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Indonesian Capital Market Reaction to Geopolitical Risk: An Event Study of the Iran–United States–Israel Conflict and its Impact on the Indonesia Composite Index (IHSG)

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ABSTRACT

The Iran–United States–Israel conflict in 2026 created global geopolitical uncertainty that potentially affected financial markets, including the Indonesian capital market. This study aims to analyze market reactions as proxied by abnormal returns before and after the conflict event. A quantitative approach was employed using an event study method, with paired sample t-test and one sample t-test applied to the Indeks Harga Saham Gabungan data over a period of 5 days before and 5 days after the event. The results indicate that there is no significant difference in abnormal returns before and after the event, and no significant abnormal return around the event date. These findings suggest that the geopolitical conflict did not contain sufficient information to influence investor reactions in the Indonesian capital market. The implications indicate that investors tend not to respond significantly to global geopolitical events that do not directly affect domestic economic conditions, highlighting that fundamental and internal factors play a more dominant role in investment decision-making.

Introduction

Global geopolitical uncertainty is one of the main factors affecting financial market stability and investor behavior. In recent years, the escalation of international conflicts has increased systemic risk in global capital markets. Geopolitical events such as wars and military conflicts can reduce average stock returns by 1% globally and by as much as 2.5% in emerging markets, while major conflicts can reduce returns by up to 5% per month (Global Indonesia Stability Report, 2025). This indicates that capital markets are highly sensitive to non-economic information that has systemic implications.

In 2026, the escalation of the conflict involving Iran, the United States, and Israel became one of the geopolitical events that attracted global attention. The conflict increased economic uncertainty and affected financial market volatility across countries. In the United States stock market, the Dow Jones Index fell by 1.7% in a single day and declined by approximately 10% cumulatively from its peak (market correction). Since the conflict began on February 28, 2026, the Dow had fallen by more than 7% (Reuters, 2026). In Asian countries, sharp declines occurred in several markets, including Japan, where the Nikkei fell by 4.7%; South Korea, where the KOSPI fell by 4.1%; and Australia, where the ASX 200 fell by 1.3% (The Wall Street Journal, 2026). In Indonesia, the Indonesia Composite Index fell by 2.65% in one day (March 2, 2026), while approximately IDR 318 trillion in market capitalization was lost. The IHSG also temporarily declined by 0.94% to 7,097 (IDN Financials, 2026).

As an open economy, Indonesia is not immune to these effects. Movements in the Indonesia

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Composite Index, the main indicator of the Indonesian capital market, tend to be sensitive to global sentiment, including geopolitical conflicts that may affect investor expectations and international capital flows. From a theoretical perspective, this phenomenon can be explained by the Efficient Market Hypothesis, which states that stock prices rapidly and accurately reflect all available information. Thus, new information, including geopolitical conflicts, should be quickly incorporated into stock prices and returns. In addition, Signalling Theory explains that external events such as international conflicts may serve as negative signals to investors, increasing perceived risk and prompting changes in investment decisions.

Several previous studies have examined the effects of geopolitical conflicts on stock markets in various event contexts. Jung et al. (2021) analyzed the effects of global geopolitical tensions, including the Russia–Ukraine conflict and conflicts in the Middle East, and found that increased geopolitical risk significantly reduced stock returns, particularly in countries with high levels of uncertainty. Similarly, Adeleke (2023), focusing on geopolitical tensions in East Asia, including the North Korea–South Korea conflict, found a negative relationship between geopolitical risk and stock returns, whereby higher geopolitical risk led to weaker stock market performance.

Zhang et al. (2024) examined the effects of the trade war between the United States and China and global geopolitical tensions on firm performance and found that firms with high exposure to geopolitical risk tended to have lower stock returns than firms with lower exposure. In addition, Ma et al. (2022), using the Global Geopolitical Risk Index, found that events such as conflicts in the Middle East and tensions between Russia and the West have predictive power for stock returns, particularly during periods of high economic uncertainty.

In emerging markets, Fianto et al. (2025) examined the impact of the Russia–Ukraine conflict on the Indonesian Islamic stock market and found that geopolitical risk significantly affected domestic stock return dynamics. Meanwhile, Agustin et al. (2025), also examining the Russia–Ukraine war, found that geopolitical conflict significantly increased stock market volatility in Indonesia.

Furthermore, Behera (2024) examined the impact of Middle Eastern conflicts and global oil price fluctuations arising from geopolitical tensions on stock markets and found that the combination of geopolitical risk and oil prices significantly affected stock returns, particularly in the energy sector. Other research also indicates that the escalation of military conflict (actual war) has a greater impact than merely the threat of conflict on stock market volatility (Caldara & Iacoviello, 2022).

Although numerous studies have examined the impact of geopolitical conflicts on stock markets, most have focused on major conflicts such as Russia–Ukraine or the United States–China trade war and have adopted a long-term macroeconomic perspective. Research specifically examining the short-term reaction of the Indonesian capital market to recent geopolitical conflict in the Middle East, particularly the 2026 Iran–United States–Israel conflict, remains limited. In addition, the use of an event study approach to directly measure market reactions through abnormal returns at an aggregate index level, such as the IHSG, is still relatively uncommon.

Based on this phenomenon and research gap, this study aims to analyze the reaction of the Indonesian capital market to the Iran–United States–Israel conflict using an event study approach. Investor responses are measured through abnormal returns and cumulative abnormal returns on the Indonesia Composite Index around the event date. This study is expected to provide empirical contributions to the literature on the effects of geopolitical conflict on capital markets in emerging economies and practical implications for investors in dealing with global uncertainty.

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Literature Review

Efficient Market Hypothesis

The Efficient Market Hypothesis states that stock prices reflect all information available in the market rapidly and accurately. The theory was first developed by Eugene F. Fama, who classified market efficiency into three forms: weak-form, semi-strong-form, and strong-form efficiency (Fama, 1970). Under semi-strong-form efficiency, stock prices immediately adjust to public information such as financial statements, government policies, and geopolitical events. Therefore, if an event contains relevant information, it will be reflected in changes in stock prices through abnormal returns (Fama, 1970).

Geopolitical risk, as measured by the geopolitical risk index, has a significant impact on global stock markets, indicating that markets respond rapidly to geopolitical information (Caldara & Iacoviello, 2022). This supports the assumption that capital markets respond efficiently to external information.

Signalling Theory

Signalling Theory explains that information received by investors is interpreted as a signal in the investment decision-making process. The theory was developed by Michael Spence, who argued that an informed party (the signal sender) provides signals to another party to reduce information asymmetry (Spence, 1973). In the capital market context, external events such as geopolitical conflicts may serve as negative signals that increase investors' risk perceptions. Such signals encourage investors to adjust their investment portfolios, which is reflected in changes in stock prices and returns.

Increased geopolitical risk resulting from international conflicts provides a negative signal to investors and consequently reduces stock returns (Jung et al., 2021). Geopolitical tensions increase market uncertainty and trigger declines in stock prices as investors respond in a risk-averse manner (Adeleke, 2023).

Stocks

Stocks are financial instruments representing ownership in a company. Stock prices reflect firm value and are influenced by various internal and external factors. According to Brigham and Houston (2019), stock prices are affected by macroeconomic conditions, interest rates, and global factors such as geopolitical conflicts.

In Indonesia, aggregate stock market performance is measured using the Indonesia Composite Index (IHSG). The IHSG reflects the movements of all stocks listed on the Indonesia Stock Exchange and serves as a major indicator of national capital market conditions. The IHSG and other Indonesian stock indices are highly sensitive to global geopolitical risk, particularly the Russia–Ukraine conflict, which has affected domestic stock returns. This demonstrates the integration of the Indonesian capital market with global dynamics (Fianto, 2025).

Stock Returns

Stock return is the rate of gain earned by an investor from an investment. Return can be calculated based on changes in stock prices over a given period. According to Ross et al. (2019), stock return is a key indicator for measuring investment performance. In event study research, the concept of abnormal return is used, defined as the difference between actual return and expected return.

Abnormal return reflects the market reaction to an event containing new information. According to MacKinlay (1997), abnormal return can be used to determine whether an event contains information content. If abnormal return is statistically significant, the event is considered to have influenced investor decisions. Geopolitical risk has a significant effect on abnormal returns, particularly during periods of high uncertainty (Ma, 2022). Exposure to geopolitical risk causes a decline in abnormal returns among firms directly affected by global conflicts (Zhang, 2024).

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Difference in IHSG Abnormal Returns Before and After the Iran–United States–Israel Conflict

Abnormal return is the difference between the actual return obtained by investors and the expected return under normal market conditions (MacKinlay, 1997). Abnormal return is used as an indicator to measure market reactions to an event containing information. If an event has information content, the market will respond through changes in abnormal returns around the event date. In the capital market context, the Efficient Market Hypothesis explains that stock prices rapidly adjust to available information (Fama, 1970). Thus, when an important event such as a geopolitical conflict occurs, the information should be immediately incorporated into investor responses and reflected in changes in stock returns. In addition, Signalling Theory states that external information can serve as a signal for investors when making investment decisions (Spence, 1973). Geopolitical conflict tends to be perceived as a negative signal because it increases uncertainty and investment risk.

The Iran–United States–Israel conflict in 2026 was one of the geopolitical events with the potential to significantly affect global financial markets. The conflict triggered economic uncertainty, higher global oil prices, and concerns about global economic stability. These conditions encouraged investors to adopt a more cautious, risk-averse stance, potentially triggering selling pressure in stock markets. Increased selling pressure can reduce stock prices and affect market returns, including the Indonesia Composite Index as an indicator of the Indonesian capital market.

Previous studies consistently show that geopolitical conflicts have negative effects on stock markets. Jung (2021) and Adeleke (2023) found that increased geopolitical risk reduced stock returns and increased market volatility. Zhang (2024) and Ma (2022) also showed that geopolitical risk affects stock returns, either directly or as a predictor. In Indonesia, Fianto (2025) and Agustin (2025) demonstrated that the Russia–Ukraine conflict significantly affected domestic stock market returns and volatility. Based on this evidence, the Iran–United States–Israel conflict may be perceived by investors as a negative signal because it increases global uncertainty and investment risk. This condition may encourage investors to adjust their portfolios through stock selling, thereby affecting market returns. Accordingly, the conflict is expected to generate differences in abnormal returns before and after the event.

H1: There is a difference in the abnormal returns of the Indonesia Composite Index before and after the Iran–United States–Israel conflict.

Significance of Abnormal Returns Around the Iran–United States–Israel Conflict

Abnormal return reflects the information content of an event to which the market responds (MacKinlay, 1997). Within the Efficient Market Hypothesis framework, if an event contains relevant information, the market will respond rapidly, as reflected in significant abnormal returns around the event date (Fama, 1970). Geopolitical events such as wars or military escalations are generally perceived as negative information that increases economic uncertainty and investment risk. Based on Signalling Theory, such conditions become negative signals for investors, encouraging market reactions in the form of changes in stock returns (Spence, 1973).

Previous studies indicate that geopolitical events can generate significant abnormal returns. Jung (2021) and Adeleke (2023) found that increased geopolitical risk triggered significant market reactions in stock returns. Zhang (2024) and Ma (2022) also demonstrated that geopolitical risk affects abnormal returns, particularly during periods of high uncertainty. In the Indonesian context, Fianto (2025) and Agustin (2025) found that global conflicts significantly affected domestic stock market dynamics.

Based on the discussion above, the Iran–United States–Israel conflict is expected to contain relevant information for investors and consequently generate significant abnormal returns around the event date.

H2: There are significant abnormal returns around the Iran–United States–Israel conflict in the Indonesia Composite Index.

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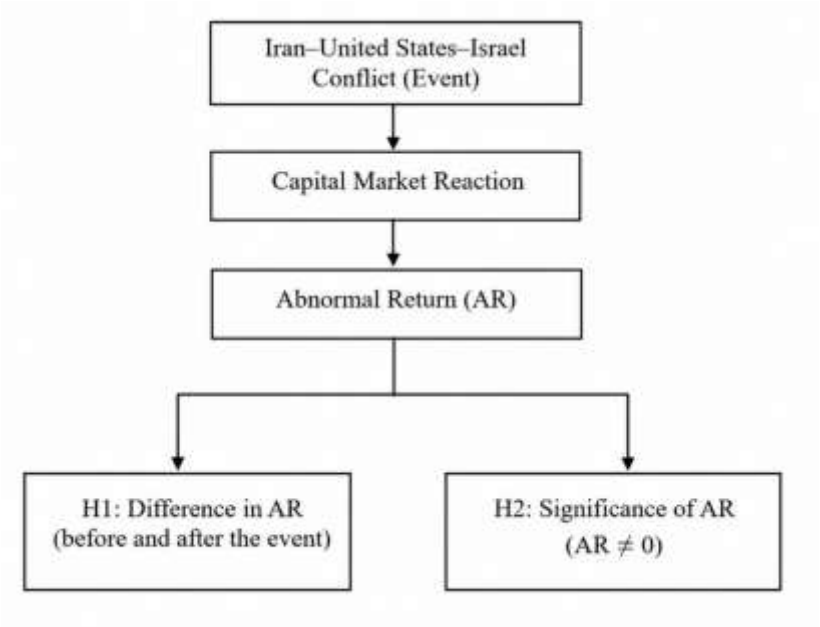

Figure 1. Research Model

Research Method

This study is a quantitative study. It employs an event study method to analyze market reactions to a particular event. It also constitutes comparative research by comparing abnormal returns before and after the Iran–United States–Israel conflict.

The object of this study is the Indonesia Composite Index as the primary indicator of Indonesian capital market performance. The population consists of all IHSG index price data traded on the Indonesia Stock Exchange (IDX). The sample consists of daily IHSG data during the observation period, namely five trading days before and five trading days after the Iran–United States–Israel conflict. In addition, an estimation period of 30 days before the event window was used to calculate expected returns.

The event date was set at February 28, 2026, when the Iran–United States–Israel conflict escalated. However, because that date was not a trading day on the Indonesia Stock Exchange, the nearest subsequent trading day was used as the event date, namely March 2, 2026. The observation period consisted of five days before (t−5 to t−1) and five days after the event (t+1 to t+5). This period was selected to identify the immediate market reaction to the geopolitical conflict. The data are quantitative secondary data obtained from Yahoo Finance (www.finance.yahoo.com).

IHSG Return

IHSG return is the rate of gain resulting from changes in the index price over time (Ross et al., 2019).

$$\mathrm{Rt} = \frac{\mathrm{IHSG}_t \ - \ \mathrm{IHSG}_{t-1}}{\mathrm{IHSG}_{t-1}}$$

Expected Return

Expected return is the average return during the estimation period, used as a proxy for normal return (Brown & Warner, 1985).

$$E(R_t) = \bar{R}$$

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Abnormal Return (AR)

Abnormal return is the difference between actual return and expected return and is used to measure market reactions to an event (MacKinlay, 1997).

$$AR_t = R_t - E(R_t)$$

Cumulative Abnormal Return (CAR)

Cumulative abnormal return (CAR) is the sum of abnormal returns over the event window and is used to observe the cumulative market reaction (Kothari & Warner, 2007).

$$CAR = \sum AR_t$$

Data Analysis Techniques

Descriptive Statistical Analysis

This analysis aims to determine the mean stock price and average trading volume, the highest and lowest stock prices, the highest and lowest trading volumes, and the standard deviations of stock prices and trading volumes during the research period.

Normality Test

The normality test is used to determine whether the stock price and trading volume data are normally distributed. In this study, the Kolmogorov–Smirnov test is used for the normality test.

Hypothesis Testing

Hypothesis testing is conducted using a paired-samples t-test to examine differences in abnormal returns before and after the event (Hypothesis 1), namely t−5 to t−1 before the event and t+1 to t+5 after the event. A significance level below 0.05 indicates a significant difference.

A one-sample t-test is conducted to examine the significance of abnormal returns around the event (Hypothesis 2):

$$AR \neq 0$$

If the significance level is below 0.05, the abnormal return is considered significant.

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Results

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
AR	10	-0,023583	0,041598	0,00509820	0,021035089

Source: Processed secondary data, 2026.

Based on the calculation of abnormal returns (AR) for the Indonesia Composite Index during the event window (t−5 to t+5), the mean abnormal return was 0.00509820, with a minimum value of −0.023583 and a maximum value of 0.041598. The positive mean indicates that, in general, the market responded positively to the Iran–United States–Israel conflict.

Table 2. Normality Test

	Periode	Shapiro-Wilk Sig.
AR	AR before the event (t−5 to t−1)	0,470
	AR after the event (t+1 to t+5)	0,848

Source: Processed secondary data, 2026.

Table 2 presents the results of the data normality test using the Shapiro–Wilk test. The normality test results show that the significance values for abnormal returns before and after the geopolitical event are both greater than 0.05. These results indicate that the data are normally distributed.

Table 3. Paired-Samples t-Test

		Paired Differences							
					95% Confidence Interval of the Difference				
		Mean	Std. Deviation	Std. Error Mean	Lower	Upper	T	df	Sig. (2-tailed)
Pair 1	AR_before – AR_after	,004038800	,032023536	,014321361	-,035723672	,043801272	,282	4	,792

Source: Processed secondary data, 2026.

The significance value is 0.792 < 0.05, indicating that there is no significant difference in abnormal returns between the periods before and after the geopolitical conflict, and therefore H1 is rejected.

Tabel 4. One Sample T Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
AR	,766	9	,463	,005098200	-,00994940	,02014580

Source: Processed secondary data, 2026.

The significance value is 0.463 < 0.05, indicating that there is no significant abnormal return between the periods before and after the geopolitical conflict, and therefore H2 is rejected.

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Discussion

The results show that there is no significant abnormal return around the Iran–United States–Israel conflict and no significant difference in abnormal returns before and after the event in the Indonesia Composite Index. This indicates that the Indonesian capital market did not respond significantly to the geopolitical conflict. The absence of significant abnormal returns suggests that the Iran–United States–Israel conflict did not contain sufficient information content to influence investment decisions among investors in the Indonesian capital market. In other words, information concerning the conflict was not significantly incorporated into market participants' responses.

From the perspective of the Efficient Market Hypothesis, these findings can be interpreted as indicating that the market reacts only to information that is relevant and has a direct impact on economic conditions or firm performance. The absence of significant abnormal returns suggests that the geopolitical conflict was not considered sufficiently relevant information by domestic investors and therefore was not reflected in changes in stock prices. In addition, based on Signalling Theory, a conflict event is not necessarily interpreted as a negative signal by investors. In this context, the Iran–United States–Israel conflict may not have been perceived as a signal with a direct impact on the performance of Indonesian firms and therefore did not trigger significant changes in investment behavior.

The findings can also be explained by the phenomenon of market anticipation or information being priced in, whereby information concerning the geopolitical conflict had already been anticipated by investors. Consequently, when the event occurred, the market no longer reacted significantly because the information had already been incorporated into stock prices. In addition, the insignificant result also suggests that investors in the Indonesian capital market tend to place greater emphasis on domestic factors than on external factors. Variables such as national economic conditions, government policies, interest rates, and firm performance may have a more dominant influence on market movements than global geopolitical conflicts.

These findings are consistent with Jung (2021) and Adeleke (2023), who showed that the effects of geopolitical risk on stock markets are not always significant and depend on the relevance and proximity of the effects to a country's economy. Fianto (2025) and Agustin (2025) also showed that although geopolitical conflicts can affect markets, their short-term effects are not always significant, particularly when they do not directly affect domestic economic fundamentals.

Thus, the findings imply that the Indonesian capital market is relatively stable and is not easily affected by global geopolitical events that do not have a direct impact on the national economy. Investors tend to behave rationally and do not overreact to external information that is not directly relevant.

Conclusion

This study aims to analyze the reaction of the Indonesian capital market to the Iran–United States–Israel conflict using an event study approach. Based on the empirical tests, there is no difference in abnormal returns before and after the event, and there is no significant abnormal return around the event date in the Indonesia Composite Index.

These results indicate that the Iran–United States–Israel conflict did not contain sufficient information to influence investor reactions in the Indonesian capital market. Therefore, the market did not respond significantly to the event, either in the short term or over the broader observation period.

Future research is recommended to:

1. Use more specific research objects, such as particular industry sectors or individual stocks that are more sensitive to global conditions.
2. Use different event windows to compare short-term and long-term market reactions.
3. Add other variables, such as trading volume or volatility, to enrich the analysis of market reactions.

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