Q1 2024 OUTLOOK

Not Much Cheer for Wine Sales This Holiday Season

By Chris Bitter, Ph.D.

THREE-TIER SALES

The post-pandemic slump in wine sales continued into the third quarter of 2023, as consumers remain skittish because of inflation and economic uncertainty. There have not been any clear signs of improvement as we enter the crucial holiday season, as the pace of the decline has been reasonably steady over the past 12 months.

The premium segment of the retail market continues to outperform relative to the lower and higher price tiers, though sales volumes are still declining slowly.

My analysis of Nielsen IQ (NIQ) data indicates that retail sales fell by 5% in volume during the third quarter versus the same period last year but dropped by just 1% in value. This compares with a 5% decline in volume and a 2% drop in value over the past 12 months.

Distributor depletions, which also capture the on-premise channel, weakened considerably during the third quarter. SipSource data indicate a drop of 12% versus the same period last year, which compares with a 7% year-over-year decline for the past 12 months. The more forceful decline in depletions suggests that retailers are working through excess inventory or reducing inventory levels because of concerns about future sales.

The premium segment ($11 to $29.99) of the retail market continues to outperform relative to the lower and higher price tiers, though sales volumes are still declining slowly. The stronger performance may be partly attributable to price taking, which has pushed some brands above the $11 threshold, but there is also evidence of consumers trading down from the ultra-premium category.

The value segment (under $11) continues to contract at a modest rate, and there has been little change in the pace of the decline over the past 12 months. California wineries are facing stiff competition from imports in this price tier and have ceded a bit of market share over the past 12 months.

The ultra-premium price tier ($30 and up) has been the weakest segment of the market in 2023, and there was no change in this dynamic during the third quarter. Nonetheless, it is important to note that sales are still tracking well ahead of their pre-pandemic level, despite a steady decline over the past five quarters.

Sales of white wines, led by Pinot Gris and Sauvignon Blanc, continue to hold up better than red wines and rosé. The sparkling wine category also continues to outperform overall, though sales have deteriorated markedly in the higher price tiers this year.

DIRECT-TO-CONSUMER SALES

The direct-to-consumer (DtC) channel continues to struggle as well. According to data from Wine Business Analytics and Sovos ShipCompliant, DtC shipments were down 10% by volume and 6% in value in the third quarter versus the same period last year. There has been little change in the trajectory of DtC shipments over the past 12 months.

While shipments are down for wineries of all sizes, those producing 500,000 cases or more have seen the most pronounced decline over the past 12 months. Moreover, shipments of wines priced at $30 and above have held up better than those priced below this threshold. This likely reflects price taking to some extent, as anecdotal evidence suggests that wineries have been more aggressive in taking price in the DtC channel. Indeed, the average bottle price has risen by 6% over the past year.

OUTLOOK

As I wrote in the inaugural issue of "Winescape," it is impossible to precisely sort out the drivers of the post-pandemic slump in wine sales. It is almost certainly the result of a combination of factors, including inflation and economic uncertainty, competition with alternative alcoholic beverage categories, demographic change, and changing attitudes toward alcohol consumption.

The economy and consumers are still facing some headwinds, but these should begin to subside in 2024.

Of these, economic factors tend to be the most dynamic, and thus have the greatest potential to influence the near-term path of wine sales.

The U.S. economy has exceeded expectations in 2023, and inflation is abating. The economy and consumers are still facing some headwinds, but these should begin to subside in 2024, and the soft-landing scenario looks much more probable than it did at the beginning of 2023.

The most important economic headwind is high interest rates, which will impact both businesses and consumers (see Chart). Thus, consensus expectations are for the labor market and GDP growth to soften over the next several quarters. In addition, political gridlock in the U.S. and geopolitical unrest abroad present risks to the economy going forward.

Nonetheless, if progress on inflation continues as expected, interest rates have likely already peaked and should begin to come down in 2024, which should boost consumer confidence.

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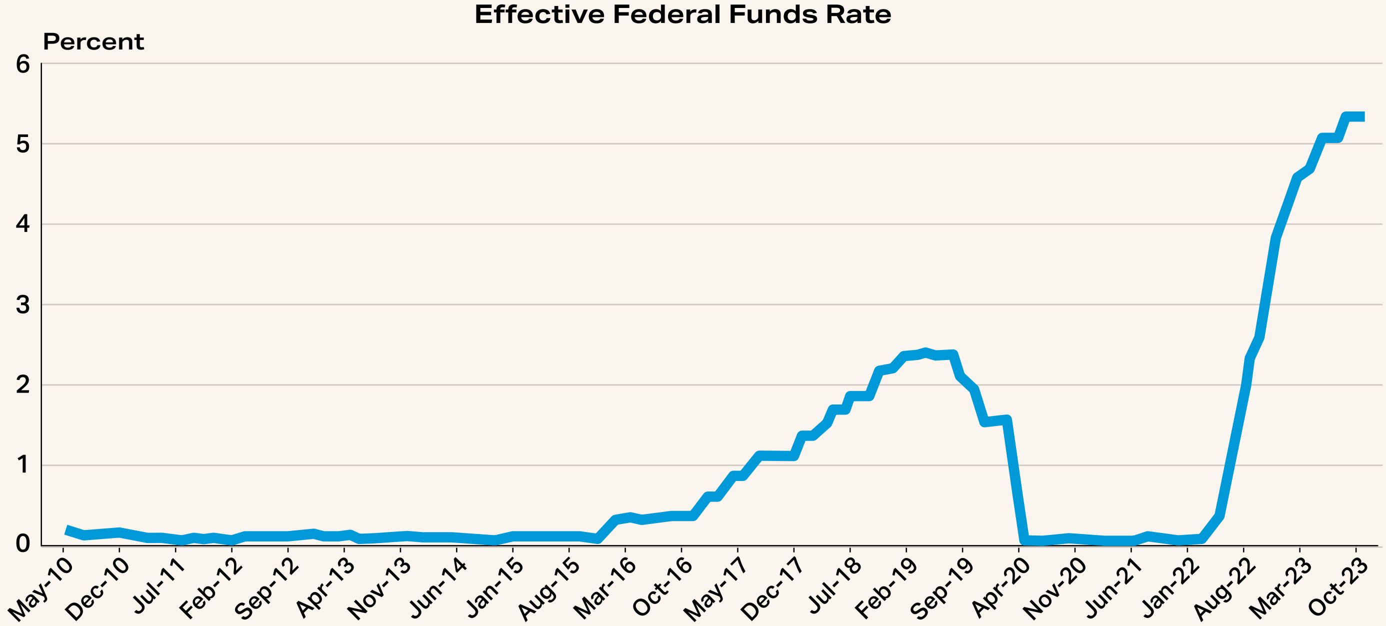
Under this relatively benign economic scenario, I expect wine sales to remain soft through the holiday season, but they should begin to stabilize in 2024. However, I do not anticipate a return to outright growth in wine consumption anytime soon because of longer-term shifts in consumer behavior and demographics.

Chart: **Interest Rates Likely to Stay Higher for Longer Given Above-Target Inflation**



Sources: Federal Reserve Bank of St. Louis, Terrain

The premium and higher price tiers of the retail market should be the biggest beneficiaries, while the value tier is not likely to see much improvement as consumers trade up. DtC sales should also improve, though growth is likely to be modest.

Elevated inventory levels at alcoholic beverage wholesalers will need to be worked through before wineries feel the full benefit of improving retail wine sales.

The grape market moved decisively in the favor of buyers in 2023 as a structural imbalance between grape supply and demand that had been masked by supply constraints in recent years became more apparent due to a larger crop. Growers with uncontracted fruit met unfavorable prices on the spot market if they were able to find a buyer at all.

Given muted expectations for a rebound in wine sales in the near term, the grape market is likely to remain under pressure in 2024. A large number of three-year deals that were signed in 2021 will also be expiring, so buyers looking for contracts will have abundant options and growers will be forced to compete for their business.

(For a more in-depth look at the grape and wine markets, visit winescape.terrainag.com.)