



Rabobank

# Wine Quarterly Q3 2019

## Update on the Chinese Wine Market

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## China's Wine Market Undergoing Phase of Adjustment

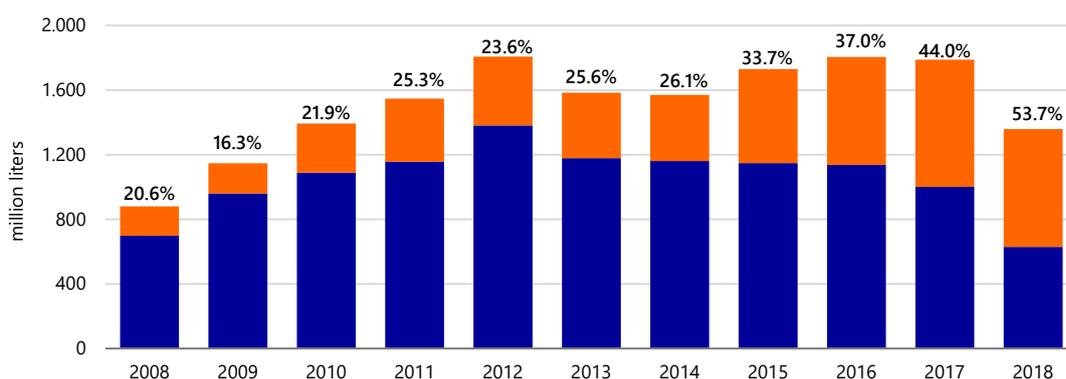
### Current Trends in Chinese Wine Consumption

Over the past decade, the Chinese wine market has been the fastest-growing market in the world, undergoing changes at a breakneck pace. Chinese consumers are becoming more knowledgeable about wine (and changing consumption habits), competitive positioning of imports is changing, domestic players are adjusting their strategies, and the retail environment is evolving faster in China than anywhere else in the world. For wine marketers, China offers an enormous opportunity, but requires a dedicated focus in order to understand the ongoing changes.

### Imports Have Been a Key Growth Driver...

Imported wine has been the biggest winner in the Chinese wine market – surging nearly fourfold in a decade – as it benefits from a high-quality, premium image in the mind of the Chinese consumer (see Figure 1).

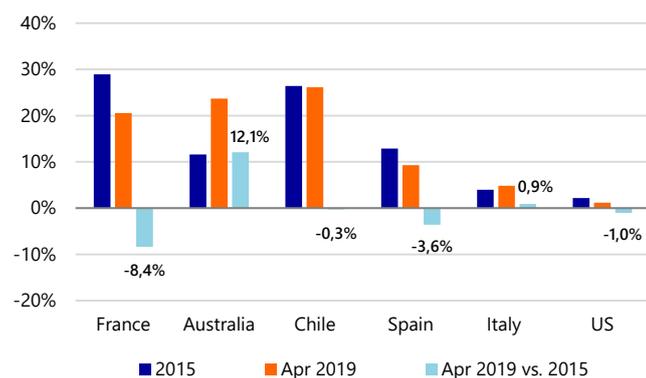
Figure 1: Imported wine is gaining market share from domestic wine, 2008-2018



Source: China Customs, NBS, Rabobank 2019

But even among imported wines, free trade agreements, currency shifts, production variations, and trade wars are driving important changes in market share among imported wines (see Figure 2).

**Figure 2: Key imported countries' volume share comparison, 2015 vs. April 2019**

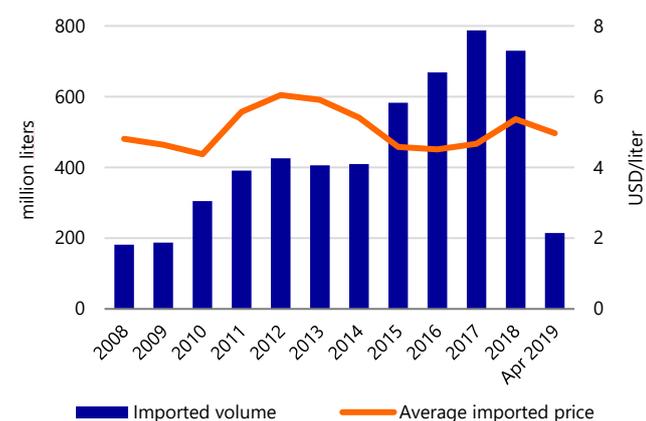


Source: China Customs, Rabobank 2019

### ... but They Are Now Turning Negative

Although imports have been an important driver of growth in the Chinese market, 2018 saw the first decline in imported wine volume since 2014 (see Figure 3). Overly optimistic expectations and aggressive investments in the wine market have resulted in oversupply and overstocked products, and the market is working to draw down existing inventories. This – in addition to several other factors, including a slowdown in economic growth, notable price increases of French wines, fading consumer confidence, the weakening of the renminbi, and uncertainty in US-China trade – have led to an overall decline in imported wine.

**Figure 3: Imported wine in volume – declining for the first time, 2008-2019**



Source: China Customs, Rabobank 2019

### Who Is Losing in Imported Wines?

Although Chinese wine imports have been softening over the past year, not all suppliers have been affected uniformly. For different reasons, France and the US have seen the biggest declines in the Chinese market.

**France.** French wine imports fell by 23% in volume and 4% in value in 2018. French wines saw a significant price increase in 2018, due to the horrendous crop in 2017. Given that the 2018 crop in France was much larger, we believe that pricing should eventually normalize and that exports to China will also eventually begin to normalize to some degree. However, the French will continue to face increased challenges from Chile and Australia, who both enjoy more attractive terms of trade.

**US.** As of the end of 2018, the Chinese wine market has emerged as a key battleground in the ongoing US-China trade war. After China imposed three rounds of increases in import duties – 15%, 10%, and 25%, respectively – US wine is now subject to a total levy of 106%, including tariffs, a value-added tax, and an excise tax. These duties are having a marked impact on the profits of stakeholders along the chain – and this is impacting the competitive positioning of US wines in this market.

Prior to the tariff increase, a bottle of US wine priced CNY 30/bottle CIF would have cost (the importer) CNY 44.5/bottle after tariffs, taxes, and VAT. With the new tariffs, that same bottle now costs CNY 61.8, an increase of 39%. Perhaps more importantly, US wines were already at a competitive disadvantage relative to Australian wines (due to the free trade agreement), and the tariff increase now means that US wines entering the Chinese market now cost 64% more than an Australian wine with the same CIF price (see Table 1). The impact on the shelf price should be even more dramatic, but it has been limited by margin compression along the value chain – the increased costs are hard to completely pass on to consumers given such a highly competitive market and recent weak sentiment.

**Table 1: Cost structure between US wine and Australian wine, before and after recent tariffs**

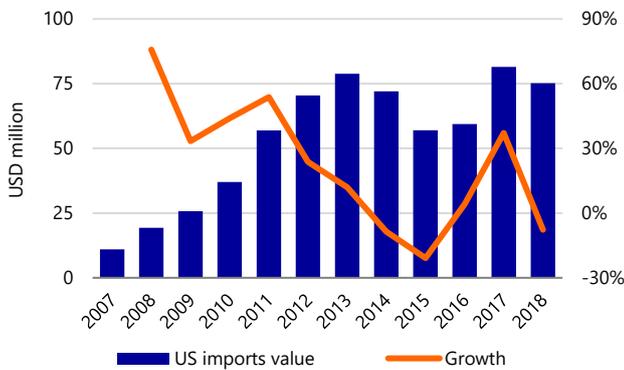
Price structure*	US wine before tariff increases (CNY/bottle)	US wine after tariff increases (CNY/bottle)	Australian wine (CNY/bottle)
CIF price	30.0	30.0	30.0
Import tariff	4.2	19.2	0.0
Consumption tax	3.8	5.5	3.3
VAT	6.5	7.1	4.3
Import cost	44.5	61.8	37.7

\* typical supermarket channel

Source: China Customs, Rabobank 2019

In the context of these tariff increases and after a decade of strong growth, US wine imports to China fell 25% by value in 2018, compared with the same period in 2017 (see Figure 4). Perhaps more concerning, the downward trend accelerated in 2019, with imports of US wines declining by 58.7% in the first four months of the year.

**Figure 4: US wine imports almost tripled in a decade, 2007-2018**



Source: China Customs, Rabobank 2019

Arguably, the loss of share in the Chinese market is only a negligible concern to the US industry (exports to China represent less than 1% of US production), but the long-term concerns should not be underestimated. China is poised to be an increasingly important wine market, with growing demand for premium wines. For forward-thinking wineries that have been trying to build their presence in the Chinese market for some time, the recent trade war creates a substantial setback, and it has undermined years of investments.

### Who Is Winning in Imported Wines?

Australian wine continues to benefit from the free trade agreement with China and has emerged as the clear winner among imports. Australia's share of imported wine value rose from 19.8% in 2018 to 25.7% in the first four months of 2019, with the average price increasing by 14.9%, to AUD 5.4/liter FOB. Among the top 5 wine importers, Australian wine hit the highest average price.

In addition to Australia, other countries that also have bilateral trade deals with China – such as New Zealand, Chile, and Georgia – have also seen tremendous growth in market share and sales volume.

### Response of Domestic Players

Given the ongoing pressure from imported wines in recent years, leading domestic wine players are actively adjusting their strategies by optimizing their product portfolios, cutting down lower-end product lines, and focusing on best-selling labels. Companies are trying to

simplify their wine offerings in order to help consumers feel less overwhelmed. For instance, COFCO's Great Wall Wine has reduced its product lines by 60% in the past two years, and it now mainly promotes product ranges between CNY 50/bottle to CNY 100/bottle. Great Wall is also expanding its presence in the mid- and high-end segments, introducing wines priced at CNY 500/bottle to CNY 2,000/bottle.

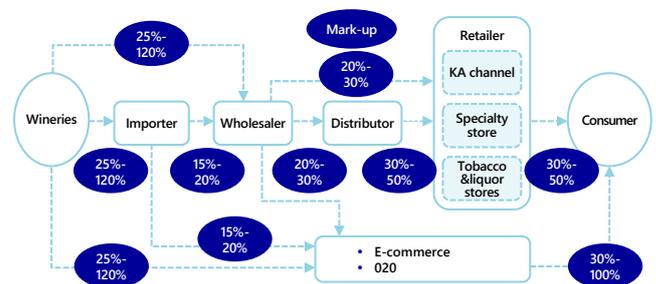
Meanwhile, domestic wine brands are making efforts to rejuvenate excitement in domestic wine by way of wine museums and wine-themed tourism destinations. Local government is also supporting these efforts, as seen with the launch of the Wine Train from Beijing to Ningxia last August. Passengers can taste wine and local cuisine from Ningxia, and participate in wine-themed activities.

Finally, domestic wineries are increasingly looking for ways to capitalize on the growing demand for imported wines. For instance, COFCO W&W International established a strategic cooperation with Grands Chais de France and Jackson Family Wines to import its brands into China.

### New Retail and Implications for Wineries

The shift to e-commerce is affecting the wine industry across nearly all geographies (see the [January 2019 quarterly](#) for an update on e-commerce in Europe), but perhaps no market has been more impacted by the rise of e-commerce than China. The more efficient route-to-market (RTM) has created much greater efficiency and pricing transparency (particularly given the less developed brick-and-mortar retail environment), allowing online sales to grow at a much faster rate (see Figure 5).

**Figure 5: Route-to-market in the Chinese wine market**



Source: industry sources, Rabobank 2019

While the rise of e-commerce is a global phenomenon, it is important to note that the New Retail models in China are much more than 'just another e-commerce platform.' The leading players (Alibaba, JD.com) have e-commerce platforms as part of what they do, but these are integrated into broader systems that also include brick-and-mortar platforms, payment systems, market insights, logistics

services, and more. These integrated models offer their operators incredible insights into consumer preferences, shopping behavior, and marketing opportunities.

Given their high level of sophistication, New Retail leaders are quickly gaining share of retail sales in China. Alibaba and JD.com saw their combined share of total retail sales rise from 3.8% in 2013 to 16.9% in 2018. Thanks to their growing presence, they can be important partners for suppliers, but they are also crowded with brands, making it hard to stand out. There are, of course, ways of working with these platforms that can help attain preferential positioning on their sites, but this often requires giving them preferential pricing in the market, which can sour the relationship with distributors and wholesalers who provide access to the rest of the market. This creates a dilemma. While New Retailers can offer direct access to an increasingly large percentage of Chinese consumers, they are unlikely to be an effective 'one-stop solution' for penetrating the Chinese market. They are better viewed as an important part of a broader RTM strategy that also includes other channels. Collaborating with New Retailers without alienating other channels is critical, but often requires creativity.

Treasury Wine Estates (TWE) has managed this process extremely well, leveraging the reputation of Penfolds to build a presence across various channels. TWE has teamed up with powerful partners and conferred exclusive agents of different series of Penfolds in order to avoid concentration risk with any single retail partner or channel (see Table 2).

**Table 2: Penfolds' major agents in China**

Series of Penfolds	Channel partnership	Types of RTM partnership	Channels	Coverage
Penfolds series	Tmall	Integrated e-commerce	Internet retailing, KA, convenience stores	Nationwide
Selected Penfolds Series labels	Vats Liquor	Integrated retailer (O2O)	Liquor specialist stores, mobile internet retailing	East China
Penfolds Rawson's Retreat	C&D Wine	Importer and retailer	Internet retailing and liquor specialist stores	Southeast China
Penfold BIN, Koonuga Hill, MAX	COFCO Wine&Wine	Importer and retailer	Internet retailing, liquor specialist stores, KA	North China
Penfolds Koonunga Hill, BIN	Hua Luxe Wine	Importer and wholesaler	Internet retailing, liquor specialist stores, KA	South China
Selected Penfolds Series labels	Greenland Group	Importer	Hotels, foodservice, import direct-selling stores	East China
Penfolds BIN 138	Luzhou Laojiao	Liquor producer	KA, Internet retailing, liquor specialist stores	Nationwide

Source: Rabobank 2019

## Focus on Creating Consumer Pull

Whether brand owners are focusing on New Retail or traditional brick-and-mortar stores, the challenge is to find creative ways for their brands to connect with consumers on a deeper level. Without this, brands will struggle to gain traction, regardless of channel.

There are no magic bullets to help brands connect with consumers, but wine companies are using a variety of strategies to achieve this end in the Chinese market. Some are partnering with influencers and key opinion leaders who advocate for their brands on popular social media sites such as Little Red and Weibo. Others are collaborating with popular online wine community websites/apps like Vinehoo to hold tasting events and interact with consumers to help them find the wines most suited to their palates. Still others are trying to help create new consumption occasions: iBarrel is a wine dispenser vending machine that allows wine brands to place mobile payment-enabled dispensers in different channels, including hotels, foodservice, and office.

## Conclusion

The Chinese wine market appears to be showing a slowdown thanks to a variety of factors, but we believe this to be a temporary phenomenon. China is expected to remain an attractive export market moving forward, though the competitive landscape for both foreign and domestic wine companies continues to evolve quickly.

The rising influence of New Retailers will make them important partners in the market, but may be better viewed as just one channel in the broader route-to-market, rather than a solution for accessing the market. Regardless of channels, the underlying challenge for brand owners is to develop effective strategies to connect with consumers.

## Winery M&A

Many recent M&A deals are being prompted by traditional drivers – expanding portfolios, consolidation in distribution, and financial sponsors entering the space. However, two recent deals stand out and are worth highlighting, as they provide some interesting insights into how the industry is evolving:

## AB InBev buys Swish Beverages (Babe Wine)

On June 28, AB InBev announced that it was acquiring the remaining shares of Swish Beverages, the beverage company co-founded by Instagram celebrity Josh Ostrovsky, known for its brands 'White Girl Rosé' and 'Babe Rosé' (sparkling canned wine). While the brand is still relatively small, it is the brewer's largest foray into the wine category to date, and we view this as an important development for the US wine industry from a wide range of perspectives. Consider the following:

- The beer industry was the first among alcoholic beverages to be affected by changing consumer preferences, as flagship beer brands lost share to craft beer. Brewers have been investing heavily to learn how to tap into emerging consumer trends more effectively (well ahead of most wineries), and they are positioning themselves to return to growth. Some of this growth may come at the expense of more traditional wine companies.
- We often talk about 'category blurring,' the trend of beverage companies expanding beyond their traditional categories (think Coca-Cola buying Costa Coffee, E&J Gallo launching New Amsterdam vodka, or Constellation Brands moving into cannabis (see the RaboResearch report ['Blurring Category Lines'](#)). However, until now, there have been very few moves by companies in other segments into the wine industry; mostly we have seen spirits companies exiting the wine category. Babe Rosé is clearly a different kind of wine brand.
- A key concern for the wine industry has been the slowdown in growth of wine consumption. Discussions at the Unified Wine & Grape Symposium earlier this year suggest that the wine industry recognizes that this slowdown is largely due to the fact that wine is struggling to connect effectively with younger consumers, even as wine's core demographic base (baby boomers) is in structural decline. Brands like Babe Rosé may help to draw younger consumers to wine consumption, but they may also change how consumers engage with wine moving forward.
- While many wineries will not want to emulate the particular brand positioning of Babe Rosé ('The Bud Light of wine'), the brand is breaking the mold of traditional wine marketing. The wine industry could learn quite a few lessons from the strategies that the founders used to build the brand:

- Effective use of social media: Ostrovsky (commonly known as 'The Fat Jew') has built an incredible following on Instagram by having a well-defined personality, and by communicating constantly and consistently.
- They target new channels and occasions: Consumer lifestyles are changing, which opens up opportunities to engage in a different context. Babe Rosé is bringing wine to gas stations and convenience stores, and it targets occasions that have traditionally been dominated by the beer space in the past.

## Majestic Wine to Sell Its stores and Invest Proceeds in Naked Wines

According to recent news, Majestic Wine is seeking to release capital from its retail and commercial business, which includes its 200 stores in the UK, in order to invest in its online business, Naked Wines. A deal may be closed as early as this summer.

At first glance, it may be easy to overlook the implications of this deal. Although online wine sales are growing and likely to gain further share, many businesses focusing exclusively on online sales are struggling to be profitable. By taking such steps, Majestic is demonstrating confidence in its ability to profitably grow Naked in the medium term, despite the high new client acquisition costs... and that it is prepared to make these investments. Success in the US, where Majestic lacks a physical retail presence, is clearly a supportive factor.

Naked has a first-mover advantage and, compared to many other pure players, also a scale advantage. The market can definitely support more players, but their financial viability depends on their execution and scalability at an adequate cost and speed. A race for scale to secure a long-term position may begin.

## Global Trade

### Export Trends of Major Producers

Each market has its own circumstances and price drivers, but in general terms, export prices seem to have bottomed out and stabilized at the levels reached in March.

## France

In the first four months of 2019, exports of French wine increased by 3.1% in volume and 8.9% in value terms. By destination, sales to the US – the biggest buyer of French wine, accounting for around 20% of the country's total exports – increased by 12% in value and 4% in volume. Sales to the UK increased by 27% in value and 14% in volume, with average prices increasing in both countries. Exports to Germany also increased, but in this case, there was a contraction in the average price paid per liter. Exports to China contracted by 19% in value and 14% in volume, affecting Bordeaux in particular, but also other wines.

## Spain

Spanish wine exports for the first four months of 2019 show a 7% increase in volume, but a 7.7% decline in value terms. The aggregated number reflects a sharp contraction in prices for bulk wine exports (+10% in volume, but with a 32% decline in average price). The current prices for bulk white and red are now back at the level of spring 2017. For bottled wines, the price contraction was just 5%, with volumes up by 3%. The low bulk wine prices have attracted demand from price-sensitive markets such as Russia and Africa, which more than offset lower volumes from other regions.

## Italy

In Q1, Italian wine exports increased by 7.7% YOY in volume and by 3.8% in value. Bulk wine prices suffered the sharpest decline, while prices for bottled wines and prosecco contracted only marginally. In volume terms, sparkling wines other than prosecco suffered a double-digit contraction that was more than offset by the positive trend of all other categories.

Exports to the UK increased by 16% in value terms, with sales of prosecco up by 5% and sales of other bottled wines up by 31%. Sales to other relevant markets, such as the US and Germany, also increased for the quarter, despite a contraction in March. Although exports increased in volume terms, the value of sales to Canada, France, and Sweden contracted due to double-digit price reductions.

## US

In the first quarter of 2019, US wine exports increased by 4% in volume, but declined by 7% in value. The volume increase was driven by a 20% increase in bulk wine exports, partially offset by a 12% reduction in bottled wine exports, as some exports to Europe are now being bottled in-market, rather than shipped in bottles.

In value terms, total exports declined by 7%, reflecting not only a mix effect, but also lower average price per liter for bulk wines, with average prices for bottled slightly up.

**Table 3: Change in wine exports for selected countries**

Country	Volume change (%)	Value change* (%)	Period of measure
France	3.1	8.9	Jan-Apr 2019
Spain	+7.0	-7.7	Jan-Apr 2019
Italy	+7.7	3.8	Jan-Mar 2019
US	4.0	-7.0	Jan-Mar 2019
Argentina	36,9	4,3	Jan-Apr 2019
Chile	7.4	1.7	Jan-May 2019
South Africa	-25	N/A	Jan-May 2019
Australia	-3.0	5.0	Apr 2018-Mar 2019
New Zealand	11.0	10.5	Jan-Apr 2019

\* value changes in local currencies, Argentina and Chile in USD  
Source: I numeri del vino, OEMV, [lekiosque.finances.gouv.fr](http://lekiosque.finances.gouv.fr), Wine Australia, SAWIS, ODEPA, Statistics NZ, Observatorio Vitivinicola Argentino, The Gomberg-Fredrikson Report, Rabobank 2019

## Argentina

Argentine wine exports in the first four months of 2019 saw a continuation of the 2018 trend: Volumes were up strongly, driven by a substantial increase in bulk wine exports (+180% YOY), with bottled wine sales also increasing, but at a more moderate 7%. In value terms, sales of bulk wine increased by 30.5%, and bottled wine was up by 2.4% – the numbers pointing to a significant contraction on average prices per liter (see *Bulk Wine Prices* section for more information). Average bulk wine FOB prices in USD more than halved when compared to a year earlier.

Exports to the US, UK, and Canada – the three largest markets for Argentine wine – saw double-digit increases in volume terms, with the American countries benefiting most from a reduction in average prices.

## Chile

For the first five months of 2019, exports of Chilean wine increased by 7.4% in volume and 1.7% in value terms, pointing to a 5.3% decline in average price per liter. Bulk wine prices were stable; DOP bottled wines saw a 3% price contraction; and prices for sparkling and 2-10-liter packages contracted by 10.7% and 7.5%, respectively. Large packages suffered greater price pressure.

Demand from China remains solid, with volumes up by 34.6% for bulk wine and 6.6% for DOP wines. China is the largest buyer in both categories. Worth highlighting are the sales of DOP wines to Brazil (up by 12% in volume and 4.7% in value terms) and exports of bulk wine to the UK (up by 42.7% in volume and 44.4% in value). In the case of the UK, sales of bottled wines were stable – meaning that this is not due to a switch from bottled to bulk, but the continuation of sustained demand for Chilean wines from the country.

## South Africa

In the first five months of 2019, South African wine exports declined 24.7% in volume terms, reflecting the scarcity of product. Bulk wine exports were down 34%, with bottled wine sales down 11%. Prices on a 12-month accumulated trend remained strongly positive (accumulated exports -14% in volume, +2% in value) due to the outperformance of bottled vs. bulk exports, as well as higher prices per liter in all categories as a result of scarcity and good quality. The vineyards are feeling the impact of three consecutive years of drought, which is also hampering replanting. Production from South Africa is therefore expected to remain below its historic average for some time.

## Australia

In the 12 months to the end of March 2019, Australian wine exports increased 5% in value and 3% in volume. Bottled wine sales increased by 3% in value and decreased by 5% in volume, while exports of bulk wine increased by 11% in value, with a 2% decline in volume terms

The volume contracted reflects a reduction in the lower end of the price range not entirely compensated by growing sales at higher price points. Higher prices reflect current tight availability – a trend not expected to reverse in the near future. By countries, volumes sold to the UK remained stable, while those shipped to China and the US declined (-14% and -7%, respectively), although sales to China did increase in value terms (+7%).

## US Import Trends

In Q1 2019, US wine imports declined by 2% in value, but increased by 3% in volume (see Table 4). All of the volume increase took place in March, compensating lower volumes in the first two months of the year. For the quarter, imports of still wine were unchanged, with volumes for sparkling wine (+16%), vermouth (+11%), and coolers (incl. sangria, +56%) accounting for all of the growth. Average import prices in USD were lower for all categories. However, it is worth noting that, in the case of

bulk wine, lower prices were due to sharp reductions in wines imported from Canada (going predominantly to the spirits industry), Argentina, and, to a lesser extent, New Zealand. Prices for bulk wine coming from the two largest suppliers by volume – Chile and Australia – increased.

From a geographic perspective, volumes imported from Italy, France, Spain, Portugal, and Argentina were larger than a year earlier. In the case of Italy, France, and Spain, to a large extent, the growth was related to sparkling wines.

For the same period, total US imports of wines from Australia, Chile, New Zealand, Germany, and South Africa declined (though imports of bottled New Zealand wines increased).

**Table 4: US imports by country of origin, Jan-Mar 2019**

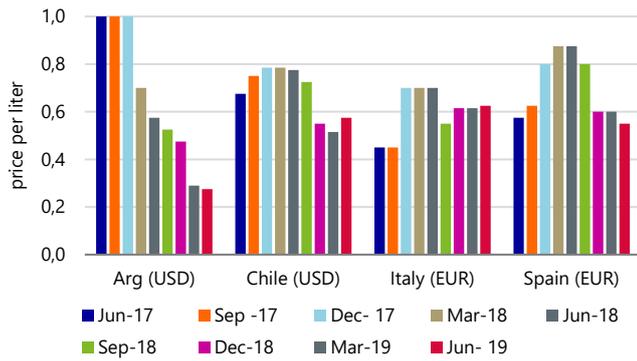
	Value (USD million)	Change (%)	Volume (thousand cases)	Change (%)
Italy	486.4	-1	10,048.4	8
France	439.0	0	4,588.3	2
Spain	96.8	6	2,327.5	9
Australia	84.7	-12	4,118.6	-21
New Zealand	118.6	-10	2,317.4	-11
Chile	60.44	-19	3,753.5	-17
Argentina	67.5	-4	2,474.4	45
Portugal	24.0	7	515.0	10
World total	1,501.8	-2	37,239.5	3

Source: Gomberg-Fredrikson Report, Rabobank 2019

## Bulk Wine Pricing

In the second quarter of 2019, bulk wine prices have generally stabilized well below last year's levels, though with a few outliers. The large 2018 crop seems to be fully priced in by now, and the forthcoming 2019 crop is unlikely to be as large as the previous year's – at least in the northern hemisphere, where most of the world's wine grapes are grown.

**Figure 6: Prices for generic red bulk wine by country of origin and currency, Jun 2017-Jun 2019**

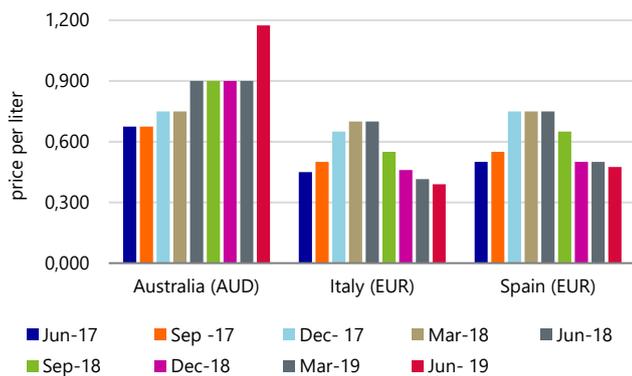


Source: Ciatti Company, Rabobank 2019

Low prices in Argentina reflect ample inventory, following two consecutive large crops and subdued domestic consumption. Good quality and attractive prices are triggering international interest in Argentine wine, while tax incentives to export provide additional incentives for producers to sell at affordable prices. Chilean wine prices have ticked upwards from their lowest point, reflecting an attractive price/quality ratio and the advantage of free trade agreements (see Figure 6).

Meanwhile, prices have edged up in South Africa and Australia (see Figure 7). In the case of South Africa, the price increases reflect tighter supply conditions, after two consecutive short crops and limited perspectives of a sharp increase in output in the near future. In the case of Australia, the rise was the result of a combination of drought-induced scarcity and ample demand induced by the free trade agreement with China.

**Figure 7: Prices for generic white bulk wine by country of origin and currency, Jun 2017-Jun 2019**

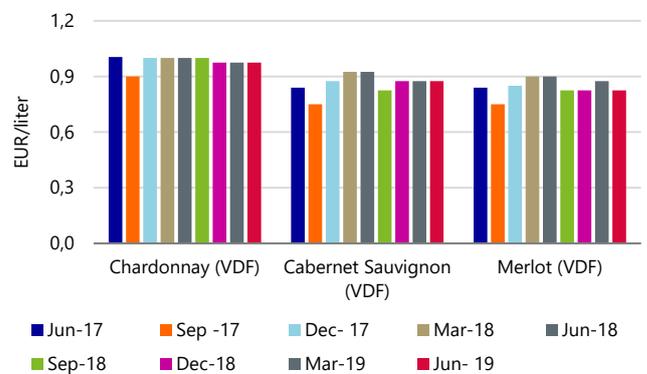


Source: Ciatti Company, Rabobank 2019

In Europe, prices for Spanish bulk wine remain stable, at a relatively low price, due to the abundant availability of generic wine and so far benign weather conditions ahead of the 2019 harvest. In Italy, unseasonable cold and wet weather this spring points to a smaller harvest than in 2018, and as a result, prices have bottomed out.

In France, the situation varies per product and region (see Figure 8). Generic wine remains abundant, and prices show it. However, availability for specific products and regions is random. In addition, frost and hail have recently affected selected areas, pointing to a tighter 2019 harvest. In the Loire region, supply was already tight, and the current circumstances support sustained prices.

**Figure 8: Prices for French bulk wine by varietal, Jun 2017-Jun 2019**

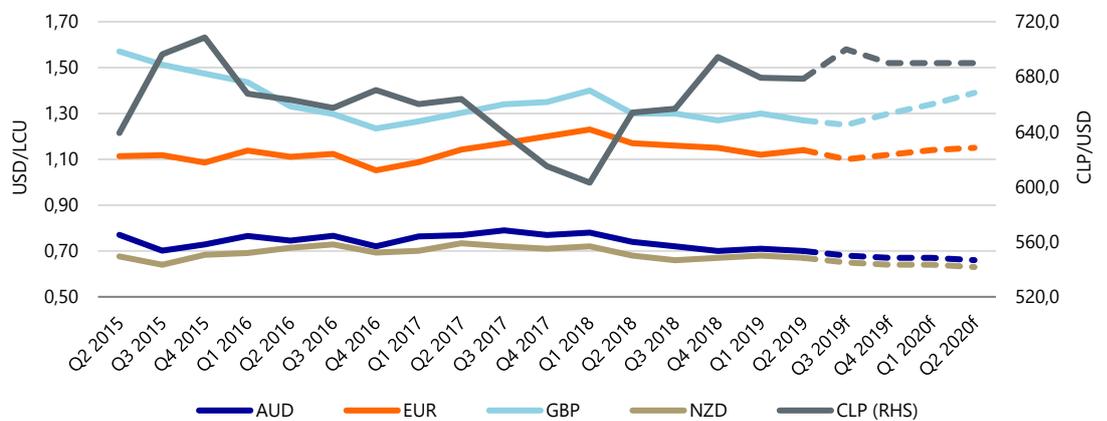


Source: Ciatti Company, Rabobank 2019

## Currency Outlook

The past quarter has brought further evidence of slowing world growth and more dovish signals from the majority of major central banks. Rate cuts have already been announced in Australia and New Zealand, and the Federal Reserve is widely expected to follow suit in July. The ECB could cut its discount rate further into negative territory in September. The AUD and NZD were among the worst-performing G10 currencies in Q2, on the back of central bank activity. Both countries have strong trade links with China and are sensitive to signs of slowing demand in the world's second-largest economy. Germany's external sector has also been hit by slowing growth in China – and with signs of this beginning to transfer into the country's labor market and consumer sector, there is good reason for the ECB to remain cautious. This could prevent the euro from gaining much ground vs. the US dollar in the coming year, despite expectations of a potentially aggressive pace of Fed rate cuts. The Chilean central bank has also turned dovish, on the back of a wave of immigrants, which should put downward pressure on wages. The outlook for the British pound remains hostage to the Brexit outcome, while that of the Argentine peso is heavily influenced by ongoing economic pressures (see Figure 9).

Figure 9: Wine currency movements and forecasts, Q2 2015-Q2 2020f



Source: Bloomberg, Rabobank 2019

# Imprint

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