

## Commodity Spotlight



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## The U.S. Wine Market Uncorked

**B**ooming demand vying for limited supply has led U.S. wineries to raise prices and search the globe for additional wine. Since late 1996, producer prices for U.S. wine have risen at double-digit rates. Imports are pouring in to fill supply gaps created by several years of limited production of U.S. wine-type grapes. But U.S. grape growers also worry that maturing vineyards in the next several years will turn the current boom into a bust as increased production and imports pull down prices.

Consumers began drinking more wine in the early 1990's, partly because of news about the health benefits of moderate consumption, and partly because a strong U.S. economy supported increased spending on wine at home and in restaurants. In addition, sales to foreign markets jumped in the last 18 months as improvements in quality and marketing have increased the competitiveness of U.S. wine in Northern Europe against traditional producers from France, Italy, and Spain.

The U.S. wine industry is increasingly important to the economic performance of U.S. agriculture. Nearly 55 percent of the

1996 U.S. grape crop was used for wine, and farm value was estimated at \$1.25 billion, compared with \$547 million in 1986. Winemaking and distribution added another \$12 billion in value to 1996 retail sales of food and beverages, according to industry sources.

In California, the largest agricultural state, with crop revenues of \$14 billion in 1996, the value of the total grape harvest reached a record \$2 billion. California typically produces more than 95 percent of the grapes crushed for U.S. wine. New York, Washington, and Oregon provide most of the remainder.

U.S. wine exports will likely reach a record \$400 million in 1997, up 25 percent from 1996. During 1985-95, the value of U.S. wine exports increased 22 percent annually, far outstripping the 6.5-percent trend for the rest of U.S. agriculture.

While wine export growth has been impressive over the last decade, imports have declined until recently. With limited domestic supplies in 1996, U.S. producers and distributors boosted wine imports 25 percent to a record \$1.4 billion, the first sharp increase since 1992. Through May 1997, import growth reached 23 percent above the same period last year.

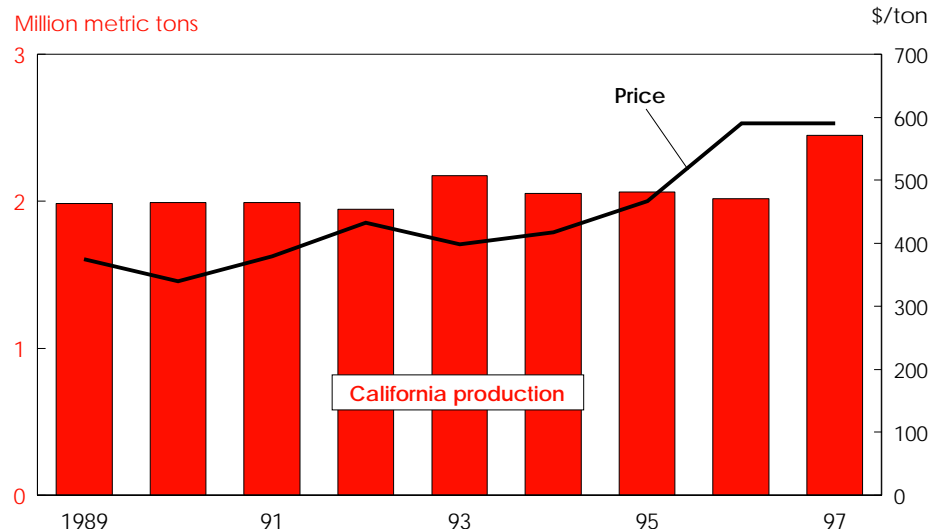
### Supply of Wine Grapes Trails Consumption

The last 10 years have seen a turnaround in the market for wine grapes. During the early 1980's, wine supplies outweighed demand, and grower prices stagnated. Growers responded by reducing vineyard area and replacing vines with quality wine-type varieties, and grower prices paid by wineries increased 8.5 percent annually during 1985 to 1995.

California prices for wine-type grapes averaged \$590 per metric ton in 1996, 26 percent higher than 1995. U.S. wine is produced increasingly from four high-valued international grape varieties: cabernet sauvignon, merlot, pinot noir, and chardonnay. In California, wineries paid growers \$1,260 per metric ton on average for these four varieties in 1996, compared with \$390 for other wine-type varieties.

In 1997, producer prices for U.S. wines will continue well above 1996, as domestic supplies are not sufficient to meet both domestic and export demand. January-June producer prices for domestic wines rose an average 10 percent in 1997, following 6 years of annual increases of 1-2 percent.

### Wine-type Grape Grower Prices to Remain Strong, Despite Record Production in 1997



USDA reports wine-type grape production for California only. Prices are for California grapes. 1997 forecast.

Economic Research Service, USDA

The current strong wine prices are the result of recent limited U.S. crops of wine-type grapes and increased demand for quality wines. A total of 2.45 million metric tons of U.S. grapes was used for wine in 1994, 8 percent less than the previous 5-year average. The impact of reduced wine production has surfaced in 1997, as most wine sales lag behind the vintage year of grape production by several months to several years. Also, California's wine-type grape crush in 1996 was the lowest in 9 years.

While wine-type grape supplies are limited, U.S. consumption of wine increased from 16.3 million hectoliters in 1992 to 21.8 million in 1995. (One hectoliter—100 liters—is slightly more than 11 cases of wine.) Wine consumption dipped 6 percent in 1996, but is likely to increase slightly in 1997. Per capita consumption in the U.S. remains less than 1 case per person annually.

U.S. wine inventories were well below what was needed to keep pace with demand and stabilize prices in 1997. However, higher prices are allowing wineries to rebuild inventories. USDA's Economic Research Service (ERS) forecasts wine inventories at 22 million hectoliters entering 1998, about equal to the 1990-95 average and 15 percent above 1997.

The July 1 forecast of California's 1997 grape crop points to a 16-percent increase in production to a record 5.26 million metric tons. Wine-type grapes are forecast up 21 percent to 2.45 million metric tons, but strong winery demand for grapes is likely to keep grower prices even with last year. U.S. wine production in 1997 is estimated by ERS at near 23 million hectoliters, up 20 percent from 1996 and 1995, and 30 percent more than 1994.

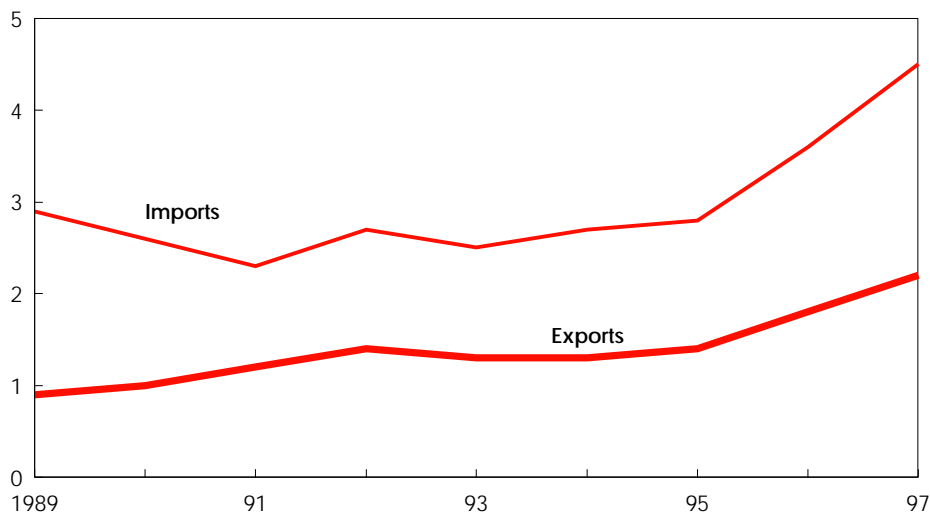
### U.S. Imports & Exports Of Wine Are Up

U.S. wine *imports* are likely to reach 4.5 million hectoliters in 1997, up from 3.6 million in 1996. Imports could account for 21 percent of U.S. net domestic use in 1997, up from about 13 percent in 1990.

Western European wine—mainly from Italy, France, Spain, and Germany—still accounts for most U.S. imports, about a

### U.S. Imports and Exports of Wine Have Accelerated

Million hectoliters



1 hectoliter = 100 liters. 1997 forecast.

Economic Research Service, USDA

70-percent share in 1997. But in the 1990's, U.S. wine imports from South America (mainly Chile, Brazil, and Argentina), Australia, and South Africa have increased substantially. These "new world" producers are expected to capture a 30-percent share of U.S. wine imports in 1997.

In 1985, Western Europe accounted for 96 percent of U.S. imports, declining to 88 percent in 1990. Western Europe's competitive position in the U.S. market weakened during the late 1980's as the U.S. dollar exchange rate declined against Western European currencies. Also, as U.S. consumers turned toward quality wines, demand for low-priced wines—mainly from Italy—decreased. As consumers turned to higher valued wines, Italy's share of U.S. imports decreased from 51 percent in 1985 to 36 percent in 1996.

With escalating land prices in prime U.S. wine-growing areas, U.S. firms are increasingly investing directly in foreign wine production in order to meet U.S. domestic and foreign demand. U.S. foreign direct investment (FDI) activity has concentrated mainly in Chile and southeastern France, but increasing attention is focused on Argentina's large, unused land capacity. Rather than displace export

potential—a common belief about FDI—firms appear to be investing abroad to ship wine back to the U.S. market.

In 1997, 12 percent of U.S. wine production will be *exported*, up from 6 percent in 1990. Despite high rates of U.S. export growth since the mid-1980's, the U.S. share of world wine trade remains only about 3 percent. But foreign markets continue to look attractive to U.S. wine producers, even while prices in the domestic market soar.

In 1996, 50 percent of U.S. wine exports went to Western Europe, mainly to the United Kingdom (U.K.), Germany, Switzerland, and the Netherlands. Canada accounted for 20 percent, Japan 10 percent, and Caribbean countries most of the remainder of 1996 exports.

U.S. wine exporters compete mainly with domestic producers in export markets and with French, Italian, and Spanish exporters. For example, in the U.K. market, with its small domestic industry, the U.S. competes mainly with other European Union (EU) countries. However, non-EU exporters are gaining market shares in the U.K., and U.S. exports have increased 23 percent annually over the last 10 years, reaching 375,500 hectoliters in 1996.

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Switzerland, importing nearly 60 percent of its wine consumption, is another growing market for the U.S. During the last decade, U.S. wine exports to Switzerland increased 36 percent per year on average to reach 85,932 hectoliters in 1996. Switzerland is likely to increase wine imports in 1997 because of changes in Swiss policy which will allow more imports of white wine, a previously heavily protected domestic industry.

Although combined wine production for 1996 in Italy, France, Spain, Germany, Switzerland, the U.S., Argentina, Chile, and South Africa—representing more than 80 percent of the world total—increased over the preceding 2 years, worldwide wine supplies are not sufficient to meet demand. With the usual period of more than a year before significant amounts of the 1996 vintage are released, the current upward pressure on prices is likely to continue.

### Emerging Issues

Imported wines are becoming more competitive in the U.S. market, cutting in on marketing advances already made by U.S. wineries. Until recently, higher prices for French, Italian, and Spanish wines dampened U.S. demand for imports from these traditional sources. But now, U.S. prices are increasing faster than European prices. And based on statistical analysis, each 10-percent increase in the U.S. price raises U.S. demand 15 percent for European wines and even more for Southern Hemisphere wines.

For U.S. growers, the future points to sharply increasing domestic supplies of wine-, raisin-, and table grapes. California's 1996 area in new vineyards—nonbearing, less than 4 years old—is estimated at 18 percent of the state's total, but industry sources place it even higher than the statistics show. How will the markets absorb the burgeoning supply? U.S. demand for raisin- and table grapes in the fresh- and dried markets has been steady or declining in the 1990's. The domestic juice and wine markets are growing, but hopes rest heavily on increasing access and demand in foreign markets.

The U.S. wine industry is concerned about foreign markets continuing to use barriers

### What's in a Label?

Most of the highest quality U.S. wines are marketed as varietals. Cabernet sauvignon, merlot, pinot noir, and zinfandel make up about two-thirds of California's red-wine grapes and produce highly rated wines. Chardonnay, sauvignon blanc, and reisling account for about half of California's white-wine varieties.

To use a variety on a wine label, regulations by the U.S. Department of Treasury's Bureau of Alcohol, Tobacco, and Firearms (BATF) require a minimum content of 75 percent of the indicated grape variety. As a marketing strategy, varietal labeling may be viewed as increasing consumers' confidence in consistency. Breaking into the international market is also easier with varietal labeling, because foreign consumers are more likely to experiment with unfamiliar producers if the varieties are familiar.

European wines, in contrast, have a long tradition of labeling based on *origin*. Geographically based, the appellation of origin controllee (AOC) is the principal designation for quality European wines. Each region's distinct quality is regulated by strict guidelines with respect to variety, yields, irrigation, and other production practices. Even though Burgundy is a well-known region in France producing quality red wines with pinot noir grapes, "pinot noir" seldom appears with "AOC" on Burgundy labels. Similarly, France's Bordeaux wines seldom mention cabernet sauvignon, and Champagnes seldom mention chardonnay, though these are the dominant grapes used in these regions.

Wineries in the U.S. are turning more to geographic designations to distinguish their wines. American viticultural areas, or AVA's, are certified by the BATF at the request of producers in a region. The region must produce grapes with distinctive character, based on terroir, which refers to the combination of climate, soil, elevation, and other factors known to have a significant impact on varietal performance. Examples of California AVA's are Napa Valley, Sonoma, and North Coast. In New York, an example is Finger Lakes. First introduced in 1982, AVA's have increased to well over 100 across the U.S.

against trade. One sticking point in negotiations is the use of semi-generic labels. For example, the EU is actively seeking an end to U.S. wines labeled as Chablis, Burgundy, and Champagne—all names of French producing regions. The Australian wine industry has recently agreed to cease this practice and thus improved their trade relations with the EU.

Tariffs remain an obstacle, albeit declining under progress made in the World Trade Organization (WTO). Technical differences among producing nations present special problems: the EU's regulations put forth specific acceptable winemaking practices, while U.S. guidelines prohibit practices mainly for food safety reasons.

The EU purchases excess production and provides export refunds and aid for acreage reduction, which totaled \$1.2 billion in 1996. Moreover, individual mem-

ber states provide substantial marketing assistance to their wine industries. As part of its WTO commitments over a 6-year period, starting in September 1995, the EU must reduce subsidized wine exports by 21 percent and the value of wine production subsidies by 36 percent. Also, the EU has agreed to decrease its import duties by 20 percent and cease using reference prices and import quotas.

Through greater access to foreign markets and market promotion, the U.S. wine industry has sought to increase exports, while U.S. trade negotiators seek to overcome trade barriers through lowering tariffs, breaking up governmental distribution monopolies, and reducing producer subsidies.

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