War, Stocks and Labour Markets: Decoding Israel's Economic Response to October' 23 attack

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Executive Summary: This article analyses Israel's economic response to the October 7, 2023 Hamas attack, focusing on stock markets, labour markets, and macroeconomic indicators. In the immediate aftermath, stock markets tumbled, the shekel weakened, and key sectors like construction, agriculture, and tourism ground to a near halt. As fear rippled through the economy, rational risk assessments and behavioural finance phenomena such as herd behaviour and fear-induced impulsive market reactions deepened the shock. Yet, what followed was equally telling: a swift and coordinated policy response that blended fiscal expansion, cautious monetary continuity, and strong institutional cooperation.

Over the next eighteen months, Israel's economy maintained macroeconomic momentum and relative stability, despite the weight of war. A key challenge, however has been the acute labour shortage following the suspension of Palestinian work permits. To address the critical gaps, especially in the construction and related sectors, Israel signed labour migration agreements with friendly countries like India, supplementing the inflow of foreign workforce from the Philippines and Thailand—the two largest sources of migrant labour in Israel.

Looking ahead, Israel faces escalating risks from a multi-front conflict—marked by tensions along the Lebanese border, the protracted Gaza offensive, growing threats from Iranian proxies, and a volatile domestic political landscape. This strategic environment is likely to further drive increased defense spending and infrastructure integration with civil-military requirements, potentially stressing fiscal balances and social sector spending. With ceasefire efforts faltering, Israel must brace for prolonged instability. In this strategic reality, the country will need to maintain robust economic stabilisation strategies or adapt to a new low-equilibrium state of conflict-driven resilience.

For India, Israel's experience offers valuable lessons in economic resilience during conflict—emphasising the importance of pre-emptive fiscal-monetary coordination, institutional agility, economic diversification, and labour market flexibility. Indian policymakers can draw on these insights to build macroeconomic frameworks and contingency plans capable of mitigating shocks from persistent security threats along its borders, ensuring sustained economic momentum in times of crisis.

War, Stocks and Labour Markets:

Decoding Israel's Economic Response to Conflict

The Hamas attacks on October 7, 2023, triggered not just a security crisis for Israel but a complex economic disequilibrium—testing the resilience of its markets, labour force, and policy architecture. Investor fears became palpable on October 8, when stock markets fell. The TA-35 index on the Tel Aviv Stock Exchange dropped 7.6%, and fear index[1] often referred to as VTA35 (Volatility index) surged by hundred percent (Alon & Frenkel, 2023; TASE, 2023). Israeli shekel (NIS – New Israeli Shekel) dropped and dollar soared, reaching NIS 4.08 - the highest rate since July 2012. Over a period of next few weeks, the construction sector suffered from labour shortages and supply chain problems, while tourism dropped steeply due to safety concerns and ensuing cancellations (ITA, 2024). Due to the inability of many workers to access farmlands, agricultural output decreased (due to the concentration of Israeli agriculture in the southern region, which also has cities close to Gaza and war-hit areas). This placed a further strain on markets and distribution networks. In the first few weeks, over-all business investment decreased by 67.8% and private consumption fell by 26.9% (Central Bureau of Statistics, 2024). The negative sentiment was clearly evident in the macro-economic indicators, and can be better decoded using some theoretical frameworks.

Analysing Israel's Economic Dynamics Through Key Theoretical Frameworks

The Efficient Market Hypothesis (EMH), proposed by American economist Eugene Fama (1970) offers an interesting lens to understand how stock markets respond to terrorist attacks. It is a foundational concept in financial economics which asserts that stock prices fully incorporate all available information at any given time. This means that markets are constantly and efficiently processing data from a wide array of sources—ranging from government reports to macroeconomic indicators, and crucially, geopolitical developments and strategic events such as wars, terrorist attacks, or political upheavals (Fama, 1970). According to EMH, it is impossible for investors to consistently achieve returns that outperform the overall market through analysis or insider knowledge, because any new information is rapidly and accurately reflected in stock prices.

However, while EMH assumes rational behavior and immediate price adjustment to new information, real-world market reactions to unexpected, exogenous shocks—such as terrorist attacks or sudden outbreaks of conflict—often involve a complex interplay of both logical assessment and emotional responses. Investors not only evaluate the tangible economic and political impacts but also react to fear, uncertainty, and speculation about what may happen next, which can intensify market volatility and cause sharp, sometimes exaggerated, price movements in the short term (Shiller, 2015; Banerjee, 1992). This emotional component is a key aspect of behavioural finance and can lead to herd behaviour, where investors mimic others' actions in times of uncertainty (Bikhchandani et al, 1992).

In the specific case of the October 7 Hamas attack on Israel, the immediate and significant drop in the Tel Aviv stock market exemplifies this dynamic. The market's rapid decline reflects the EMH principle in action: investors quickly digested the new information about the attack and its implications, recalibrating asset prices to account for the increased risk and uncertainty (TASE, 2023). The heightened market volatility was driven by concerns over potential escalation, disruptions to economic activity, and the overall impact on Israel's security environment. Thus, the market reaction was both a logical adjustment to the tangible risks and a reflection of collective anxiety about the unfolding situation.

This event underscores how EMH can explain the initial market response to conflict: prices move swiftly to integrate all known information, balancing rational analysis with the human elements of fear and uncertainty that naturally arise during crises. Over time, as more information becomes available and the situation stabilises, market prices tend to find a new equilibrium reflecting the longer-term economic outlook (Barberis, Shleifer, & Wurgler, 2005).

This is further corroborated by the Herd Behaviour theory given by (Noble-prize winner Indian American economist) Abhijit Banerjee (1992) along with Bikhchandani et al. (1992). Their works collectively form the basis of Behavioural Finance theory. They explained how individuals' decisions in markets can be influenced by the behaviour of others, particularly during periods of uncertainty, creating a negative spiral. This implies that short-term stress selling of stocks or withdrawal of capital can spiral into major capital pullback from markets, unless state institutions step in to revive investor confidence. Building on their work, Robert Shiller, in his 2000 book *Irrational Exuberance*, further examined how psychological factors such as fear and herd behaviour, can lead to speculative bubbles and market overreactions. In 2005, Barberis, Shleifer, and Wurgler in their statistical work on "Comovement" in stock markets, also demonstrated that investor behaviour during times of crisis is influenced by cognitive biases and emotional reactions, which can lead to exaggerated market movements.

These theoretical tenets elucidate the reasons for significant decline in the stock values on the Tel Aviv Stock Exchange. Market players may have divested assets not just based on reasonable risk assessments, but due to constant barrage of negative information about the security situation and fear of further escalation. Thus, the collective behavioural tendency to follow the crowd, compounds market volatility (Shiller, 2015), also evident in case of Israel stock market movements in the short run. From a policy perspective, this suggests that unless government and/or financial institutions step in to boost investor confidence via institutional measures, conflicts can lead to notable capital flight, impacting the GDP and economic growth of a country.

Understanding the state of Israel's response for Economic Stabilisation: Since October 2023, Israel significantly ramped up government spending to manage the crisis. Guided by Keynesian[2] logic of increased government spending, Israel expanded its budget by 88.1% year-over-year by October 2024 (Central Bureau of Statistics, 2024). In November 2023, one month after the attack, Israeli government increased spending by 22.17% from 36.5 billion shekels (approx. US$ 9.86 billion) in 2022 to 46.9 billion shekels (approx. US$ 12.66 billion), mainly on account of 5.8 billion shekels (US$ 1.6 billion) as war expenditure (Times of Israel, 2023). Media reports based on Israeli government data suggest that the next year (between January and November 2024), government expenditure touched 553.8 billion shekels (approx. US$ 149.5), registering a 24.5% hike (Xinhua, 2024).

Defense spending surged by NIS 15 billion (US$ 4.5 billion) during the first quarter post-attack. Finance Minister Bezalel Smotrich underscored the need to balance national security with economic stability (Smotrich, 2024). Aid extended beyond defense, including NIS 5 billion (US$ 1.5 billion) for displaced citizens, support for tourism and agriculture, and infrastructure repairs (Israeli Ministry of Finance, 2024). These measures also mirrored Keynesian principles of demand stimulation and targeted economic relief by pumping money in the economy for macro-economic stabilisation. Additionally, the Bank of Israel maintained its policy rate at 4.5% to keep inflation under check and investor confidence high (Bank of Israel, 2025)[3]. In the first quarter of

2024, Isreal's GDP grew at a 14% annualised rate, mainly due to increased consumer spending and rise in investment, particularly in residential construction sector (The Times of Israel, 2024a; Wall Street Journal, 2024). However, for the entire year of 2024, economy grew at one percent (slightly higher than the Bank of Israel's GDP growth estimate of 0.6%)[4] (Wrobel, 2025).

The increased government spending was a major factor behind the economic sustenance, besides Bank of Israel's balanced macro-economic policy. This strategy is consistent with the concept of Economic Resilience in which strong institutions insulate the economy from sudden shocks (Briguglio & Cordina, 2021).

Economic Rebound and Structural Strength: North (1990) and Hall & Soskice (2001) in their respective body of work argue that sound institutional frameworks enhance a nation's capacity to manage crises. They contend that robust institutional frameworks provide essential governance, policy coordination, and financial structures, which are crucial during crises and conflicts. Such institutions enable efficient resource allocation, maintain market confidence, and facilitate recovery by ensuring stability and adaptability in response to disruptions. Countries which lack these institutional frameworks face severe short-term economic shocks, which spiral into severe medium-term economic recession. In Israel, the central bank, regulatory agencies, and inter-agency collaboration enhanced policy credibility and instilled confidence in investors, therefore mitigating the impact of significant economic shocks.

It is also essential to highlight that economies with diverse bases are more resilient to external shocks, as per the Economic Diversification framework given by Briguglio et al. (2009). They contend that economies with diversified sectoral bases[5] are better equipped to absorb exogenous shocks including wars and conflicts. A broad economic foundation guarantees that recessionary trends in one sector (in this case, agriculture, tourism, or manufacturing) can be offset by growth in others, promoting overall economic stability during crises when populist knee-jerk reactions fail to produce stability in the economy. In case of Israel, agriculture contributes 1.2% to the country's GDP. Industry and manufacturing sector contribute 18.9% and 11.5% respectively, while maximum share of GDP (70.8%) comes from the Services sector (World Bank, 2023). While agriculture and industry were hit, services-sector maintained resilience thereby insulating the economy from severe shocks. These factors collectively contribute significantly to economic normalization amid prolonged geopolitical upheaval.

Labour shortages:

Despite general macroeconomic stability, one major area of concern in Israeli economic scene was labour shortage. On the one hand, displaced Israelis faced forced unemployment or underemployment. By February 2025, approximately twenty percent of displaced Israelis (who were forced to evacuate their homes post-Hamas attack, mostly concentrated near Gaza and Lebanese border) were unemployed (Reuters, 2025). According to the nonpartisan IDI think tank's survey conducted in December last year, little over a third (39 percent) had returned home, implying unstable living conditions and loss of livelihood. Additionally, military call ups for deployment of conscripts further exacerbated worker shortage. On the other hand, in the aftermath of the Hamas attack, Israel's construction sector faced a significant labour shortage due to the suspension of work permits for approximately 80,000 Palestinian workers (Le Monde, 2024). The construction industry, which relies heavily on Palestinian workers, experienced severe labour shortages, cost escalation and delays in project deadlines. There was a serious demand-supply gap in Israel's labour market.

Indian worker migration: To address this gap, Israel turned to India, initiating a large-scale recruitment of Indian construction workers[6]. In November 2023, a formal MOU was signed between Israeli and Indian government to facilitate labour migration (India Today, 2024b; The Times of Israel, 2024b). Within a year, Israel's construction sector attracted approx. 16,000 workers from India, primarily from Indian states like Uttar Pradesh, Bihar, and Punjab, where unemployment rates remain high despite economic growth (India Today, 2024a; The Hindu, 2024a; AP News, 2024). As per some estimates, the workers were offered a monthly salary of approximately ₹1.32 lakh (US$ 1556), with additional bonuses of ₹16,000 (US$ 188), which is much higher than their earnings in India[7] (Hindu, 2024a). This labour flow from India enabled Israel to replace the Palestinian labour which has traditionally been employed in their construction sector and other informal sector jobs.

However, notable gaps remain and there has been 25 percent decline in construction activity (Al-Monitor, 2024), having serious implications for Israel's overall economic growth. Labour migration from partner countries such as India may enable to Israel to fill the labour supply gaps in the long run, but in the short and medium run, it will affect the economic activity in the country. Moreover, foreign labour in conflict zones such as Israel face serious risks, besides cultural and language barriers (India Today, 2025). The dynamic nature of global labour markets and labour mobility offer a long-term possibility to cover labour supply gaps, in the short-run it will be a challenge.

Conclusion: Risks and Lessons

Israel's economic trajectory after the October 7 Hamas attack underscores how quick, well-coordinated, and institutionally-sound policies can help to manage the political-economy of a conflict zone. The market response in a conflict zone is driven by a mix of logic and emotion, often resulting in declining investment, labour shortages, and collapsing stock markets. But Israel's ability to sustain and recover relatively quickly was due to Keynesian fiscal expansion, steady monetary policy, and institutional cooperation. Maintaining macroeconomic health required increased spending by the government (despite high public debt) across military and civilian sectors. Furthermore, the economy was shielded against protracted stagnation by Israel's robust governance structures and (service-sector oriented) economic profile. However, ongoing labour shortages, which have been made worse by the suspension of Palestinian permits, highlight weaknesses and vulnerabilities that need longer-term structural fixes including formal labour migration agreements with friendly countries.

Looking ahead, Israel's economic and labour market landscape will continue to be shaped by its strategic compulsions in an increasingly volatile regional environment. The risk of a multi-front conflict remains elevated, particularly with rising tensions along the Lebanese border, the continuation of Israel's military offensive in Gaza, and uncertainty around Iran's proxy network in the region. In the next five years, Israel is likely to expand its defense-industrial base, allocate a higher GDP share to homeland security, and further integrate domestic infrastructure with civil-military logistical requirements. This strategic pivot may put pressure on social sector spending and widen fiscal deficits unless offset by targeted reforms and foreign investments.

In the labour market, sustained shortage of Palestinian workers will necessitate institutionalisation of foreign labour pipelines. Friendly countries and Asian partners such as India will continue to play a pivotal role but success will depend on mutual agreements around worker safety, training, and rights. Meanwhile, Israel's high-tech and defense-tech sectors are expected to attract capital, supported by its innovation ecosystem and strategic alliances with the U.S. and Europe. However, economic inequality may widen if war-related spending diverts attention from social redistribution mechanisms. Ultimately, Israel's experience serves as a compelling case study in how economic resilience must be strategically engineered—not assumed—through foresight, institutional agility, and an unwavering alignment between national security and economic policy.

India's Strategic Takeaways from Israel's Economic Response: For India, the Israeli experience offers critical lessons in navigating the economic fallout of conflict and terrorism. The importance of fiscal-monetary coordination, institutional flexibility, and economic diversification during contingencies cannot be overstated. In India's own experience, disruptive events such as the 2001 Indian Parliament attack, the 2008 Mumbai terrorist attacks, the 2016 Uri attack, and the recent Pahalgam attack—as well as subsequent military responses—have triggered short-term volatility in markets due to investor fears. However, in most cases, markets were very quick to recover.

According to Ms ShilpaShree Venkatesh[8], Bangalore-based senior economist and subject expert, "*over the last few years, investor sentiment toward India's stock market has been strongly supported by robust domestic macroeconomic indicators such as steady GDP growth, fiscal discipline, and a resilient private sector. This solid economic foundation has helped cushion the market against short-term geopolitical shocks. Consequently, even during the recent military tensions, investor confidence remained intact, sustaining the market's bullish momentum.*"

That said, this resilience should not be interpreted as immunity. India's tense political geography—surrounded by nuclear-armed neighbours like Pakistan and China—exposes it to persistent strategic risks. The possibility of future high-impact incidents or even prolonged conflict cannot be ruled out. Therefore, it is imperative for India to continue investing in strong economic institutions, build fiscal buffers, and promote sectoral and spatial diversification. These steps are crucial not just for short-term shock absorption, but for ensuring long-term economic continuity in an unpredictable security environment. The Israeli model reinforces the value of resilient institutions and rapid fiscal responses, which help absorb shocks without derailing long-term growth trajectories. India must also invest in robust inter-agency coordination frameworks and financial buffers capable of ensuring economic continuity even in the face of sudden external shocks.

Indian policymakers would benefit from strategies that reduce regional economic concentration in one sector, enhance distributed manufacturing capacity, and ensure the integrity of multiple trade corridors and logistics networks. Establishing flexible labour and capital markets—along with diaspora-linked remittance streams—will also enhance resilience. In the end, economic resilience in conflict situations is contingent upon institutional capability, policy credibility, and the ability to strike a balance between security imperatives and long-term economic momentum.

Note: All Shekel and Rupee conversations into US$ have been done at the current rates

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