Understanding the September-October 2008 ADS Index Movements

Inspection of any ADS Index plot reveals a sharp drop in September 2008 and an equally sharp rebound in October. Those movements are not spurious – real activity did indeed drop and rebound that way, but the episode is highly anomalous and should largely be dismissed.

In particular, according to the Federal Reserve’s G.17 Industrial Production (IP) release of October 16, 2008, September IP was severely affected by a highly-unusual and largely exogenous “triple shock” (Hurricanes Gustav and Ike, and a strike at a major aircraft manufacturer), which caused an annualized September IP drop of nearly fifty percent. A similar pattern exists for Manufacturing and Trade Sales (MTS), as shown in Figure 1.

Figure 1 - Industrial Production and Manufacturing and Trade Sales in 2008 and 2009

IP and MTS also rebounded unusually sharply in October – indeed IP appears to “overshoot” – presumably in an attempt by manufacturers to make up for September’s loss.
A rigorous and reasonable way to “adjust” the ADS Index is simply to re-run the Kalman filter with the September and October IP and MTS data treated as missing. We show the result in Figure 2.

**Figure 2 - Aruoba-Diebold-Scotti Business Conditions Index (1/1/2008-4/11/2009)**

We continue to report ADS calculated using all available data, but as the figure makes clear, the sharp drop/rebound of September-October 2008 can be largely ignored.