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Negative "PPD" explained for dairy farmers

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It hasn't happened for several years, but August milk checks for milk shipped in July will contain a negative Producer Price Differential, also known as the PPD.

The PPD is an adjustment made on milk producer's milk checks (usually positive). With federal milk marketing order pricing, dairy producers get paid for the total pounds of butterfat, protein and other solids sold. The prices of these components are the ones used to determine the Class III price (milk used for cheese). But in addition to these component values per pound dairy producers receive an additional value paid on a hundredweight basis for the additional value of milk used in other Class uses-the Class I price (beverage milk), Class II (soft manufactured products) and Class IV (butter and powder). A differential is added to a pricing mover that represents the manufacturing use of milk to get the Class I price (\$1.40 to \$1.80 in the Upper Midwest Order) and to get the Class II price (\$0.70 differential). The Class IV price is independently derived from the value of butter and nonfat dry milk. So the PPD is the sum of the percentage utilization of milk in Classes I, II and IV multiplied by the difference between Class I, Class II and Class IV and the Class III price. Since Class I and Class II, and sometimes Class IV milk, is typically valued at a higher price than manufactured milk, the PPD usually adds money to producer checks but, not always.

The Class I and Class II, "mover" is the "higher of" either the advanced Class III or Class IV price. This advanced mover must be announced on a Friday on or before the 26th of the previous month to which it applies (for example, the mover for July Class I and Class II milk was announced on Friday, June 20). As a result, the mover only takes into account what has been happening to butter, cheese and nonfat dry milk prices for about the first half of the month. But, the Class III price is announced on a Friday on or before the fifth of the following month to which it applies (for example, the July Class III price was announced on August 1). The announced mover was the advanced Class IV price for July because it was higher than the advanced Class III price. But, the reason the July PPD became

negative is because the cheese price during the last half of July moved up rapidly and the July Class III price announced on August 1 was 19 cents per hundredweight higher than the July Class I price that was announced on June 20th. As a rule of thumb, the PPD will be negative whenever the difference between the monthly Class III price and the Class I mover (higher of advanced Class III or Class IV price) is greater than the market's Class I differential.

The PPD was announced on August 12th at a negative 41 cents per hundredweight. This will be the deduction for the zone base price used for August milk checks. The exact price will depend on how far away from Chicago the milk plant is located. The base price is adjusted in 5-cent increments per zone. For example a plant located in Southern Wisconsin will use a deduction of 5 cents more than the announced base price while the deduction for a plant in Central Wisconsin will be 10 cents. Further complicating the situation is the ability of milk plants to "depool" their milk to avoid having to pay into the producer settlement fund. A cheese plant may "depool" because its Class III milk is worth more than Class I or Class II milk. The more milk that is "depooled" the greater the deduction will be on milk that is "pooled". That is because a greater percentage of the milk left in the pool will be priced at this lower Class I and Class II value. Remember, when the PPD is positive as it is most of the time, plants receive payments from the pool which may be paid out to producers.

Other complicating factors include the option plants have to not itemize the PPD on their milk checks. The exchange of money within the "pool" can still occur but may not be labeled as such on producer checks. For example some plants have opted to place the PPD money on quality or component values vs. the PPD. The result is that producers who ship to different plants may have different PPD prices on their milk checks or, may have no PPD value itemized on their check at all.

Unfortunately for Midwest producers the Upper Midwest Federal Order has a lower Class I differential added to the price mover than other orders so a negative PPD is more likely than in other markets. On the positive side prior to market reform in 2000 negative PPDs happened much more frequently than they do now. Also keep in mind that the present negative PPD is due to the rapid rise in the Class III price, a welcome development after two and one half years of low prices.

The PPD, whether negative or positive, affects producers whose plants identify the deduction on producer checks as well as those who do not. It may be helpful to keep in mind that more often than not, the PPD is positive versus negative.

To learn more about milk marketing, the Producer Price Differential and milk price risk management, telephone your local UW-Extension Agricultural Agent or Dr. Cropp at 608-262-9483.