"How Capital Markets Price Extreme Political Shocks: Evidence from Israel after October 7"

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This paper studies how financial markets and economic expectations respond to extreme geopolitical shocks. Focusing on the events of October 7, 2023, we examine the causal effect of a sharply dated political rupture on a broad set of outcomes, including long-term government bond yields, sovereign risk spreads, financial market indices, and measures of consumer and business confidence using a granular multi-year monthly-level data. The empirical design exploits the precise timing of the shock and combines modern panel counterfactual methods with a carefully constructed donor pool of comparable countries. This approach allows me to recover the trajectory that these variables would have followed in the absence of the event. We find that the shock led to a large, immediate, and persistent deterioration in financial conditions and expectations. Sovereign borrowing costs rise sharply relative to their counterfactual path, equity and financial market indices decline, and confidence indicators fall in a sustained manner. Importantly, pre-treatment dynamics are flat and statistically indistinguishable from zero across all outcomes, lending support to the identifying assumptions. Taken together, these results show that extreme geopolitical events are rapidly capitalized into asset prices and expectations, and that their effects extend well beyond short-run volatility. The findings provide new evidence on how markets process rare political shocks and how such events translate into persistent changes in perceived risk, long-horizon expectations, and the cost of capital.