Research Department
Federal Reserve
Bank of
San Francisco

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FRBSF Weekly Letter

# '83: Less Than Vintage Year

The California wine industry, after many years of rapidly growing sales, experienced a disappointing year in 1982. California wine shipments turned flat in the midst of a bountiful grape harvest. The resulting excess winery inventories, weak prices and stale overall sales figures hurt the industry at all stages of production, from the grape growers to the winemakers. For 1983, wine shipments will likely show some modest improvement, perhaps rising by two or three percent, but the tonnage of grapes demanded probably will decrease again as wineries cut production in an effort to reduce excess inventories. Because of reduced demand, grape prices should fall even further this year, while prices for wine will suffer from intense competitive pressures.

**Industry structure**

The California wine grape growing and producing industry is a significant part of the State's economy and contributes 90 percent of the wine produced in the United States, although California farmers also grow table and raisin grapes. But in 1982, despite a drop in prices, wine grapes still were the second largest grape crop, after raisins, bringing in $468 million in revenue. Gross revenues to vintners amounted to around $1.9 billion.

Wine grapes are grown primarily in the Mendocino-Sonoma-Napa Valley area of northern California and in the San Joaquin Valley in the southern part of the State. Independent farmers, who sell their output to wineries, account for over four-fifths of the State's total wine grape production, while winemakers grow the remaining 17 percent.

Wine-making companies now number over 500 throughout the State. Nevertheless, a few large firms account for the bulk of the State's total wine shipments. In 1981, the top five companies accounted for 72 percent of California's total shipments. The State's two largest producers—E. and J. Gallo Winery and United Vintners—accounted for the bulk of that total. The next five largest wineries accounted for another 11 percent of the State's total shipments. The market structure, therefore, consists of a few major wineries that buy a predominant share of the crushing grape supply and which, as a result, play an important role in determining the level of grape and wine prices.

The larger wineries produce most of the lower-priced, generic (blended) wines, such as chablis and burgundy, for which the bulk of the wine grapes in this state are grown. Varietal wines—the higher-priced wines, whose content originates from at least 51 percent of one grape variety specified on the label—account for less than 4 percent of total shipments. This segment of the industry, made up of so-called "boutique" wineries, is highly fragmented; it is composed of numerous small wineries, some with an annual output of less than 50,000 cases.

**Industry growth**

The industry's recent problems can be traced to the increased acreage and manufacturing capacity that it put into place during the late 1970s and early 1980s when it expected continued heady growth in the demand for California wine. Between 1972 and 1981, California wine shipments grew at an average annual rate of nearly 6 percent (Chart 1). In the United States, adult per capita consumption of wines increased by nearly 30 percent over that period, rising from 2.6 to 3.3 gallons per year. The robust growth in wine demand exceeded that of all other groups of beverages except soft drinks, for which demand grew at approximately the same rate.

Among the different wines, table wines showed by far the most rapid growth in

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demand between 1972 and 1981. As these wines became more popular, they came to dominate the overall wine market; their share of total shipments rose from 51 to 78 percent. The remaining shares consist of sales of dessert wines, sparkling wines and special fruit blends.

Lured by the bubbly prospects for the industry, numerous new growers and producers entered the business between 1972 and 1981. As a result, the number of bonded winery manufacturing establishments more than doubled, while total acreage planted with wine grapes increased from nearly 233,000 acres to 343,000 acres. Most of this 47 percent increase in acreage occurred between 1978 and 1981.

Among the new competitors were several large non-wine beverage firms that acquired older establishments and injected huge amounts of new capital into the development of new wineries and vineyards. For example, in 1977, the Coca-Cola Company purchased several wineries, including Monterey Vintners, Sterling, Taylor and Great Western Wineries, and consolidated them into its Wine Spectrum operations (recently sold to Joseph E. Seagram & Sons Inc.).

The period also witnessed the proliferation of boutique wineries as many small entrepreneurs were lured to the famed Napa Valley in search of profits and a new life-style. An acre of good bottom land, available in the early 1960s for $2,000, approached $30,000 by the early 1980s.

**Excess production**

The huge acreage of new vineyards planted during the late 1970s culminated in a record harvest in 1982 (Chart 2). Grape production increased 33 percent during that one year, after rising at an average annual rate of nearly 11 percent over the 1975–80 period, and more than offset a 10 percent reduction caused by weak markets in 1981. This record harvest—surpassing all expectations—occurred despite the loss of an estimated 15 percent of the crop from frost, hail and rainstorms during the growing season.

While grape production rose, the demand for California wines stabilized under the impact of the U.S. recession and the increased penetration of foreign imports. In 1982, California wine shipments increased by less than one percent over the 1981 level. Imported wine, which had risen from 13 to 23 percent of the total market between 1975 and 1981, captured 24 percent of the market in 1982. Import sales were boosted by sharply declining prices caused by the rising exchange value of the dollar. In addition, foreign winemakers, especially those from France and Italy, launched heavy advertising campaigns to increase their inroads into the U.S. market because European consumption was faltering.

Faced with a stable demand for wine and a bountiful wine grape harvest, growers who had not managed to contract for the sale of all or any of their harvests were forced to leave some 280,000 tons on the vines. Another 50,000 tons of harvested grapes went unsold. The effect of this excess production was to depress the average price per short ton from $266 in 1981 to $218 in 1982—a decline of 18 percent. The total value of production used fell from $478 million to about $468 million.

The decline in wine grape prices undoubtedly would have been even greater had not the manufacturers produced far more wine than they could market. Inventories at California wineries rose 16 percent over the course of the year. Price competition for wine at wholesale was intense. Profits plunged and some wineries, particularly more recent newcomers into the industry who had entered when capital costs were especially high, were unable to survive.

**Outlook for 1983**

Americans should consume moderately more wine this year as the U.S. economy

Chart 1
CALIFORNIA WINE MANUFACTURING SECTOR

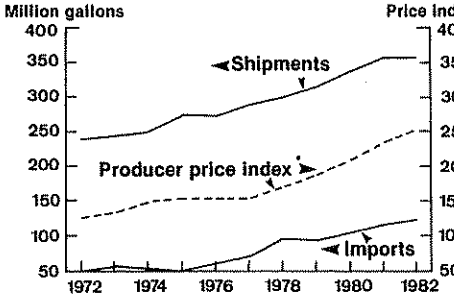
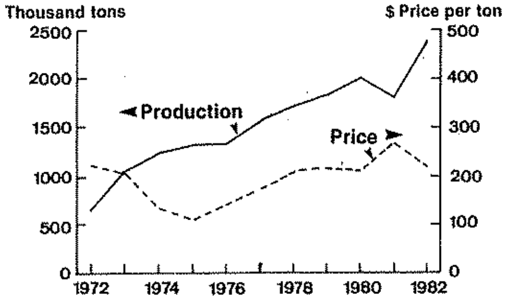



*Table and dessert wines, 1967=100

Chart 2
CALIFORNIA WINE GRAPE GROWING SECTOR




recovers from the recession and more discretionary income becomes available to them. During the first seven months of 1983, California wine shipments were up by only 2 percent from the same period a year earlier, but July showed a notable pick-up and this gain may widen somewhat before the end of the year. The continued strength of the dollar in exchange markets will benefit sales of imported wines once again. Indeed, during the first seven months of 1983, the volume of foreign wine entering the U.S. was up 11 percent from the comparable period a year earlier. This pressure will tend to siphon away some of the increased business that would otherwise go to domestic producers.

With demand for their products increasing only moderately thus far, winemakers will have to reduce their 1983 production sharply if they are to work off excess inventory. This cutback will severely reduce their demand for wine grapes as well as depress wine grape prices.

However, the degree of downward pressure on wine grape prices will finally depend upon how much the decline in grape production turns out to be this year. In mid-September, the California Department of Food and Agriculture estimated that wine grape production would decrease nearly 17 percent in 1983 to about 2.0 million tons. That forecast was lower than the July estimate and recent rains could cause the harvest to be even smaller. But although the grape crop could be shorter than predicted earlier, preliminary price data suggest that wine grape prices on average still could be 15 to 20 percent lower than last year's depressed level.

**Longer term prospects**

By 1984, the improvement in California wine shipments should begin to become more buoyant as economies here and abroad rebound. Prices for both California wine grapes and bottled wine will increase as inventories at the wineries are finally restored to more normal levels in relation to sales.

Over the longer term, the outlook for the rapid growth of California wine shipments appears bright. Annual adult per capita wine consumption in the United States—at just over 3 gallons—is only a fraction of the 7 gallons consumed per capita in Germany and the more than 20 gallons consumed in France and Portugal. Currently, only 7 percent of the U.S. population consumes nearly two-thirds of the total volume of table wine sold; this suggests that the opportunities for market expansion are great.

Based on the projected growth in per capita consumption, the California wine industry's annual rate of shipment growth of the last decade should resume in the 1980s, even allowing for an increase in the import share of the market. Agricultural experts maintain that the land base can support such growth given advances in production techniques. Competition among the various foreign and domestic wineries should intensify as well.

Another contributor to shipment growth might be the export market. Currently, less than one percent of the total volume of California wine shipments is destined for export. Because European wine-producing nations have imposed tariff barriers and quotas on imports, the market for California wines overseas has been limited mainly to such non-producing nations as Great Britain and Canada. Nevertheless, exports grew extremely rapidly over the 1972–81 period before the market weakened in 1982. A recent European Economic Community agreement with regard to labelling and other standards should also help the industry increase its sales abroad.

The year 1983 may not be a vintage sales year for the California wine industry, but subsequent years should witness more rapid growth in shipments and increased prices for both grape growers and wineries.

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## BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

| Selected Assets and Liabilities Large Commercial Banks | Amount Outstanding 9/21/83 | Change from 9/14/83 | Change from year ago Dollar | Change from year ago Percent |
|---|---|---|---|---|
| Loans (gross, adjusted) and investments* | 162,046 | 541 | − 567 | − 0.3 |
| Loans (gross, adjusted) — total# | 141,952 | 494 | − 198 | − 0.1 |
| Commercial and industrial | 43,266 | 208 | − 2,248 | − 4.9 |
| Real estate | 57,065 | 86 | − 535 | − 0.9 |
| Loans to individuals | 24,572 | 78 | 1,098 | 4.7 |
| Securities loans | 2,390 | 57 | − 359 | − 13.1 |
| U.S. Treasury securities* | 7,411 | 31 | 860 | 13.1 |
| Other securities* | 12,682 | 16 | − 1,230 | − 8.8 |
| Demand deposits — total# | 40,275 | −3,567 | 1,419 | 3.7 |
| Demand deposits — adjusted | 28,662 | −1,623 | 1,142 | 4.1 |
| Savings deposits — total† | 65,482 | − 530 | 34,394 | 110.6 |
| Time deposits — total# | 67,236 | − 85 | − 33,458 | − 33.2 |
| Individuals, part. & corp. | 61,485 | − 35 | − 29,254 | − 32.2 |
| (Large negotiable CD's) | 17,366 | − 178 | − 20,563 | − 54.2 |

| Weekly Averages of Daily Figures | Week ended 9/21/83 | Week ended 9/14/83 | Comparable year-ago period |
|---|---|---|---|
| **Member Bank Reserve Position** | | | |
| Excess Reserves (+)/Deficiency (−) | 156 | 117 | 261 |
| Borrowings | 118 | 31 | 10 |
| Net free reserves (+)/Net borrowed(−) | 38 | 86 | 251 |

* Excludes trading account securities.
# Includes items not shown separately.
† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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