

Tbilisi 2022 Abstract Submission

Title

The financialization of the bulk wine market: issues, constraints and limits of the introduction of a futures contract

I want to submit an abstract for:

Conference Poster Session

Corresponding Author

Jean-Marc Figuet

E-Mail Corresponding Author

jean-marc.figuet@u-bordeaux.fr

Affiliation

Bordeaux School of Economics (BSE)

Keywords

Bulk wine, futures market, contract, risks

Research Question

Could a future market be implemented for bulk wine?

Methods

We develop an econometric analysis. We use weekly data between 2000 and 2020 on the average price of bulk red and rosé wines without geographical indication (France, Italy, Spain).

Results

Using the results of our econometric analysis, we conclude with operational recommendations to the public authorities and the actors of the bulk wine sector.

Abstract

The financialization of the bulk wine market: issues, constraints and limits of the introduction of a futures contract

Jean-Marie Cardebat, Jean-Marc Figuet, Yves Jégourel, Catherine Lis-Castiblanco
Bordeaux School of Economics (UMR CNRS 6060), H 2, Bordeaux University, Ave Léon Duguit, 33608 Pessac, France

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Abstract:

This article aims to determine to what extent bulk wine can be considered as a commodity and, therefore be subject, like the vast majority of agricultural products, to an organized futures market. Although differentiation by quality, defined by expert ratings and/or "appellations", is an essential characteristic of the world fine wine market, this is not the case for bulk wine. Three key factors make bulk wine a potential "commodity" and legitimize the question we address in this article: (a) the geographic concentration of its production while its demand is globalized, implying significant international trade flows, both physical and financial; (b) its economic homogeneity leading to the inevitable failure of any quality differentiation strategies, and (c) a high price variability. In the first part of the paper, we clarify these arguments and explain, with reference to the existing literature, the conditions leading to the creation of an agricultural futures market.

We develop an econometric analysis in the second part of this article. We use weekly data between March 2000

and October 2020 on the average price of bulk red and rosé wines without geographical indication (as transmitted to the European Commission) for each of the three countries studied: Italy, France and Spain. Together, these three countries account for nearly half of the world's wine production. If the homogeneity of bulk wine is proven, it must translate into a high degree of substitutability between different origins and thus into geographic arbitrage resulting in a convergence of European bulk wine prices. To test for the existence of a long-run relationship between French, Spanish and Italian bulk wine prices, we rely on different econometric approaches, from linear cointegration tests to vector error correction model (VECM) with structural breaks. We also implement threshold cointegration tests. The same model is used to measure the speed of adjustment to deviations from the equilibrium relationship. We also analyze the causal relationships between these different prices and measure their volatility using traditional GARCH modeling. We then explain why this high volatility and the high degree of convergence between European bulk prices, as indicated by our preliminary results, are a prerequisite for the launch of a futures contract.

The development of a commodity derivative depends on objective factors such as those analyzed in our econometric study, but also on technical characteristics that rely on both the market structure and the way the futures contract is defined (maturity, physical characteristics of the underlying asset, possible delivery conditions - cash settlement vs. physical settlement, delivery locations -, existence of premium/discount mechanisms). We explain this assertion in the third part of this article. Beyond the launch of a futures contract per se, the conditions for its success should also be discussed. We suggest that it depends on the needs expressed by the key players in the wine industry or, more subjectively, on the way such financial tools are perceived. These are of two kinds: a desire for greater price transparency within the value chain and a need to manage price risk in a necessarily second-best strategy. We detail this approach in this final part for each industry player: wine producers, brokers and traders. We finally discuss the stakes and constraints that a futures contract on bulk wine could have on the structuring of the French wine industry and notably on the role played by intermediaries.

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Using the results of our econometric analysis, we conclude with a certain number of operational recommendations to the public authorities and the actors of the bulk wine sector.