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Trends and Outlook for the International Market

Rabobank International

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- **Sparkling wine demand continues to shift downmarket in downbeat economies in 2012.**
- **Weak euro and emerging economies provide some support for suppliers in markets outside of Europe and the US.**

Sparkling wine—still bubbly for some

The headline story for Europe's sparkling wine producers continues to be the changing face of consumption in the traditional European and United States (US) markets. The prolonged economic downturn in these economies has played havoc with demand for sparkling wines, channelling consumers downmarket and further into the hands of the off-premise retail chains. Europe's three major countries of origin supply roughly 80% of global trade volumes of sparkling wine, and this export trade has become increasingly important as demand and pricing in mainstay domestic markets has steadily deteriorated. Even still, growth in shipment volumes in 2012 has again favoured lower value suppliers (see Figure 1) as many well initiated but price-conscious sparkling wine consumers in traditional markets have sought to explore the value on offer at lower price points.

Figure 1: Changes in sparkling wine exports by major producer

Country	Volume change (percent YOY)	Value change (percent YOY)	Average value (EUR/litre)	Period of measure
Champagne	-3	+5	22.70	Jan-Sep 2012
Italy	+1	+14	3.26	Jan-Sep 2012
Italy (DOP)	+13	+34	3.75	Jan-Sep 2012
Spain	+4	+13	2.68	Jan-Oct 2012

Source: Agreste, AIE, OeMv & Rabobank, 2012

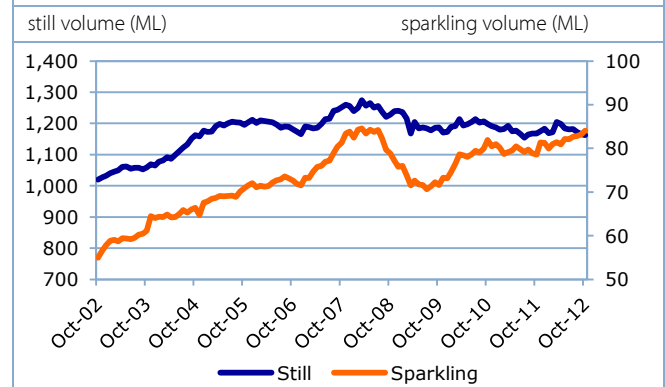
In this economic climate, a range of high quality yet somewhat previously overshadowed products and producers have found new opportunities in the European and US markets. Wines such as prosecco and cava have found new life, and even within the

Champagne region, the relatively low profile cooperatives have availed themselves of opportunities to supply European retailers with private label contracts at price points where the big houses may fear to tread.

An opportunity to grow consumption?

It is unsurprising that consumption is beginning to rebound in some key markets as consumers discover new and more affordable wines. In the UK for example, sparkling wine consumption has resumed its upward trajectory over the past 12 months and is only fractionally short of its historical peak level reached in early 2008. Still wine consumption, on the other hand, continues to slip and remains almost 9% short of its historical peak level (see Figure 2).

Figure 2: Wine cleared for consumption in UK, Oct 2002-Oct 2012



Source: HM Revenue and Customs, Rabobank, 2012

In the US market, despite a recovery in French sparkling wine imports in 2011 to near pre-financial crisis levels, French shipments appear set to slow again in 2012. For some time now, the significant growth in sparkling wine volumes imported into the US has been captured by Italian, and to a lesser extent, Spanish suppliers. What's more, is that shipments by these suppliers tend to be somewhat more evenly distributed throughout the year and are playing a role in encouraging more 'everyday' consumption of sparkling wines.

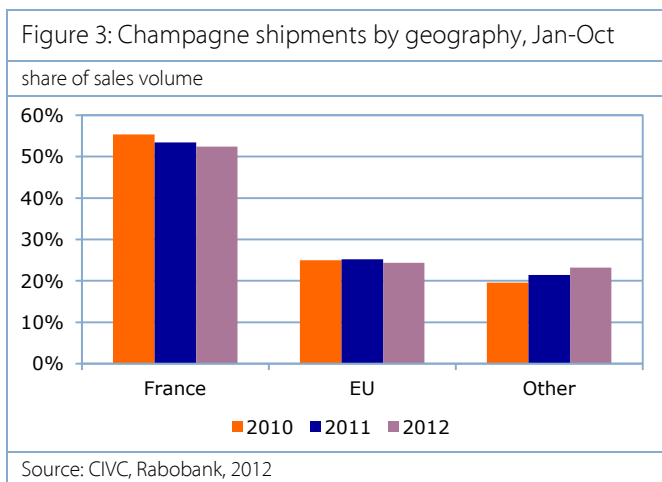
The significant shift in consumption to lower value wines in major import markets, such as the UK and US, has begun to create some welcome pricing tension for suppliers. Average prices for Italian and Spanish sparkling wine exports have risen in 2012, and producers in regulated DOP/IGP regions are soon likely to have to face the

prospect of supply constraints and the temptation to expand their production.

It's not all bad news for champagne's heavyweights

While the big champagne brands may have lost some of their lustre in traditional markets in the present environment, the leading houses that dominate the supply of champagne outside of the EU still have reason for optimism. Budding demand has been uncovered amongst increasingly young and wealthy consumers who are looking to premium brands in the world's emerging wine markets of Russia, Brazil, China, Mexico and Nigeria. In addition, consumption of sparkling wine has displayed strong growth in already established and premium markets like Japan, as well as countries such as Canada and Australia, where champagne consumption is receiving a significant boost from the low value of the euro and a better economic outlook.

As a result, shipments of champagne have declined proportionally in France and the broader EU over the past three years in favour of markets in other parts of the world (see Figure 3).



For champagne's lesser known vigneron and cooperatives, a typical lack of distribution outside of the EU has left many to contend with rising competition and the discounting pressure that comes with retailer power in markets closer to home. What they so dearly desire, and the global economy so desperately needs, is some sign that Europe's economic woes will somehow take a turn for the better in 2013.

International supply

Total global wine production declined in 2012 and inventories are expected to remain tight in 2013 despite the pressure that price rises may place on near-term demand.

Northern Hemisphere update

The 2012 Northern Hemisphere harvest was mixed, with US production increasing by more than 7%, while production in Europe declined by 9%.

US

The 2012 California grape harvest was near ideal, with volumes up nearly 7%, and quality was excellent. The improvement in production helped take pressure off bulk wine prices, but the market remains structurally short. Most bulk wine prices in December were down 30% from their highs over this past summer, but were still 50% higher than two years earlier.

Europe

As noted in the last quarterly report, the hot, dry summer of 2012 had a significant adverse impact on the EU harvest. Overall wine grape production was down 9% by OIV estimates, led by declines in France (-19%), Spain (-6%) and Italy (-3%). These estimates may still be understating the size of the decline as the Italian Wine Union estimates that Italian production may be down by as much as 8%. The major questions this raises looking forward are 1) whether the tight supply across Europe will drive an increase in bulk wine prices in other production regions, and 2) whether the drought stress from 2012 will adversely impact yields for 2013.

Southern Hemisphere update

All eyes are on the weather as the middle of the summer season approaches in the Southern Hemisphere. At this stage, early indications are for higher supply in 2013.

Australia

The extended heat wave that has affected much of the Australian continent from late December into January 2013 has the potential to moderate production from the 2013 harvest. Wine grape markets have been subdued to this point, however are likely to respond should these extreme conditions continue.

New Zealand

The 2012/13 growing season is shaping up to deliver a larger 2013 harvest in New Zealand. Despite the anticipated recovery in production, the low level of ending stocks is likely to support grape pricing in the key Marlborough region.

Chile

Estimations of the size of the coming crop have varied across clients surveyed, but the general sense is that Chile will see a good season. The least optimistic forecasts point to a relatively unchanged crop compared to 2012, whereas the most positive forecast is that last year's bumper crop can be surpassed.

Argentina

Argentina's 2013 crop will likely rebound from last year's light crop. The National Institute of Viticulture (INV) published its first estimates of the grape harvest, predicting 26% growth compared with last year. The output increase is largely explained by the absence of adverse weather events such as those seen in 2012, the recovery of vineyards affected by frost and hail last year, good bud burst and fruit set, and timely rains.

International Trade

Looking back, in Q3 2011, the main story was the success that Old World exporters were enjoying. Spain in particular had registered nearly 30% volume growth in exports, led by strong demand for its bulk wine, supported by the weakness of the euro. In 1H 2012, Spain no longer had large volumes available for sale, and it is the New World suppliers that are once again experiencing strong growth in exports and largely in bulk format (see Figure 4).

Export trends of major producers

Italy

Italian export volumes through September 2012 fell 9.4%, reflecting tighter inventories following the poor harvest in 2011. However, the tighter inventories have allowed improvements in average pricing,

which rose 18.6% and drove a 7.5% increase in export values in spite of the volume decline. One of the brightest spots of Italian exports has been sparkling wines.

France

French wine exports continue to show strong results, with volumes being supported by last year's large harvest. Average prices have also been rising, as value growth (+12%) has outpaced volume growth (+5%). Still wine exports improved across nearly all major production regions, and with the exception of the Loire Valley, value growth outpaced volume growth. The US remains the largest market for French wines by value, but Asia continues to drive the acceleration in demand, with China, Singapore and Japan all registering growth above 20%.

Spain

With Spain's aggressive move over the past year and a half to shift excess supplies of bulk wine, inventories have tightened up and bulk wine exports are now beginning to fall. Monthly bulk exports (non-DOP) were down nearly 40% compared to September 2011, and were down 13.7% for year-to-date 2012. With tighter inventories, producers are now raising prices for bulk wine, up 32.6% over the first nine months of 2011. Although bulk wine volumes are declining, bottled volumes grew 6.3% in 2012. Average pricing for Spanish bottled wine exports has remained fairly steady, but Mexico has now surpassed Ireland, the US, Norway and Switzerland to become the market paying the highest average prices for Spanish wine.

Australia

Export volumes have stabilised following the larger and higher quality 2012 harvest, ending a prolonged decline that extends back to late 2010. Growth in volumes to the US have been bolstered by renewed demand for bulk supplies, similar to the spike experienced back in 2009, but this time with a much higher currency. Growth in bottled shipments to China and Hong Kong has eased in 2012, although average prices have continued to rise.

New Zealand

Total New Zealand export growth has slowed and will soon begin to dip on lower available supply from the 2012 harvest. The impact has not been uniform across markets, with shipments to the UK, Europe and Australia beginning to slip in order to feed more profitable shipments to markets such as the US, Canada and China.

Argentina

Argentine exports continue to shift from bottled to bulk under the pressure of the country's high level of inflation. Total exports grew 27% by volume but only 12.9% by value through the first 10 months of 2012 as bottled exports were down 2%, while bulk exports grew 103%.

Chile

Bulk wine exports (+31.8%) continue to drive total export volume growth, as bottled wine exports remain essentially flat (-0.3%) through November. For bottled wine, increased exports to Japan (+17.8%), Brazil (+4.6%) and China (+29.3%) helped to compensate for declines in Chile's largest export markets, the UK (-8.3%) and the US (-9.5%). The growth in exports to Brazil was achieved in spite of a 10.6% decline in the strength of the Brazilian real in 2012 and the ongoing threat of safeguard measures.

US

Tight supply within the US market led to a 5% decline in bulk wine exports through the first ten months of 2012, with a 12% decline in bulk exports overshadowing the 2% growth in bottled exports. Overall, the tighter global supply situation appears to be benefiting exporters, allowing them to focus on margins rather than volumes. High paying markets such as Canada saw strong growth (+22%), while price increases in low-paying markets such as the UK drove volume declines. In spite of the overall decline in export volumes, revenues increased 4%.

South Africa

South Africa's wine exports increased 11.5% for the 12 months ending in November 2012. Bottled exports declined 10.5%, which was more than compensated by the 35.6% growth in bulk exports. The growth in bulk exports was driven by significant increases in sales to major trading partners such as the UK (+39%), Russia (+520%), the US (+286%) and Canada (+95%). With tighter global inventories, South Africa is becoming an increasingly important supply source, but this does not seem to be benefiting domestic branded players.

Figure 4: Change in exports for key exporters, 2012

Country	Volume change (%)	Value change (%)	Period of measure
France	5	12	Jan-Oct
Spain	-5.4	10.5	Jan-Sep
Italy	-9.4	7.5	Jan-Sep
US	-6	3	Jan-Oct
Australia	1.2	-3.6	Jan-Oct
Argentina	38	23	Jan-Aug
Chile	8.2	5.0	Jan-Oct
New Zealand	2.7	9	Jan-Sep
South Africa	11.5	na	Nov-Oct

Note: Value changes in local currencies

Source: Australian Wine and Brandy Corporation, 'The Gomberg-Fredrikson Report', Instituto Nacional de Vitivinicultura (Arg.), Observatorio Español del Mercado del Vino, South African Wine Industry Information System, Unione Italiana Vini, Federation des Exportateurs de Vins et Spiritueux, Wines of Chile, New Zealand Wine Growers, 2012

US import trends

Imports into the US have recorded 18% growth in the first 10 months of 2012 (see Figure 5), but have been driven by demand for bulk wine, as the supply situation in the US remained tight. The large 2012 harvest in California is helping to ease demand for foreign bulk wine, but bulk imports for the first ten months of 2012 grew 103% over 2011. Most of the growth in bulk imports has come from Chile and Argentina (both up more than 100% over 2011) and to a slightly lesser degree, from Australia (up nearly 95% over 2011).

Bottled wine imports into the US declined 4% over the first ten months of 2012. The biggest declines were registered by the same countries with the biggest increases in bulk exports (Chile, Argentina and Australia).

Italian bottled wine imports into the US were down slightly (-1%), reflecting the tighter supply conditions in Italy following the light 2011 harvest. Both France and Spain registered significant improvements in bottled wine imports (+5% and +8%, respectively), but their growth trends show signs of slowing.

Given the substantial rise in bulk wine imports, imported wines are poised to take significant share from domestic wines in the US market for 2012. When the final figures are available, imported wines will likely account for at least 35% of the US market, up from 31% in 2011.

Figure 5: US imports by country of origin, Jan 2012-Oct 2012

	Value (USD million)	Change (%)	Volume (million cases)	Change (%)
Italy	1,091.9	-1	23.9	1
France	948.2	9	9.2	16
Spain	237.8	9	7.5	19
Australia	394.1	-5	16.3	13
New Zealand	175.7	23	3.2	28
Chile	241.4	21	12.8	62
Argentina	289.6	23	13.7	65
World total	3,693.2	5	97.3	21

Source: The Gomberg-Fredrikson Report, 2012

Bulk wine pricing

The last quarter of 2012 saw continued easing of bulk wine prices in California (due to the large 2012 crop) and rising prices throughout Europe. To date, the other major bulk wine suppliers—Chile and Australia—have not seen much of a lift in bulk wine prices from the tightening of global inventories. Ciatti has reported that Chile is beginning to see an increase in new buyers from countries such as Spain and Italy, which has helped stabilise prices, but the prospect of a large Chilean harvest and declining demand from the US seem to be compensating for this increase in demand from new, non-traditional sources (see Figures 6-8).

Figure 6: Prices for bulk Chardonnay by region, Dec 2010-Dec 2012

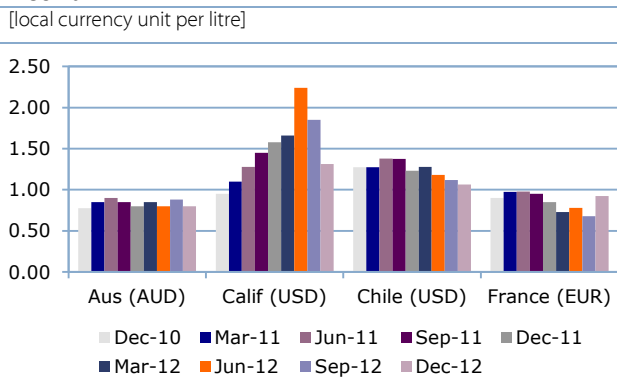


Figure 7: Prices for bulk Cabernet Sauvignon by region, Dec 2010-Dec 2012

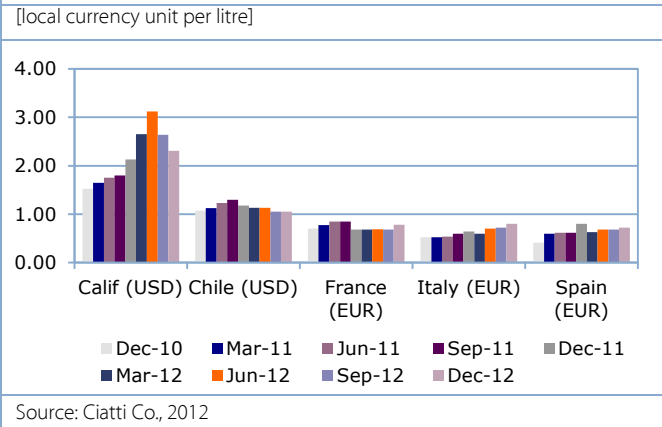
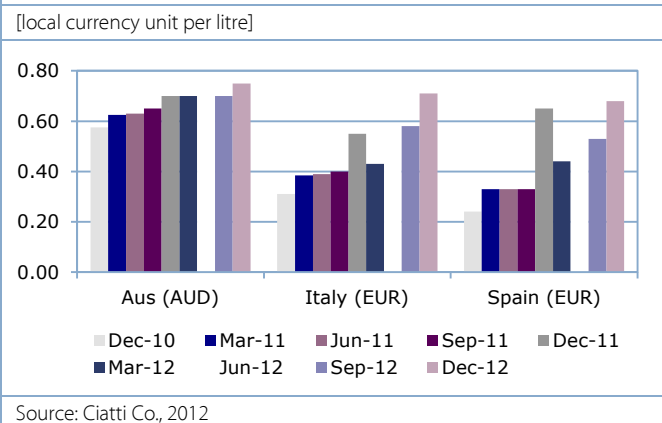


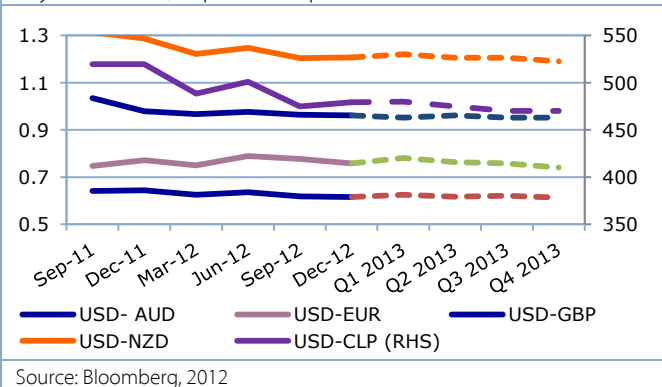
Figure 8: Prices for generic bulk white wine by region, Dec 2010-Dec 2012



Key Currency Forecasts

Extraordinarily loose monetary policy settings in the US, the EU and Japan are expected to be maintained well into 2013, and these and other advanced economies such as the UK continue to contend with flagging growth and burgeoning debt. For high yielding currencies such as the Australian and New Zealand dollars, relief still appears to be some way away (see Figure 9), and is most likely to come only through a sustained global economic recovery that restores confidence in advanced economies and their respective currencies.

Figure 9: Historical and projected exchange rate of USD vs. key currencies, Sep 2011-Sep 2013f



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