Producers Price Differentials, or PPDs, are on every milk check. To deliver on our promise of providing members with more information, we sat down with Vic Halverson, Assistant Market Administrator in Federal Order 30, to get some insight on PPD values and the how they work.

WHAT ARE THEY?
Milk of dairy farmers that is pooled on a Federal order is valued based on how milk is used in the marketing area (Federal Order 30 is the Upper Midwest Order, Federal Order 32 is the Central Order). All milk use is categorized into one of four use classes. Beverage milk is Class I, while most cheeses are Class III. Milk used for butter and dried milk is Class IV, and milk for yogurt, cream, ice cream and a variety of other products is Class II. For a marketing area, the minimum pay price for farmers is a weighted average of the milk values in these four classes. A simplified example would be that if half the milk in the area was used for bottling and valued at $22 per hundredweight (cwt.), and half was used in cheese and valued at $18, the average value of milk would be $20 per cwt.

In the Upper Midwest Order, this weighted average value of milk is broken into components representing the Class III value (butterfat, protein and other solids) plus a per cwt. value representing the other milk uses in the area. This per cwt. value is the PPD.

“Another way of looking at this is producers are paid Class III plus a figure representing the difference between Class III and the rest of the uses of milk in the market. This is a simplified version of the calculations, but helps one understand what the PPD represents,” Halverson explained. In regards to Federal Orders 32 and 33, the concepts are the same, however much less of the milk in these orders is used for Class III. “Since the PPD represents the value of everything other than Class III, they have a much higher percentage of their pool value at something other than Class III. This frequently leads to significantly larger PPDs, whether negative or positive.”

EFFECT ON MILK PRICE
Minimum farm pay prices under the Upper Midwest and Central Orders are computed as pounds of butterfat, protein and other solids multiplied by their respective prices in their order, plus the PPD, plus or minus a somatic cell count adjuster. PPDs are generally a small part of the
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By Lauren Brey
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total producer pay price in the Upper Midwest market, averaging 31¢ per cwt. in 2013 and 24¢ per cwt. in 2014. In the Central Order, the averages were 83¢ in 2013 and 57¢ in 2014.

NEGATIVE PPD
When the average value of the milk uses in the area is less than the value of milk for cheese (Class III) the PPD will be negative. This can happen for a variety of reasons, ranging from the timing of the price release dates (Class I is announced about six weeks before Class III) to wide spreads in the dairy commodity prices that are used to compute Class prices.

“In late 2014, very low nonfat dry milk prices relative to cheese prices pushed Class II and Class IV prices to be significantly below Class III. While Class I prices were above Class III, offsetting this somewhat, the average value of the milk used in Class I, II and IV combined was below Class III, creating a negative PPD in October and November,” Halverson said.

In regards to the effect on milk checks, Halverson noted that farmers need to consider the total value of their milk check.

“While a low or negative PPD is never a good thing, neither is a low price for any of the other items that make up the farmer’s milk check. During the last few years, there has been tremendous volatility in several of the components that make up the milk check,” he noted.

Butterfat prices have ranged from about $1.52 per pound in August 2013 to $3.25 in September 2014. Similarly, protein prices have ranged from $2.82 per pound in March 2013 to $4.71 in April 2014. Most farmers during the past two years have seen the per cwt. value of their milk check vary by around $7 per cwt. The PPD during the past two years has varied by about 80¢ in the Upper Midwest Order and $2.25 in the Central Order.

“The point is that the PPD is only a small part of the producer pay price and is not the reason for the vast majority of the pay price volatility,” he concluded.

OUTLOOK FOR FEDERAL ORDER 30
The Upper Midwest Order had small negative PPDs in October and November 2014, but a much larger positive PPD in December. “The negative PPD in October was the first negative PPD in about two years. We are currently forecasting PPDs in the range of a negative 10¢ to a positive 20¢ for the first half of 2015,” Halverson pointed out. “This forecast is based on the current futures market prices and estimates of dairy product prices in 2015.”

If you would like to learn more about how the Federal Orders work, you may contact Vic Halverson, Assistant Market Administrator in Federal Order 30, at 952-277-2335 or vhalverson@fmma30.com.

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