly more or less than that in the alternative scenarios. Virtually all of the increase is due to China's import growth. In terms of the real value of global trade, the projected upgrading of qualities demanded in most markets means that China accounts for only about one-third of the growth in the value of global imports. In all three scenarios the value of global wine trade rises by about one-sixth (last row of Table 3).

Australia's export prospects depend very much on the scenario. If RERs did not change from 2011 to 2018, Australia's exports to all destinations other than Asia would decline, and in aggregate volume would be no more than in 2011 (Table 4). By contrast, if exchange rates settled at half-way back to those of 2009, Australian total annual export volumes would increase to become as much as one-eighth more than in 2011 (but somewhat less under slower import growth by China of course). The final rows of Table 4 show, however, that the impact of the scenario on total exports from Australia is much greater in value terms, the increase ranging from 20 percent to 50 percent over 2011 values in USD.

Australian producers of non-premium wines (and thus grapes) cannot be excited by these projections, however, because their exports are projected to fall in all but the most optimistic scenario. This is partly because only a small fraction (between one-quarter and two-fifths) of the increased volume of imports by China from Australia is projected to be non-premium wines – hence they account for even smaller fractions of the value of those sales.

Acknowledgements

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References

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Table 1: Projected real producer price changes in Australia, 2011 to 2018

(percent)

	No RER changes	**RERs return half-way to 2009 rates**	
		High Chinese import growth	Lower Chinese import grow
Non-premium wine	-15	-6	-12
Commercial-premium	3	19	12
Super-premium	50	68	59
Iconic still wine	45	50	50
Sparkling wine	8	19	19
Premium grapes	20	35	30
Non-premium grapes	-6	12	4

Source: Authors' model results

Table 2: Projected changes in volume of production in Australia, 2011 to 2018

(percent)

	No RER changes	**RERs return half-way to 2009 rates**	
		High Chinese import growth	Lower Chinese import grow
Non-premium wine	-8	1	-4
Commercial-premium	8	13	12
Super-premium	15	18	17
Iconic still wine	15	16	16
Sparkling wine	11	15	15
Premium grapes	10	11	11
Non-premium grapes	6	10	8

Source: Authors' model results

Table 3: Projected change in global wine imports and exports, 2011 to 2018

	No RER changes	**RERs return half-way to 2009 rates**	
		High Chinese import growth	Lower Chinese import grow
(a) Exports (ML)			
Australia	0	90	59
Other New World	78	219	75
Old World	538	412	263
(b) **Imports (ML)**			
United Kingdom	-54	-36	-29
North America	-23	11	37
Other Europe	-122	-162	-140
China	627	739	334
Other Asia	20	14	16
Other developing	152	133	141
WORLD TRADE	**600**	**698**	**359**
% rise in volume (ML)	*(6%)*	*(7%)*	*(4%)*
% rise in real value	*(17%)*	*(17%)*	*(15%)*

Source: Authors' model results

Table 4: Projected change in Australian wine exports, 2011 to 2018

	No RER changes	**RERs return half-way to 2009 rates**	
		High Chinese import growth	Lower Chinese import grow
United Kingdom	-40	-25	-11
Other Europe	-20	-13	-5
United States	-36	-14	4
China	108	147	65
Other	-12	0	56
WORLD	**0**	**90**	**59**
% rise in volume (ML)	*(0%)*	*(13%)*	*(8%)*
% rise in real value	*(18%)*	*(49%)*	*(36%)*

Source: Authors' model results