

Study of the effect of terror and anti-terror policies on financial markets

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Abstract

In this study we examine whether and to what extent terror attacks and anti-terror policies have a permanent effect on the financial markets, after a long and almost uninterrupted period of terror attacks in the country. This study is based on a unique sample of 460 terror events in Israel and 58 targeted assassinations during 2000-2003, which allows us to use a case study method to study this topic. The main findings of this study are: (1) Share prices drop in response to terror events. Responses are evident immediately if the attack occurs during trading hours, or at the beginning of the next trading day if the attack occurs after trading hours. On average we found no evidence of any exaggerated response and subsequent correction in response to terror events. The drop in share prices is not accompanied by increased uncertainty. (2) Anti-terror policy did not benefit financial market investors – share prices were hardly affected by the targeted assassinations that were performed in response to terror attacks. (3) As the number of terror events grew, investors shifted from the stock market to more conservative investment vehicles such as short-term government bonds.

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