Economic Policy Papers

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The Effects of Conflicts and Wars on Real Estate in Israel

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1. Introduction

What would Israel's real estate market look like if the "Iron Swords" war did not occur? Since the establishment of the state, Israel has faced numerous conflicts that have shaped its economic and social landscape. The ongoing war, which began on October 7th, 2023, marks the longest and most expensive conflict in Israel's history, underscoring the urgent need to understand its impacts. Historically, each conflict has had profound effects on various sectors of the economy, including the real estate market. This paper aims to explore these impacts in-depth, focusing on how wars have historically influenced real estate prices and market stability in Israel so that we can better understand what effects we should expect now.

Historically, Israel's real estate market has experienced significant volatility during periods of conflict. The Second Lebanon War in 2006, a 34-day conflict between Israel and Hezbollah, had notable economic repercussions, particularly in northern Israel. Similarly, the Gaza conflicts, including Operation Cast Lead (2008-2009), Operation Pillar of Defense (2012), and Operation Protective Edge (2014), although shorter, also impacted the real estate market. These conflicts often led to temporary declines in housing demand and prices, followed by periods of recovery (Horiuchi & Mayerson, 2015; Bank of Israel, 2007; Swirski & Konor-Attias, 2015).

During past conflicts, real estate prices in Israel experienced significant volatility. Before the deployment of the Iron Dome system, which provided a sense of security, prices often dropped or froze. With the Iron Dome in place, the market showed resilience, yet the current prolonged conflict presents new challenges that necessitate a re-evaluation of the real estate market's response mechanisms.

The Israeli real estate market plays a crucial role in the national economy, serving as a primary avenue for savings and investments for many citizens. Its stability is vital not only for individual financial security but also for broader economic health. Unlike GDP, interest rates, or unemployment rates, which are influenced by a wide array of factors, the real estate market directly affects the daily lives of citizens through housing availability and affordability. Additionally, real estate often represents a significant portion of personal wealth and investment for Israeli families, making its stability critical during times of conflict.

Given the current situation, it is imperative to provide policymakers with insights and tools to stabilize and grow the real estate market even amid ongoing conflicts. This policy paper seeks to analyze the impact of the current war on the real estate market, comparing it with

historical data and trends. It will examine price trends, market freezes, and other significant changes, providing a comprehensive overview of the market's reaction to prolonged conflict.

The ultimate goal is to offer actionable recommendations for policymakers to ensure market stability and resilience, safeguarding one of the most critical sectors of the Israeli economy during these challenging times.

By quantifying the immediate impacts of the current war on the housing market, this research contributes to the broader academic literature on the economic costs of conflict and offers valuable insights for policymakers seeking to mitigate the negative effects of geopolitical instability on the housing market.

2. Executive Summary

This paper examines how the ongoing "Iron Swords" war, which began on October 7th, 2023, has impacted Israel's real estate market. By using a method called the synthetic control method (SCM), we created a "synthetic Israel" to estimate what the real estate market might have looked like if the war had not occurred. Our analysis covers data from 2000 to the present, focusing particularly on the months following October 2023.

Israel's real estate market has historically been volatile during periods of conflict. For example, the Second Lebanon War in 2006 and various Gaza conflicts (Operation Cast Lead, Operation Pillar of Defense, and Operation Protective Edge) led to temporary declines in housing demand and prices, followed by periods of recovery (Horiuchi & Mayerson, 2015; Bank of Israel, 2007; Swirski & Konor-Attias, 2015). The introduction of the Iron Dome missile defense system in 2011 provided a sense of security that helped stabilize the real estate market during subsequent conflicts.

Our SCM analysis reveals a significant divergence between the actual housing price index (HPI) and the synthetic HPI post-October 2023, indicating a marked decrease in housing prices due to the conflict. The decline in the actual HPI suggests reduced housing demand, likely due to increased uncertainty, security concerns, and economic disruptions. The intersection of the actual and synthetic HPI in early 2022 can be attributed to the global impact of the COVID-19 pandemic, which caused a slowdown in construction activities, reducing housing supply and driving up prices temporarily.

The period of divergence starting in Q2 2021 can be linked to Operation Guardian of the Walls, which began at the end of Q2 2021. This conflict, along with Operation Breakwater

(Q1 2022 – Q3 2023), and the subsequent opening of the Iron Swords war, contributed to market instability. These events likely exacerbated the decline in housing demand and prices, as they introduced additional uncertainty and economic strain.

Based on our findings, we propose the following policy recommendations to stabilize and support Israel's housing market in the wake of the conflict: Implement policies to phase out the employment of Palestinian workers in Israel. This measure aims to reduce dependency on a volatile labor source and enhance national security. The government should provide support for Israeli workers to fill these roles, including training programs and incentives. Implement financial assistance programs for homeowners affected by the conflict, including mortgage relief and property tax deferrals. These measures can help stabilize the housing market by reducing financial strain on homeowners. Introduce incentives for investment in the housing sector, such as tax breaks for developers and subsidies for construction projects, to stimulate housing supply. This can help address supply constraints and support market stability. Invest in security infrastructure to mitigate the risks associated with future conflicts, thereby boosting consumer confidence and stabilizing the housing market. Enhanced security measures can reduce the perceived risk of investing in real estate. Expand affordable housing programs to ensure that low- and middle-income families have access to safe and affordable housing options. This can help address affordability issues and support overall market stability. Develop insurance schemes to protect homeowners and investors from financial losses due to geopolitical instability, thereby reducing the perceived risk of investing in the housing market. Insurance can provide a safety net and enhance market resilience.

3. Background and Problem Statement

a. Historical Conflicts and Wars in Israel

Since 2000, Israel has experienced several major conflicts that have had significant economic impacts, including effects on the real estate market. The Second Intifada (2000-2005) was particularly damaging, reducing Israel's GDP by an estimated 8.6% compared to projections (Horiuchi & Mayerson, 2015). The 2006 Second Lebanon War cost Israel about 1% of its GDP and caused considerable damage to northern Israel (Bank of Israel, 2007). Subsequent conflicts in Gaza, including Operations Cast Lead (2008-2009), Pillar of Defense (2012), and Protective Edge (2014), each resulted in economic costs to Israel ranging from 0.4% to 0.5% of GDP (Swirski & Konor-Attias, 2015).

These GDP impacts, while providing a broad measure of economic effects, are closely linked to real estate market dynamics. Economic shocks from conflicts can

affect various aspects of the housing market, including demand, construction activity, and investment patterns. For example, periods of conflict may lead to reduced foreign investment in real estate or shifts in domestic housing preferences (Eckstein & Tsiddon, 2004). Additionally, Israel relies on a significant number of foreign Palestinian workers in its construction sector. During conflicts, the movement of these workers can be restricted, leading to a reduction in the supply side of the housing market. This reduction can be observed in housing permits and construction activity, as fewer workers are available to complete projects, thus slowing down the rate of new housing supply.

Analyzing the Housing Price Index (HPI) in the context of these conflicts can offer valuable insights into how geopolitical events shape the real estate market. While initial economic assessments often focus on GDP impacts, changes in housing prices can reflect both immediate reactions to conflicts and longer-term adjustments in the real estate sector. For instance, Elster et al. (2017) found that house prices in conflict-prone areas of Israel were significantly affected by changes in the intensity of the Israeli-Palestinian conflict. Therefore, examining HPI trends alongside broader economic indicators provides a more comprehensive understanding of how conflicts influence Israel's housing market.

b. <u>The Israeli Residential Real Estate Market</u>

The Israeli residential real estate market plays a crucial role in the country's economy, significantly influencing both economic stability and individual financial security. Since 2000, the market has experienced substantial changes, characterized by periods of rapid growth, occasional declines, and overall volatility. Understanding the factors that affect housing prices, demand, and supply is essential for analyzing market dynamics.

Key Characteristics and Influences on Housing Prices
Price Trends:
From 2000 to 2023, real home prices in Israel have shown a significant upward trend. This trend has been particularly pronounced in the years following the global financial crisis of 2008, with prices rising by approximately 80% (Bank of Israel, 2021).

Demand Factors:

Population Growth: Israel's population has been growing at an annual rate of about 2.2%, significantly higher than most developed countries. This growth has been a key driver of housing demand (Weiner & Fuerst, 2017).
Income Growth: Rising incomes have increased purchasing power, further driving demand for housing. The Bank of Israel's model shows that income growth has been a consistent factor supporting price increases, especially since 2008 (Bank of Israel, 2021).
Interest Rates: Low interest rates, particularly in the period following the 2008 global financial crisis, have made mortgages more affordable and stimulated demand.

Supply Constraints:
Limited Land Availability: Especially in central areas, land scarcity has constrained new construction.
Construction Costs: The Bank of Israel's model indicates that construction costs have a significant impact on housing supply, with a 1% increase in costs reducing construction by 0.12% (Bank of Israel, 2021).
Regulatory Environment: Cavalleri et al. (2019) found that Israel's construction supply elasticity is moderately lower than the median in OECD countries, possibly due to stricter land-use regulations.

Market Dynamics:
Price-to-Income Ratio: Over the long term, home prices and income have tended to increase at similar rates, although there have been periods of significant deviation (Bank of Israel, 2021).

Rent-Price Relationship: The interaction between rents and prices is complex. Rising rents tend to increase home prices by raising the return on homeownership while rising prices can potentially decrease rents by stimulating housing supply.
Regional Variations: Tel Aviv and Jerusalem consistently rank as the most expensive markets, while peripheral areas have seen increased interest due to affordability concerns.

As of late 2023, the market has shown signs of cooling, with transaction volumes decreasing. December 2023 saw the lowest number of home acquisitions for that month in recent years. However, prices have continued to rise, with a 0.7% increase observed in November-December 2023 despite economic challenges (Central Bureau of Statistics, 2024).

In conclusion, Israel's residential real estate market from 2000 to 2023 has been characterized by strong overall growth, driven by demographic factors and economic conditions, but constrained by supply limitations. The market has shown resilience in the face of various challenges, including geopolitical events, but also faces ongoing issues of affordability and supply shortages.

c. Impact of Iron Dome on Israel's Real Estate Market

The deployment of the Iron Dome missile defense system in 2011 had a profound impact on Israel's real estate market, particularly in areas previously considered high-risk due to rocket threats. Research by Elster et al. (2017) provides compelling evidence of the system's stabilizing effect on property values during periods of conflict.

Prior to Iron Dome's implementation, rocket attacks had a significant negative impact on house prices. An additional 1,000 rocket-related damage claims in a locality were associated with a 9.5% decrease in property values. However, after the system's deployment, this effect was substantially reduced to only 3.8%, demonstrating Iron Dome's role in mitigating conflict-related market volatility.

The study also revealed interesting shifts in market dynamics following Iron Dome's introduction. The price premium for properties with in-house shelters dropped from 22% to approximately 10%, indicating a reduced perceived need for such safety features. Additionally, positive spillover effects were observed in northern Israel, where house prices in areas at risk of rocket attacks from Lebanon showed relative increases after Iron Dome's successful performance in the south.

These findings suggest that the Iron Dome system has played a crucial role in stabilizing Israel's real estate market, particularly in areas previously vulnerable to rocket attacks. By reducing the perceived risks associated with living in these areas, the system has helped maintain property values and market activity even during periods of heightened geopolitical tension.

d. The synthetic control method

The synthetic control method (SCM) is a powerful statistical technique used to evaluate the impact of interventions or events when randomized controlled trials are not feasible. Developed by Abadie and Gardeazabal (2003) and further refined by Abadie, Diamond, and Hainmueller (2010, 2014), SCM constructs a synthetic version of the treated unit (in this case, Israel) by creating a weighted combination

of control units (other countries) that did not experience the intervention or event. This method is particularly useful for assessing the impact of conflicts, policies, or other significant events on aggregated entities like regions or countries.

Previous studies have successfully applied SCM to similar contexts, such as assessing the economic impact of the Second Intifada on Israel's GDP (Horiuchi & Mayerson, 2015). This precedent supports the method's applicability to our study of the real estate market.

By comparing the real estate market outcomes of Israel with those of synthetic Israel, we can estimate the causal impact of the ongoing conflict on housing prices, transaction volumes, and market stability. This approach allows us to provide policymakers with evidence-based insights and recommendations to mitigate the adverse effects of the conflict on the real estate sector.

e. Existing policies

The Israeli residential real estate market is significantly influenced by a range of government policies aimed at managing demand, supply, and overall market stability. These policies have evolved in response to various economic, social, and geopolitical challenges. This section outlines key policies and their impacts on the housing market, with a focus on the role of foreign Palestinian workers, tax incentives for new immigrants, and measures to control speculative investments.

The Oslo Accords, signed in the early 1990s, had a profound impact on the Israeli labor market, particularly in the construction sector. As part of the agreements, Israel agreed to allow a significant number of Palestinian workers to enter the country for employment. Over time, these workers came to constitute nearly 50% of the construction workforce. This influx of labor helped to meet the high demand for housing and kept construction costs relatively stable. However, during periods of heightened conflict, the movement of Palestinian workers was often restricted, leading to labor shortages and delays in construction projects. These disruptions in the labor supply contributed to reduced housing permits and slowed the rate of new housing completions, exacerbating supply constraints and driving up prices. The reliance on Palestinian workers thus introduced a layer of volatility to the housing market, closely tied to the geopolitical situation (Bank of Israel, 2021).

Israel has a long history of encouraging Jewish immigration, and this policy has included significant tax incentives for new immigrants. For instance, new

immigrants are granted a ten-year tax exemption on foreign income, which includes income from foreign investments. This policy has been instrumental in attracting a large number of immigrants, particularly from the former Soviet Union in the 1990s and from France and the United States in more recent years. The influx of new immigrants has driven up demand for housing, particularly in urban centers like Tel Aviv and Jerusalem. This increased demand has, in turn, led to higher property prices. The surge in demand has also attracted Israeli investors, who have sought to capitalize on the rising market by purchasing additional properties. This speculative activity further fueled price increases, creating a cycle of rising demand and prices.

Recognizing the potential for speculative investments to destabilize the housing market, the Israeli government has implemented several measures to curb such activities. One notable policy is the introduction of higher taxes on second and third properties owned by the same individual. This measure aims to discourage investors from accumulating multiple properties, thereby reducing speculative demand and helping to stabilize prices. In addition to higher taxes on multiple properties, the government has also introduced regulations to limit the loan-to-value (LTV) ratio for mortgages on investment properties. These regulations are designed to reduce the risk of defaults and ensure that investors have a significant equity stake in their properties.

Other relevant policies have also shaped the real estate market. Public housing programs aimed at providing affordable housing to low-income families and new immigrants have been essential in accommodating waves of immigration and ensuring housing availability for vulnerable populations. Strict land use regulations and zoning laws have been implemented to manage urban development and preserve green spaces. However, these regulations have also contributed to housing supply constraints, particularly in high-demand areas. The government provides various subsidies and grants to first-time homebuyers, particularly in peripheral areas, to encourage homeownership and regional development. The Bank of Israel regulates mortgage lending practices to ensure financial stability, with policies including limits on loan-to-value ratios and requirements for mortgage insurance.

The combination of these policies has created a complex and dynamic housing market in Israel. The reliance on foreign Palestinian workers has introduced a degree of volatility tied to the geopolitical situation, while tax incentives for new immigrants have driven up demand and prices. Measures to control speculative investments have aimed to stabilize the market, but the overall impact has been mixed. The Israeli housing market remains characterized by high demand, limited

supply, and significant price volatility. Understanding the interplay of these policies is crucial for developing effective strategies to ensure market stability and affordability, particularly in the context of ongoing conflicts and economic challenges.

4. Analysis

a. Methodology: The Synthetic Control Method

This study employs the synthetic control method (SCM) to analyze the impact of the October 7th, 2023 conflict on Israel's real estate market. Developed by Abadie and Gardeazabal (2003) and further refined by Abadie, Diamond, and Hainmueller (2010, 2014), SCM is a statistical technique used to evaluate the effects of interventions or events in settings where randomized controlled trials are not feasible.

The key advantage of SCM is its ability to construct a counterfactual "synthetic" version of the treated unit (in this case, Israel) by creating a weighted combination of control units (other countries) that did not experience the intervention. This synthetic control closely resembles the characteristics of the treated unit before the intervention, allowing for a more accurate comparison of outcomes.

We chose the synthetic control method for this research due to several key advantages. SCM allows for a more accurate comparison by creating a synthetic counterpart that closely resembles the treated unit's characteristics before the intervention. This is crucial for isolating the effects of the conflict on Israel's real estate market from other confounding factors. The method assigns weights to control units based on their similarity to the treated unit in the pre-intervention period. This ensures that the synthetic control is a weighted average of control units that best replicate the characteristics of Israel, enhancing the validity of the comparison. SCM can incorporate multiple predictors and outcome variables, making it flexible enough to handle the complexity of real estate market dynamics. Additionally, it provides robustness checks through placebo tests and sensitivity analyses, which help validate the findings.

We use the synthetic control method (Abadie, 2021) to evaluate the impact of military conflict on housing prices in Israel. The Synthetic Control Method constructs a synthetic control group for Israel, comprising a weighted combination of the following countries: Austria, Belgium, Denmark, Finland, Netherlands, Portugal, and Sweden. These countries were selected for their economic and

demographic similarities to Israel but were not directly affected by the same conflicts.

b. Data

Data for the donor countries (all except Israel) in this study were sourced from EUROSTAT (Home - Eurostat, s. d.), covering the period from the start of 2006 to Q2 of 2023. The datasets include:

- **House Price Index (HPI):** Quarterly data representing changes in residential housing prices
- **Gross Domestic Product (GDP):** Quarterly data reflecting Israel's economic performance in real terms.
- **Permits for Dwellings:** Quarterly data on the number of permits issued for new dwellings.
- **Real Interest Rate:** Quarterly data on the real interest rate, adjusted for inflation.
- **Percentage of Population Over 20 Years Old:** Quarterly data on the demographic composition of the population.

Data for Israel were sourced from the Central Bureau of Statistics (הלשכה המרכזית לסטטיסטיקה - cbs.gov.il, s. d.).

c. The Econometric Model

In this study, we construct a synthetic Israel using data from a donor pool of countries that did not experience the October 7th, 2023 conflict. The donor pool includes Austria, Belgium, Denmark, Finland, Netherlands, Portugal, and Sweden. We use key predictors such as GDP per capita, housing permits, long-term interest rates, and population over 20 years old to ensure the synthetic control closely matches Israel's pre-conflict characteristics.

To create an accurate synthetic control, we follow a structured process for selecting appropriate countries and defining the analysis period. Firstly, we select countries with GDP per capita between 30,000-55,000 USD to ensure economic comparability, with Israel at around 42,000 USD. This ensures that the economic characteristics of the donor pool closely match those of Israel. Secondly, we limit the pool to countries with populations between 5-20 million to match the scale of housing markets and demographic pressures in Israel. Thirdly, New Zealand is excluded from the donor pool due to its geographical isolation and unique housing market characteristics that differ significantly from Israel and other European countries in the donor pool. These differences include land availability, urban development patterns, and exposure to different global economic influences, which could potentially skew the synthetic control.

In our analysis, we construct a synthetic Israel using data from a donor pool of countries that did not experience the October 7th conflict. The donor pool includes Austria, Belgium, Denmark, Finland, Netherlands, Portugal, and Sweden. We use key predictors such as GDP per capita, housing permits, long-term interest rates, and population over 20 years old to ensure the synthetic control closely matches Israel's pre-conflict characteristics. The graph below shows the weights assigned to each country in the donor pool.

Notation:

$j = 1, 2, ..., J + 1$: index of the unit (without loss of generality, unit 1 is the treated unit).

$X_1, X_2, ..., X_{J+1}$ - vector (dimension $k \times 1$) of predictors for unit j

t - the time index

T_0 - time of treatment/exposure

Y_{jt}^{N} - the potential response without treatment in unit j at time period t

Y_{1t}^{I} - the potential response of the affected unit (j=1) under treatment.

The goal is to estimate the treatment effect for the treated unit:

$$\tau_{1t} = Y_{1t}^{I} - Y_{1t}^{N}$$

The synthetic control is represented by a $J \times 1$ vector of weights

$$W = (w_2, w_3, ..., w_{j+1})^T.$$

The gist of the SCM is an estimation of unobserved counterfactuals Y_{1t}^{N}; given the weights W, the estimators of Y_{it}^{N} and τ_{1t} are:

$$\hat{Y}_{it}^{N} = \sum_{j=2}^{\hat{J}+1} w_j Y_{jt}$$

$$\hat{\tau}_{1t} = Y_{1t}^{I} - \hat{Y}_{it}^{N}.$$

The numerical inner workings of the SCM (Abadie and Gardeazabal (2003) and Abadie, Diamond, and Hainmueller (2010) comprise choosing the "best" weights $w_2, w_3, ..., w_{J+1}$. The weights are restricted to be nonnegative and to sum to unity;

this avoids extrapolation, making every counterfactual a weighted average of the observed response. The best choice W according to Abadie (2021) is that which minimizes:

$$\left\|X_1 - X_0 W\right\| = \sqrt{\sum_{h=1}^{k} v_h\left(X_{h1} - w_2 X_{h2} - w_3 X_{h3} - \ldots - w_{J+1} X_{hJ+1}\right)}$$

where:

X_0 - a $k \times J$ matrix of the stacked predictor vectors, $X_0 = \left[X_2, X_3, \ldots, X_{J+1}\right]$,

and $V = v_1, v_2, \ldots, v_k$ is a vector of positive constants that reflect the importance of each predictor. The values V are selected by out-of-sample validation, which is described by Abadie (2021) and the references within.

Graph 1: Country's Weights for the Synthetic Control Method

Country	Number	Weight
Sweden	10	7.696669e-01
Portugal	9	2.303313e-01
Belgium	3	1.802748e-06
Austria	2	1.822934e-08
Denmark	5	1.796709e-08
Netherlands	7	1.477894e-08
Finland	6	9.504959e-10
Israel	1	NA

The SCM approach offers several benefits for our study. It provides a data-driven method for selecting comparison units, avoiding arbitrary choices of control countries. It allows for the effect of unobserved factors on the outcome variable to vary over time, unlike difference-in-differences methods that assume parallel trends. It transparently shows the relative contribution of each control unit to the synthetic control, facilitating the interpretation of results. It also enables various robustness checks, such as placebo tests, to validate the findings.

By comparing the real estate market outcomes of Israel with those of the synthetic Israel, we can estimate the causal impact of the ongoing conflict on housing prices, transaction volumes, and market stability. This approach allows us to provide policymakers with evidence-based insights and recommendations to mitigate the adverse effects of the conflict on the real estate sector.

Beginning the analysis from 2006, just before the Second Lebanon War, is a valid approach. This aligns with the practice described in the Horiuchi and Mayerson (2015) paper on synthetic Israel, where they argue for selecting an appropriate pre-treatment period. Starting in 2006 allows us to capture a more recent and relevant period of Israel's housing market dynamics, avoid potential structural changes in earlier periods that might affect comparability, and ensure a better fit for the pre-treatment period, which is crucial for the validity of the synthetic control.

Our multi-step filtering process (GDP per capita, then population, then qualitative considerations) is a thorough approach to creating a suitable donor pool. This method helps ensure that the countries used to construct the synthetic control are as similar as possible to Israel in key economic and demographic characteristics.

d. Key Findings and Analysis

The results of our synthetic control method (SCM) analysis provide valuable insights into the impact of the October 7th, 2023 conflict on Israel's housing price index (HPI). The graph compares the actual HPI for Israel with the synthetic HPI, representing the counterfactual scenario where the conflict did not occur. Several key observations and interpretations arise from this analysis. The synthetic HPI closely tracks the actual HPI for Israel from 2006 until the start of 2022. This indicates that the synthetic control method successfully created a valid counterfactual by accurately replicating the pre-intervention trends in Israel's housing market. The close alignment between the actual and synthetic HPI during this period suggests that the selected donor pool countries (Austria, Belgium, Denmark, Finland, Netherlands, Portugal, and Sweden) and the chosen predictors (GDP per capita, housing permits, long-term interest rates, and population over 20 years old) were appropriate for constructing the synthetic control.

The actual and synthetic HPI intersect at the beginning of 2022. This intersection can be attributed to the global impact of the COVID-19 pandemic, which caused a general slowdown in construction activities, reducing housing supply and subsequently driving up prices. The effects of the pandemic likely caught up with the market by 2022, causing the actual HPI to align with the synthetic HPI temporarily. Following this period, the actual HPI continues to rise sharply, reflecting the pent-up demand and reduced supply due to the pandemic. However, the synthetic HPI shows a more moderated increase, suggesting that in the absence of the conflict, the market would have experienced a more stable growth trajectory.

Following the onset of the conflict in October 2023, a noticeable divergence emerges between the actual HPI and the synthetic HPI. The actual HPI shows a sharp decline starting in the fourth quarter of 2023, while the synthetic HPI continues to follow the pre-intervention trend. This divergence highlights the significant negative impact of the conflict on Israel's housing market. By the end of the observation period, the actual HPI is substantially lower than the synthetic HPI, indicating that the conflict has led to a marked decrease in housing prices.

The divergence between the actual and synthetic HPI post-October 2023 provides strong evidence that the conflict has had a detrimental effect on Israel's housing market. The decline in the actual HPI suggests that the conflict has led to reduced demand for housing, possibly due to increased uncertainty, security concerns, and economic disruptions. The sudden drop in demand is likely a result of the immediate economic and psychological impacts of the conflict, leading to a sharp price decline. The intersection of the actual and synthetic HPI in early 2022 can be explained by the global impact of the COVID-19 pandemic. The pandemic caused a slowdown in construction activities, reducing the supply of new housing units. This reduction in supply, coupled with sustained demand, drove up housing prices, which only caught up by 2022. The pandemic's effects created a temporary alignment between the actual and synthetic HPI.

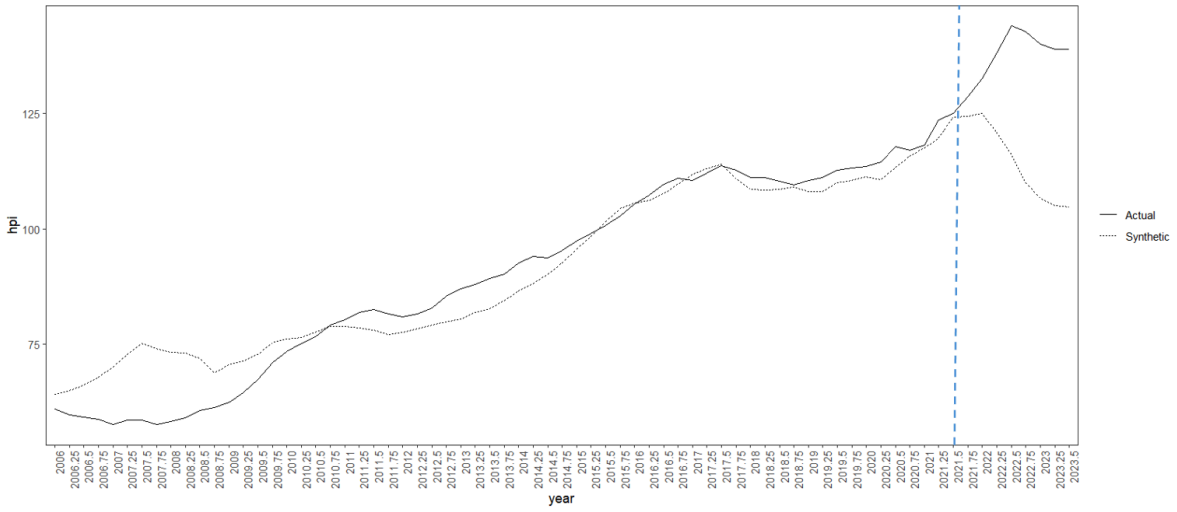
The period of divergence starting in Q2 2021 can be linked to Operation Guardian of the Walls, which began at the end of Q2 2021. This conflict, along with Operation Breakwater (Q1 2022 – Q3 2023), and the subsequent opening of the Iron Swords war, contributed to market instability. These events likely exacerbated the decline in housing demand and prices, as they introduced additional uncertainty and economic strain.

e. Policy Recommendations

Based on the findings of this study, the following policy recommendations are proposed to stabilize and support Israel's housing market in the wake of the conflict: Implement policies to phase out the employment of Palestinian workers in Israel. This measure aims to reduce dependency on a volatile labor source and enhance national security. The government should provide support for Israeli workers to fill these roles, including training programs and incentives. Implement financial assistance programs for homeowners affected by the conflict, including mortgage relief and property tax deferrals. These measures can help stabilize the housing market by reducing financial strain on homeowners. Introduce incentives for investment in the housing sector, such as tax breaks for developers and subsidies for

construction projects, to stimulate housing supply. This can help address supply constraints and support market stability. Invest in security infrastructure to mitigate the risks associated with future conflicts, thereby boosting consumer confidence and stabilizing the housing market. Enhanced security measures can reduce the perceived risk of investing in real estate. Expand affordable housing programs to ensure that low- and middle-income families have access to safe and affordable housing options. This can help address affordability issues and support overall market stability. Develop insurance schemes to protect homeowners and investors from financial losses due to geopolitical instability, thereby reducing the perceived risk of investing in the housing market. Insurance can provide a safety net and enhance market resilience. By implementing these recommendations, policymakers can help stabilize the housing market, support affected homeowners, and enhance the resilience of Israel's real estate sector in the face of ongoing and future conflicts.

Graph 2： Comparing Israel and synthetic Israel



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