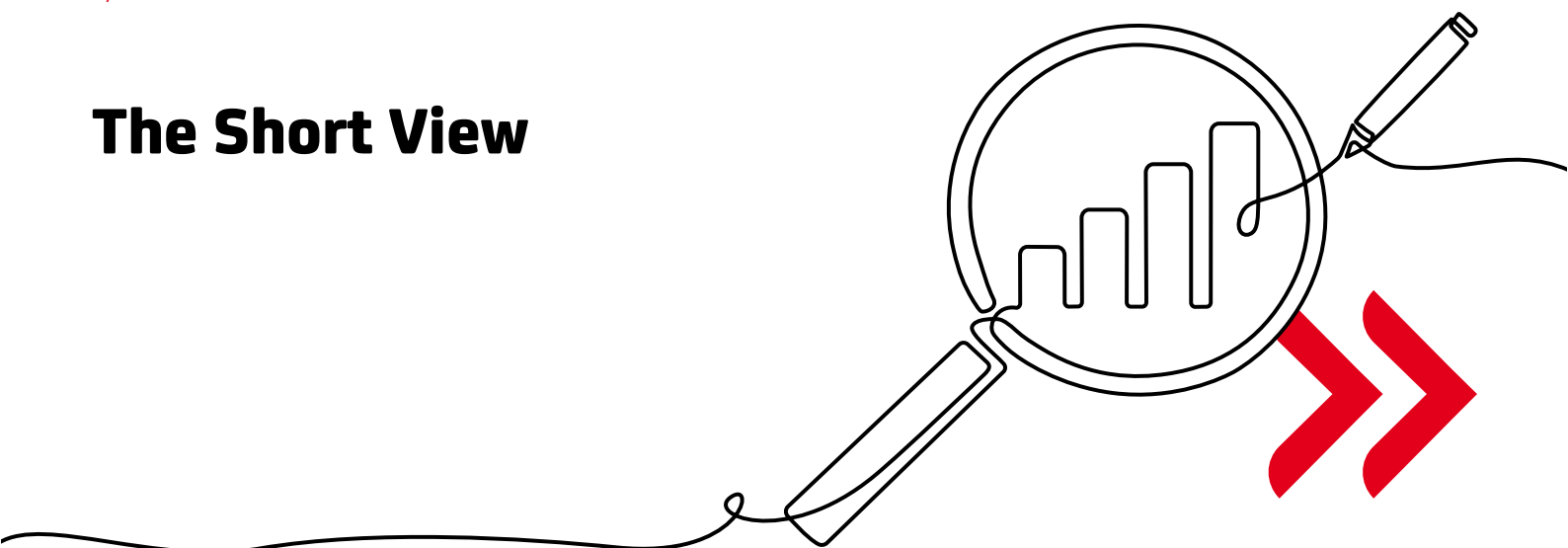


# The Short View



*The Short View offers insights on key macro and market stories.*

## Bulgaria's euro adoption: the next stage of convergence will be harder

08 July 2025

Today, the Ecofin gave Sofia green light to join the eurozone in 2026. This is an important milestone for Bulgaria, but euro adoption alone will not guarantee convergence of its standards of living towards those of its eurozone peers. Sustained structural reforms are still needed. The positive experience of the Baltics serves as a good example in this respect.

1. Since joining the EU in 2007, Bulgaria has achieved a remarkable convergence of living standards towards the levels prevailing in the more advanced economies. Nevertheless, there is no room for complacency, as the next stage of the convergence process will not happen by default.
2. Neither eurozone nor EU membership can act as an autopilot to help achieve strong, sustainable and inclusive standards of living.
3. Continuous and relentless efforts are needed to improve the quality of institutions and boost productivity, while pursuing a prudent fiscal policy.

## Eurozone membership will bring tangible benefits

Eurozone membership will reduce Bulgaria's transaction costs, including FX risk-management costs. This is because instead of two currencies – the lev (the national currency) and the euro (the reserve currency), which under the requirements of the currency board arrangement are competing to fulfil the functions of money in the Bulgarian economy – only one currency will remain, the euro.

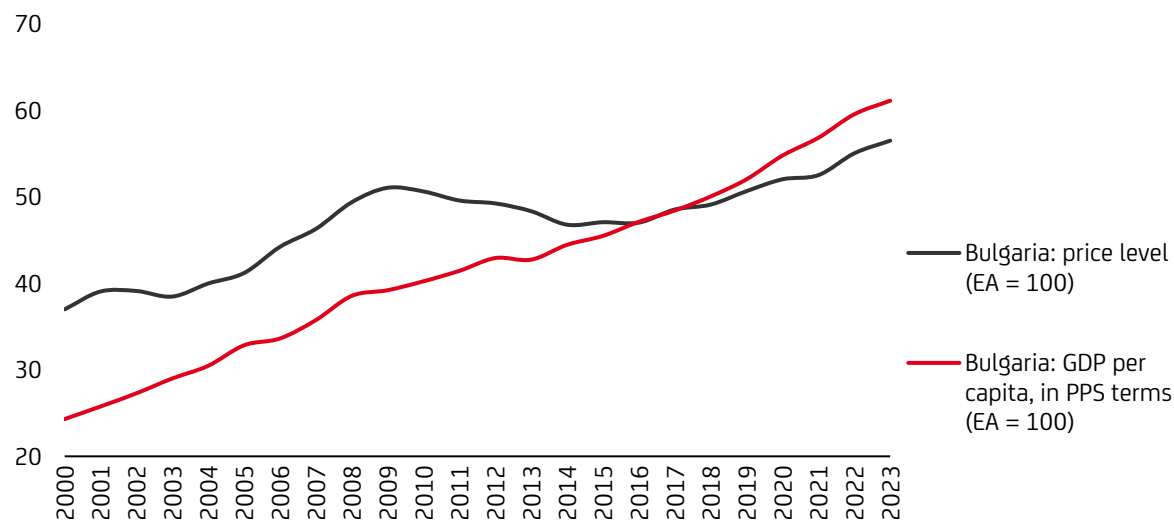
The resilience of the economy will improve in many ways. First, the risks from volatile capital flows, which typically affect small and open economies like Bulgaria, will diminish. This is important because capital flows are inherently unstable, and Bulgaria could become vulnerable to shocks the next time when the global economy is in troubles. In addition, eurozone membership will strengthen the independence of the central bank, which will contribute to the stability of the financial system, including by reducing the risk of unsustainable monetary expansion that could lead to asset-price bubbles and spikes in inflationary pressure.

## Progress so far

Bulgaria has achieved an impressive convergence towards the standards of living in the more advanced economies since the country joined the EU in 2007. Bulgaria's GDP per capita rose from about 34% of the eurozone average in 2006 to 61% in 2023. At the same time, Bulgaria's aggregate price level grew from around 44% of the eurozone average in 2006 to 56% in 2023 (Chart 1). Over the past seventeen years, GDP per capita in Bulgaria has grown by an average of 3.4% per year, considerably outpacing the eurozone's average of 0.7%. Similarly, prices in Bulgaria have risen by 3.5% per year, whereas the eurozone has posted an average price increase of 2.1% accordingly.

### CHART 1: BULGARIA'S INCOME AND PRICE LEVELS ARE FAR FROM THOSE IN THE EUROZONE

PRICE LEVEL INDICES AND GDP PER CAPITA, IN PPS (EA = 100)



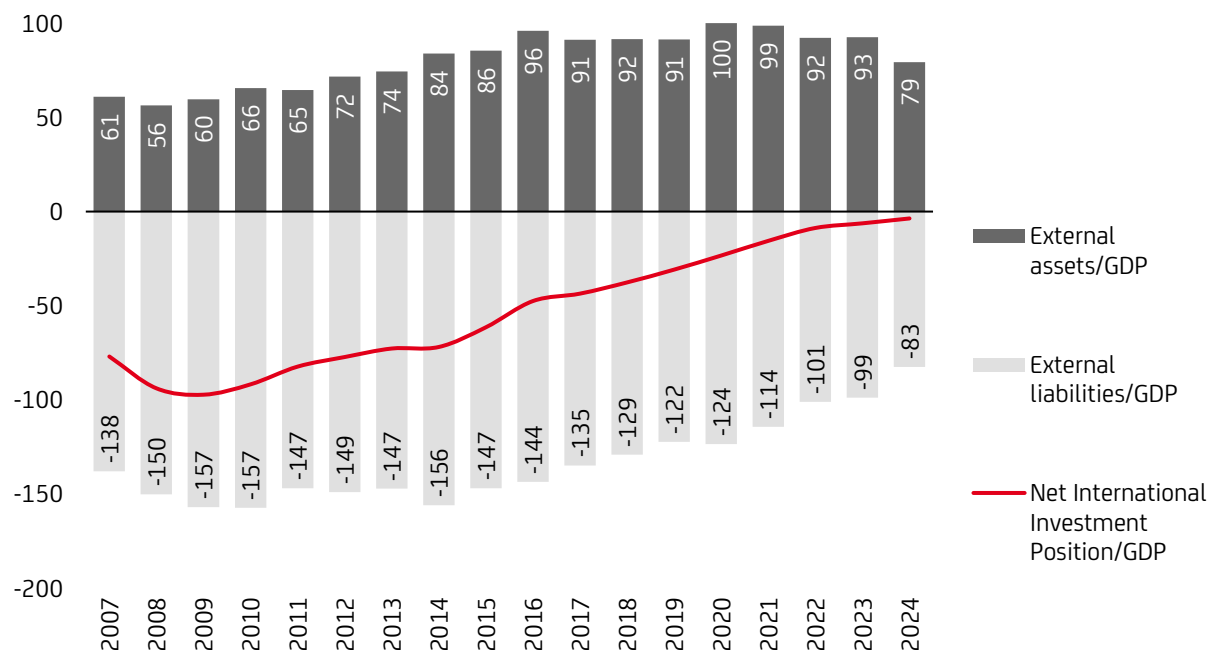
Source: Eurostat, The Investment Institute by UniCredit

The remarkable progress in bringing Bulgaria's income and price levels closer to the eurozone average took place under a fixed-exchange-rate regime and without the economy losing competitiveness. Perhaps the best evidence that competitiveness has improved is the remarkable transformation of the country's current account balance, which went from an unsustainable shortfall equivalent to a whopping 24% of GDP in 2007 to a small and manageable deficit of just 1.8% of GDP in 2024. As a result, Bulgaria's net international investment position (NIIP), which represents the balance between the country's stock of external financial assets and liabilities, improved from a massive shortfall equal to 77.0% of GDP in 2007 to a small deficit of only 3.7% of GDP in 2024 (Chart 2).

This impressive performance is primarily attributable to the country's solid progress in implementing the structural reforms aimed at improving the quality of its institutions. These reforms, in turn, increased competitiveness, thereby more than compensating for the loss of competitiveness stemming from the alignment of income and price levels in Bulgaria with the aggregate levels prevailing in the eurozone economies.

## CHART 2: PRESERVING COMPETITIVENESS

EXTERNAL FINANCIAL ASSETS AND LIABILITIES AND NIIP (%)



Source: Bulgarian National Bank, The Investment Institute by UniCredit

## Not enough

There is no room for complacency, however, as the next stage of the convergence process will likely be harder. Since full alignment has not yet been achieved, we expect both income and price levels to continue to grow at a faster pace compared to those in the eurozone. For example, if eurozone prices were to increase by 2% annually during the next decade, it would not be surprising if prices rose by 2.5-3% in Bulgaria at the same time.

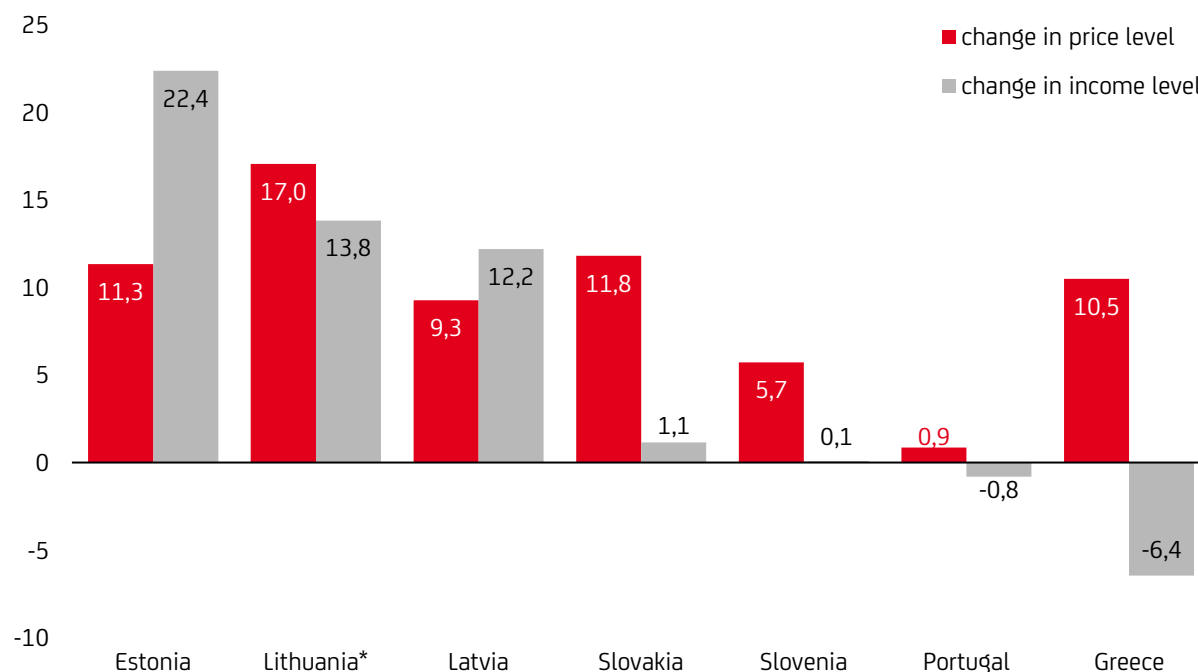
At 2.5-3% per year, inflation does not look worrisome. In fact, inflation of 3% can be better for the economy than 2%, as slightly higher inflation allows for the acceleration of resource reallocation. When inflation is higher, the difference in relative prices is larger, increasing the likelihood of investors withdrawing resources (capital and labour) from underperforming sectors and channelling them to sectors with an improving outlook. In other words, slightly higher inflation will make the Bulgarian economy more dynamic and will help to accelerate investment growth, because stimulus to speed up country's reallocation of resources will increase.

What matters more for Bulgarian households, however, is what happens to the purchasing power of their income – namely whether it is increasing, and, if so, how the rise in the purchasing power of the country's incomes compares with that in other eurozone economies. If Bulgarian incomes grow faster than inflation, while, at the same time, catching up with those in the more advanced eurozone countries, there is no cause for concern.

Such a positive scenario is not guaranteed but empirical data suggest that this would be the most likely outcome. Chart 3 shows the degree of convergence achieved in the first decade after eurozone entry for seven countries, which, similarly to Bulgaria, exhibited large initial gaps in income and prices when compared to those in the eurozone.

### CHART 3: FOLLOW THE BALTIC EXPERIENCE

CHANGE DURING THE FIRST TEN YEARS AFTER EUROZONE ENTRY (EA = 100)



Source: Eurostat, The Investment Institute by UniCredit

Note: \*Lithuania - change during the first nine years after eurozone entry.

The performance of individual countries seems to be driven by several factors. The starting point of the income and price gap matters, as countries that joined the eurozone with larger initial gaps have achieved stronger progress in terms of convergence in the first decade of their eurozone membership. The performance of Greece, Slovenia and Slovakia was more severely affected by the shocks triggered by the global financial crisis than those in the Baltic countries, which joined at a time when the global downturn was pretty much over. Most importantly, countries' performance was driven by their progress in implementing the structural reforms to improve the quality of their institutions. The countries leading in the implementation of reforms experienced the most significant improvements in competitiveness and were thus able to fully compensate for the loss of competitiveness resulting from the alignment of incomes and prices with the aggregate levels prevailing in the eurozone. The countries' performance was therefore mostly driven by their own progress in implementing the above-mentioned structural reforms.

During the transition from centrally planned to a market-based economy, Bulgaria successfully implemented a long list of reforms. Initially, the reforms were focused on creating the institutional and legal framework necessary for the free market to operate, and were accompanied by macroeconomic stabilization policies, which were aimed at minimizing social costs and smoothening the transition process. Later, the focus shifted on the deepening and consolidating the reforms necessary to build a fully functioning, efficient, and competitive market economy.

The reforms that lie ahead tend to be harder to implement. These reforms not only focus on fixing past problems, but also on preparing the Bulgarian economy for future challenges. They include structural measures aimed at ensuring long-term sustainability and fulfilling global climate commitments, helping labor market adopt to changing technology and demographics, promoting innovations and knowledge-based economy, while deepening citizen trust in institutions and markets. These reforms, sometimes referred to as third generation reforms, require adaptive governance and continuous improvement, which make them more complex, nuanced, and longer term oriented.

## Structural reforms will continue to shape the economy's performance

First and foremost, eurozone membership does not remove Bulgaria's obligation to continue to pursue a prudent fiscal policy. Maintaining lower levels of debt and deficit in country's public finances compared with the eurozone average must continue, especially given the unfavourable demographic trend in Bulgaria, where the pace of ageing and the decline in the population are among the most worrisome in Europe.

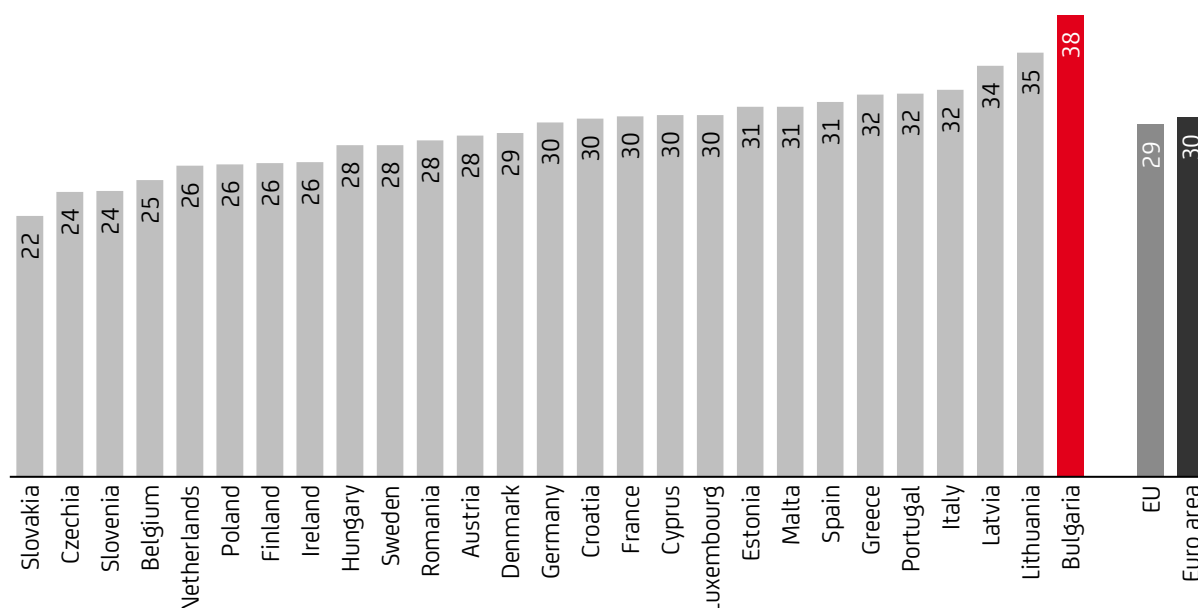
Containing inflationary pressure with appropriate structural policies is also key. To this end, Bulgaria needs to strengthen national policies aimed at enhancing competition in product markets and take decisive steps to build up the administrative capacity needed to reduce money laundering and tax evasion to more tolerable levels.

Furthermore, it would be essential for Bulgaria to press ahead with the modernization of its infrastructure and education sectors, which are crucial to boosting productivity. In addition, structural reforms to reduce corruption are of key importance to attract more investment. Bulgaria has already done a lot to cutback corruption, but more is needed to prevent cases where defendants with money and connections are able to escape justice.

It is key that there are not too many households who feel left behind and fail to benefit from the convergence process. This is particularly important for Bulgaria, where income inequalities (Chart 4) and the share of people at risk of poverty and social exclusion have remained elevated. Reinvigorating such policies will be crucial for the way the eurozone membership will be perceived and evaluated by the Bulgarian citizens in the decades to come.

### CHART 4: IN 2024, BULGARIA HAD THE MOST ELEVATED INCOME INEQUALITY IN THE EU27

GINI COEFFICIENT IN EU MEMBER STATES



Source: Eurostat, The Investment Institute by UniCredit

Note: The Gini coefficient measures how income is distributed across a population. A Gini coefficient of zero indicates perfect equality where all values are the same (where everyone has the same income). A Gini coefficient of one (or 100%) reflects maximal inequality.

To prosper, any economy needs a stable and credible national currency. The adoption of the euro is an important moment for Bulgarian economy. It will remove some obstacles to trade and investment, while, at the same time, will create the preconditions necessary for the acceleration of some structural measures, particularly those related to the functioning of the financial system and the central bank, but only that. By itself, eurozone membership does not provide an autopilot to achieve convergence of incomes toward the levels prevailing in the more advanced economies. To achieve that relentless efforts are needed to improve the quality of the country's institutions.

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