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Voluntary Public

Date: 11/20/2018

GAIN Report Number: GAIN0063

China - Peoples Republic of

Post: Beijing ATO

Lessons Learned from China's Wine Producing Regions: Implications for U.S. Exporters

Report Categories:

Wine

Promotion Opportunities

Market Promotion/Competition

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Report Highlights:

While tariffs have made U.S. wine more expensive, importers believe there is still demand, not only in first-tier cities, but also in growing second-tier cities. As China's wine drinking culture matures, consumer growth appears to be trending toward younger drinkers who value lower priced wines, mild taste profiles, and convenience. Wine tourism is becoming more popular as wineries replicate European chateaus and New World wine trails for domestic tourists. U.S. exporters should consider tapping into this trend by promoting their imported wines within these tourist destinations. U.S. exporters should also consider participating in imported wine anti-counterfeiting initiatives that are organized by Chinese distributors and e-commerce companies. These initiatives use wine tracing technologies to provide consumers with more information about their purchase. Participating could also help U.S. exporters create mutually beneficial relationships with Chinese distributors who also want to ensure their

imported wines are authentic.

Background

After Spain, China boasts the second largest area under vine cultivation with 847,000 hectares, while France is third, and Italy is fourth. In terms of wine production, Italy was the world's leading producer in 2018 with 42.5 million hectoliters (mhl), followed by France with 36.7 mhl, and Spain with 32.1 mhl. While China has the second largest land area under vine cultivation, it produces three to four times less than the European leaders at just 11.5 mhl. This amount is on a par with Australia at 11.9 mhl and South Africa with 11.2 mhl. In 2017, China imported \$2.8 billion in wine. U.S. wine accounted for only \$78 million or less than three percent of imports, while France accounted for approximately 40 percent and Australia 25 percent. Chinese tariffs on U.S wine is now 39 percent (14 percent + 25 percent additional tariffs). Tariffs for major competitors are much less; France, Italy, and Spain's tariff rate is 14 percent. Australia's tariff rate is at 2.8 percent in 2018, and will be zero starting from 2019. Due to free trade agreements, Chile and New Zealand wine enters China duty free.

The six most well-known wine producing provinces in China are Shandong, Hebei, Shanxi, Shaanxi, Ningxia (autonomous region), and Jilin. Far western Xinjiang Province leads wine production by volume, however this region generally produces lower quality mass volume (i.e., not bottled) wine for blending or domestic consumption. Recently, some Xinjiang wineries have begun releasing bottled wines, however its geographic location and logistical challenges will prevent it from gaining a larger share of the bottled wine market. Similarly, Gansu Province is the second leading wine producing region, however like Xinjiang, transportation and logistical hurdles will likely prevent this region from gaining more market share.

Ningxia and Shandong Wine Production

Ningxia and Shandong are China's two most important wine production regions, yet they differ in many respects. Ningxia's wine development is newer than Shandong's. It also has the country's first and only provincial/autonomous region government wine development bureau. Shandong's wine industry has a long history of producing fine wines, is centrally located near coastal population centers, and also has the highest wine sales in volume and value. Wineries in both regions have attracted significant foreign investment, and are have placed wine culture and tourism at the center of industry development. These two regions lead China's fine wine production, however they have several key differences.

Ningxia

Most wineries in Ningxia are located between the Helan Mountains and the Yellow River. The Helan range supports grape production by shielding the region of cold air from the north, while the Yellow River provides producers with irrigation water. Due to the cold winters, most grape vines in Ningxia must be covered with soil to overwinter safely and dug out again in spring. There are hundreds of wineries in this region, most of which are newly built, and small to medium sized. In 2011, wine production began to grow in earnest with foreign investments from well-established wineries such as France's Moët Hennessy that began sparkling wine production under its Chandon brand. In 2012,

Ningxia founded its own autonomous region's wine development bureau which raised the stature and development of wine production for government economic planners. Many of these region's wineries, in cooperation with the tourism bureau, now market Ningxia's wineries as a tourist destination.



Ningxia winery (left) and vineyard (right)

Yantai-Penglai Region

Shandong Province has the longest history of winemaking, and the largest sales volume and value in China. Most fine wines produced here come from its northeast peninsula outside the port city of Yantai (and which also includes the nearby wine making region of Penglai). The Yantai-Penglai region provides grape producers favorable growing conditions with cool moist ocean air and moderate winter temperatures which help promote grape vine growth during warmer months. There are about 200 wineries in the greater Yantai-Penglai Region, which together produce 40 percent of the total volume in China. Like Ningxia, several well-known international wine producers have invested in building wineries here, including France's Chateau Lafite Rothschild which is scheduled to finish construction in 2019. Two advantages this region have over Ningxia are its proximity to major cities along the east coast, and being able to benefit from Shandong's well established bottling, transport, and packing industries. Unlike Ningxia which has one centralized wine promotion bureau, Yantai and Penglai have separate wine bureaus and local officials must balance other economic promotion efforts in addition to wine production.



Yantai winery (left) and vineyard (right)

The wine bureaus in Ningxia and Yantai-Penglai expressed their wish to export wine to other countries and to attract more foreign investment. In terms of government support, Ningxia's wine bureau has more support, as it is provided funds from the autonomous regional level, while Yantai and Penglai receive support and funding from the municipal/county level. Ningxia's government considers wine production to be a critical, if not the single most important economic growth engine for the region. Yantai-Penglai's wine development is more market oriented, and must compete with other agricultural production priorities including providing fruit and vegetables to Beijing and surrounding areas. Ningxia's government organizes many international wine festivals, ranking competitions, and promotion activities. Although potential consumers of U.S. wine in Ningxia are few, participating in these local activities may be a good opportunity to promote U.S. wine nationally to media, distributors, and industry leaders.

U.S. Wine Awareness in China's Wine Country

Ningxia and Yantai-Penglai residents drink local wine as they are more familiar with the local cheaper brands. Ningxia residents know little about U.S. wine; it was common for residents to seem surprised that U.S. produces wine. Among the six wineries visited in Ningxia, staff from two wineries mentioned that they heard about California's Napa Valley. Staff from all six reported being knowledgeable about wines from France and Australia. Most wineries in the region have foreign winemakers; staff most frequently study winemaking in France. These wineries also generally use French oak barrels. In the Yantai-Penglai region, wine knowledge and consumption is more cosmopolitan. While domestic wine is distributed in typical alcoholic beverage shops, supermarkets, and gift shops, imported wine is sold in restaurants, bars, and specialized wine shops.

Chinese wine tastes pair well with many of the export-oriented new world wine varieties the United States produces. Local wine media and distributors report that high quality U.S. wine, in general, is well received by Chinese consumers. It is valued for its sweetness, and complex fruit fragrances. Many prefer U.S. wines over cheaper vintages from Australia, New Zealand, and European countries. Due to higher tariffs, less export supply, and other production factors, U.S. wines are usually more expensive than many other imported wines of comparable vintage.

Market Opportunities and Challenges for U.S. Exporters

Wine Popularity Continues to Grow

Out of a country with nearly 1.4 billion people, there are only 50 million regular Chinese wine drinkers. Interestingly, U.S. and Chinese wine consumption patterns bear some historical and cultural similarities. Historically, China and the United States have remained major consumers of spirits and beer, however wine consumption is popular among certain segments of the population. The United States and China are major wine consuming countries with the United States ranking first (32 mhl) in 2017, and China fifth in the world (18 mhl). Fine wine consumption in the United States only began to grow in earnest in the late 1980s as younger, well-traveled, and relatively affluent Americans became interested in fine

wines and its perceived health benefits. Similarly, it has been only in the past 10 years that affluent Chinese consumers began to prize wine for its perceived health benefits and social sophistication.

Youth Consumption Patterns

Wine industry media and distributors note that there are many potential consumers of U.S. wine, however it is not easy to find outside of first-tier cities. The Yantai wine bureau noted that France, Australia, and Italy have special organizations, representing all regions, promoting their country's wine in China. Although consumers in these regions are not major drivers of wine consumption, they along with Ningxia, constitute the country's growing domestic wine producing influencers. Several contacts noted a shift in wine consumption toward young urban professionals and away from older more affluent wine drinkers. These young wine drinkers are less interested in purchasing expensive wine merely for its high price, and they do not want to bother worrying about what wine best pairs with which food. Rather, these urban professionals are short on time and not as concerned about showing others they have the means to purchase expensive wine. They are more interested in wine that works well for any occasion and is not too expensive, since it will be consumed among friends and family rather than business associates.

Growing Wine Trail Tourism

China's wine consumption is still in its infancy as is the national wine culture. Ningxia, Yantai, and Penglai's governments prioritized making their region's wineries into full-fledged tourist destinations similar to how France's Bordeaux and California's Napa Valley successfully entices visitors to stay, drink, and experience the local culture. During summer 2018 visits to Ningxia and Yantai-Penglai, few visitors were seen compared to the network of tourist-oriented wineries recently built to receive visitors. The Yantai-Penglai region includes a major port city, and has multifaceted manufacturing and agricultural production activities. Wine tourism is one of several economic initiatives for the region. Ningxia appeared to be attracting more visitors which might be explained by the general trend of east coast citizens becoming more interested in the Northwest's minority ethnic groups and natural wonders. Grape production and the wine industry is one of the main driving forces for Ningxia's economy, and the local government has provided industry with tax incentives, reduced power rates, and infrastructure development projects hoping visitors will flock to this region and boost to local economy. While visitors are few compared to other international wine destinations, these local governments are making the investments necessary to attract greater numbers of visitors if wine and wine tourism becomes more popular in the future.



Ningxia wine bureau and exhibition center

Counterfeiting

While it is difficult to accurately gauge the scale of wine counterfeiting in China, by some estimates, 30 percent of all wine and spirits sold to consumers and up to 70 percent of imported wine is counterfeit. Expensive imported wine, particularly those with a strong brand identity, tend to be targeted by counterfeiters. Counterfeit imported wine is typically a mixture of water, cheaper domestic wine, and additives that are either sold in reused authentic bottles or in manufactured bottles with copied labels. Profit margins for counterfeiters is large, and punishment unlikely. Many consumers and retailers continue to judge wine based on its price point rather than taste, which makes counterfeiting harder to detect by end users. Counterfeiting remains a large problem for importers, however some in the industry are fighting back.

The China e-commerce company, JD.com (and several other major distributors), are experimenting with using quick response (QR) codes to educate consumers about the wine they are purchasing and for tracking the authenticity of each individual bottle of wine. When scanned by the purchaser, the unique QR code is logged and cannot be reused by another bottle. These programs are still experimental, and therefore have yet to be proved practical. Meanwhile, it remains essential for U.S. exporter associations to organize activities to teach distributors and importers how to detect counterfeit wine and how to educate their customers about fine wine's attributes.

Recommendations to U.S. Exporters

Consider Marketing to Young Professionals

Young people tend to be more open-minded, experimental, and willing to try new wines and tasting concepts. China is developing its own wine consumption culture, and young people are poised to become the leaders. Whereas in the past, wine consumption was driven by business engagements and social prestige,

future consumption will likely be sustained by rising middle income earners. These younger drinkers will tend to be less interested in wine's complex tastes and pairing rules, and more interested in lower price points, moderate taste profiles, and convenience.

Take Note of China's Wine Tourism

China's wine tourism is still emerging, however the major wine producing regions are ready to accept large numbers of visitors. Most wineries have been built with European and New World architectural tastes, with parks, golf courses, kid's activities, and event facilities. Western wineries appeal to many Chinese consumers since wine is viewed as foreign product even if it is produced within these same regions. U.S. exporters should consider promoting U.S. wines within these wine tourism regions, as holding an event here could capture an interested audience from many parts of affluent China at one time. They could also consider organizing an outbound trade/tourism mission to the United States or introduce U.S. wine tourism (and wines) to bureau authorities and other key contacts.

Don't Forget Second-tier Cities

Second-tier cities have three to 15 million consumers and GDPs reaching \$300 billion. Most wine exporters begin by working with first-tier city importers, however competition in these first-tier cities (e.g., Shanghai and Beijing) is getting fierce while middle class demand for imported food and beverages in second-tier cities is increasing. Cold chain and logistics have improved in these second-tier cities, and wine importers are very eager to connect with U.S. exporters directly. U.S. exporters should build more contacts, or organize more promotions, in second tier cities, such as Qingdao, Xian, Shenyang, Chongqing, and Zhengzhou.

Solve the Authenticity Riddle

Counterfeiting is an intractable problem in many sectors, and wine is no exception. Producers and reputable distributors find it especially difficult to stop counterfeit imported wines from being sold, since consumers and even retailers do not always know what authentic fine wine tastes like. Consumer education is essential, but new technologies and distribution partners may be able to help exporters. U.S. exporters should consider joining with domestic distributors and e-commerce in finding ways to decrease counterfeiting and increase technology's ability to put more information at the consumer's fingertips.

U.S. wine exporters seeking further assistance in North and Northwest China may contact the Agricultural Trade Office (ATO) in Beijing:

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