

THE ENLARGEMENT OF THE EUROZONE – BULGARIA A MEMBER STARTING 2026

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Abstract

Bulgaria joined the European Monetary Union (EMU) on January 1, 2026, following formal approval by the EU Council in July 2025. On the one hand, the adoption of the euro probably represents the most important event in the economic history of Bulgaria, a country confronted with unprecedented transformations in recent decades. On the other hand, the entry into the Eurozone may determine an improvement of macroeconomic performance in the coming years, a scenario supported by the low level of the real interest rates and the low level of the public debt, with a positive impact on the investment climate. In this paper, standard econometric tools are applied, and the databases of the International Monetary Fund (IMF, 2026) and Eurostat (2026) are used to assess the macroeconomic developments during 2000 – 2025 and to identify the main challenges Bulgaria's economy faces in the context of the euro's introduction. The results indicate an upward trend for the annual potential growth in recent quarters (towards the highest level since 2008), an evolution supported by the improvement in gross fixed capital formation. This expresses a better outlook for the economic activity in Bulgaria in the coming years. However, the policymakers should pay attention to the structural component of the budget deficit. Furthermore, the pace of structural reforms should accelerate in the country in order to transform all the opportunities induced by the euro area adoption into more sustainable and inclusive growth in Bulgaria.

Keywords: Bulgaria, Eurozone, structural reforms

JEL Classification: C53, F15, F33, H60

1. Introduction

The adoption of the euro constitutes probably the most important event in the economic history of Bulgaria, a country confronted with unprecedented structural transformation in the past decades, among which we mention: the transition from a state-run to a market economy, accession to the European Union, and the impact and consequences of global shocks (the Great Financial Crisis, the COVID-19 pandemic, and intensifying geopolitical tensions).

On the one hand, this accession represents a natural process for Bulgaria, following the currency board regime (implemented from 1 July 1997 in the context of the 1996–1997 economic crisis) and EU accession (1 January 2007). This exchange-rate regime, in place for 28 years, generated a high degree of macroeconomic stability, as evidenced by developments in the current account and public finances. According to the database of the International Monetary

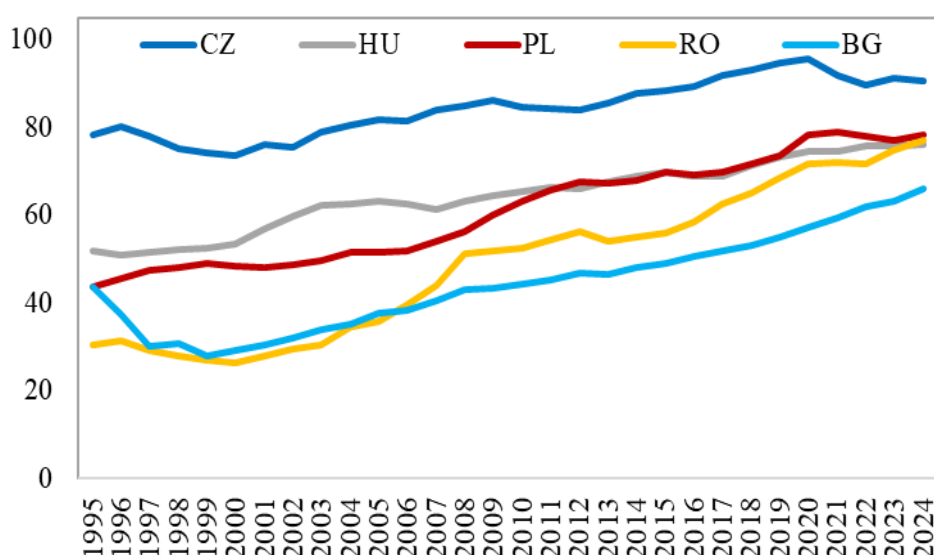
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Fund (IMF, 2026), Bulgaria recorded a budget deficit above the 3% of GDP threshold only in 2010 and 2014.

We emphasize that this exchange-rate regime also made a fundamental contribution to Bulgaria's economic convergence toward the EU average over recent decades. Thus, thanks to the currency board, Bulgaria has been the Central and Eastern European country with the most sustainable European economic convergence in recent decades.

Indeed, over the period 2000–2024, GDP per capita expressed at purchasing power standards, as a percentage of the EU average, increased every year in Bulgaria — except in 2013 (when a decline of only 0.3 percentage points was recorded) — rising from 29% to 65.9%, according to the estimates of Eurostat (2026) represented in the following chart. All the other countries from Central and Eastern Europe, currently members of the European Union, have recorded declines in GDP per capita (at purchasing power standards, as a percentage of the EU average) several times in the past 25 years. For instance, there were six years of decline in the case of Poland (the largest economy in Central and Eastern Europe), three years in Romania (the second largest economy in the CEE region), nine years in Czechia, and four years in Hungary.

Figure 1. GDP per capita (Purchasing Power Standards) (% of the EU average)



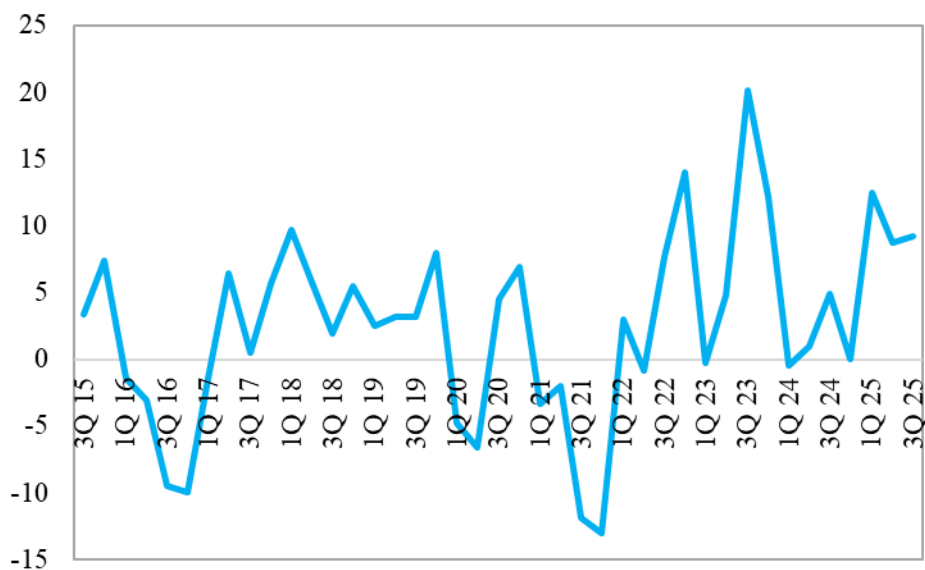
Source: representation of the author based on the statistics of Eurostat (2026).

On the other hand, the entry of Bulgaria into the Eurozone generates opportunities for both Bulgaria and the euro area economy, a point also highlighted by the European Central Bank (ECB, 2026) at the beginning of the year.

The introduction of the euro will positively impact the international companies on the Bulgarian market, a finding confirmed by the increase in foreign direct investment at an annual rate of 11.4%, reaching €3 billion over the period January–November 2025, according to the estimates of the Bulgarian National Bank (BNB, 2026). At the same time, the Bulgarian companies will be able to manage international trade flows more easily, given that the euro is the second most important currency in the international financial system (after the US dollar).

In this respect, we point out the acceleration of the annual pace of the investments before the effective introduction of the euro. According to the estimates of Eurostat (2026), gross fixed capital formation increased for the sixth quarter in a row in 3Q 2025, at an annual rate accelerating to 9.2%, as represented in the following chart. Therefore, during January – September 2025, the gross fixed capital formation advanced at an average annual rate of over 10%. This evolution expresses favourable prospects for the growth pace of the economic activity in the coming years.

Figure 2. Gross fixed capital formation in Bulgaria, annual rate (%)



Source: representation of the author based on the statistics of Eurostat (2026).

In this paper, we apply standard econometric methods in order to assess the macroeconomic developments in Bulgaria during the period 2000 – 2025 with a focus on public finance. The aim of the paper is to identify the main challenges for the economic policy in Bulgaria in the context of the entry into the Eurozone. In this respect, on the one hand, we estimate the annual potential growth rate in Bulgaria by implementing the filter developed by

Hodrick-Prescott (1997) while using quarterly observations for the annual pace of the GDP from Eurostat (2026). On the other hand, we estimate the structural component of the budget deficit in Bulgaria by implementing the method of Balassone and Monacelli (2000).

The rest of the paper has four chapters. The next chapter briefly presents the literature review, while Chapter 3 describes the methodology. The results are analysed and interpreted in Chapter 4, and the main conclusions are underlined in Chapter 5.

2. Literature Review

The entry of Bulgaria into the Eurozone has been intensively analysed by Bulgarian and international institutions and senior experts in recent years.

For instance, the Managing Director of the International Monetary Fund (IMF, 2025) considered the integration of Bulgaria into the Eurozone as a key milestone and emphasized the positive consequences, including the most likely decline in borrowing costs, improvement in sovereign rating, and a significant increase in the number of foreign tourists. On the other hand, Kristalina Georgieva also mentioned the main structural challenges for Bulgaria in the coming years, including the aging of the population, the brain drain, and the intensifying fiscal pressures (given the infrastructure and defense needs).

At the same time, the President of the European Central Bank (ECB, 2025) underlined the advantages of Bulgaria joining the Eurozone, especially in terms of prosperity (through lower financing costs, and better integration in the Single Market), and security (shield from the volatility of international capital flows, and from imported inflation). However, Christine Lagarde also underscored the importance of the continuity of structural reforms in Bulgaria, needed for the transition from convergence to lasting competitiveness and better living standards for all citizens.

Furthermore, the Governor of the Bulgaria National Bank (BNB, 2025) emphasized the historical economic and institutional efforts of Bulgaria and underlined that the entry into the Eurozone increases confidence (real and financial sides of the economy), intensifies integration with the European financial markets, and improves the resilience of the economy.

The main economic advantages of Bulgaria joining the Eurozone were also underlined in the analysis of the World Economic Forum (WEF, 2025): disappearance of the exchange rate risk, price transparency, lower transaction costs, and lower financing costs.

As regards the macroeconomic costs of joining the Eurozone, Todorov (2023) analysed the similarity of the shocks in Bulgaria and the Eurozone during the period 2001 – 2022 by applying standard econometric tools. The results of this analysis indicate a high level of similarity in terms of origin and impulse effect, as Bulgaria has presented a high degree of integration with the

economy of the Eurozone in the past. Therefore, the costs of Bulgaria joining the Eurozone are limited, from this very important perspective developed within the theory of optimal currency areas (OCA).

The main advantages and costs related to the entry of Bulgaria into the Eurozone were previously synthesized by Gechev et al. (2020). In the benefits category, the senior experts from the University of National and World Economy in Sofia also included access to financial support mechanisms and diminishing risks for currency crisis and banking crisis. Among the main costs, the Bulgarian experts also included the one-off costs (including the one-off increase in prices) and the risk of macroeconomic imbalances.

Furthermore, in their analysis based on the comparative analysis between Bulgaria and Lithuania (also from the point of view of the Maastricht criteria), Tikova and Dvorak (2025) underlined the main challenges for Bulgaria adopting the euro, including the higher inflation than in the Eurozone, the low level of the GDP/capita, the high level of income inequality, and the low level of the public support (around 40% of the population).

Last, but not least, from the social point of view, we point out that Bulgaria has been confronted with one of the highest levels of energy poverty among the EU member countries, according to Peneva (2024), who has regularly monitored and analysed the energy poverty in Bulgaria. The Bulgarian senior expert has recently recommended several measures to counter energy poverty in the country, including the implementation of a poverty reduction mechanism before the liberalisation of the electricity market, the targeted mobilisation of EU support funds towards vulnerable households, and the development of an active investment policy for energy efficiency and decarbonisation.

3. Methodology

Standard econometric instruments are applied in this paper to assess the main structural macroeconomic developments in Bulgaria during the period 2000 – 2025.

On the one hand, the filter developed by Hodrick and Prescott (1997) was implemented in order to estimate the trend components for the annual rate of the GDP and its components from the demand side perspective (private consumption, gross fixed capital formation, public consumption, exports, and imports). In this respect, quarterly observations for the annual rate of the GDP and its components from the Eurostat (2026) database were used (unadjusted data).

The Hodrick-Prescott filter represents one of the most applied methods to estimate the structural and the cyclical components of the macroeconomic indicators, expressed in the following relation:

$$\text{Min} \sum_{t=1}^T (\ln Y_t - \ln Y_t^*)^2 + \lambda \sum_{t=2}^{T-1} ((\ln Y_{t+1}^* - \ln Y_t^*) - (\ln Y_t^* - \ln Y_{t-1}^*))^2 \quad (1)$$

In the above relation, Y_t , Y_t^* , and λ are the macroeconomic indicator, its trend component, and a smoothness parameter. As we worked with quarterly data, in this paper, a value of 1,600 for this parameter was considered, as recommended by Hodrick and Prescott (1997).

On the other hand, we estimated the structural component of public finance balance in Bulgaria, by employing the method of Balassone and Monacelli (2000), reflected in the following relation:

$$\text{def}_t = \text{def}_s + \text{def}_c \quad (2)$$

where def_t , def_s , and def_c represent the budget balance, its structural element, and its cyclical component, all expressed as a % of the GDP.

As regards the cyclical component of the budget balance, it was estimated considering the following formula:

$$\text{def}_c = (Y_t - Y_t^*) \times \eta \quad (3)$$

In relation (3) $Y_t - Y_t^*$ is the output gap, while η represents the budgetary elasticity, for which we considered a value of 0.36 in the case of Bulgaria, as estimated by Mourre et al. (2019).

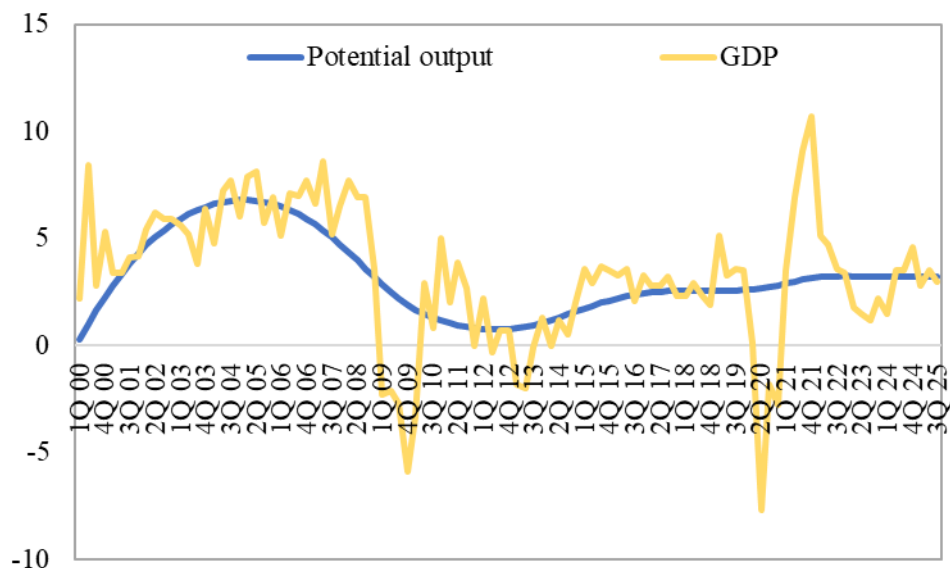
Afterwards, from the total budget balance, we eliminated the cyclical component to estimate the structural component, according to relation (2).

For the total budget balance for Bulgaria (as a % of GDP), we considered the estimates of Eurostat (2026), quarterly data, seasonally and calendar adjusted.

We worked with the econometric software E-Views in this paper.

4. Interpretation of the Results

The econometric estimates indicate the consolidation of the annual rate of the potential output in Bulgaria in recent quarters at the highest level since 2008, the year the economy started to be confronted with the Great Financial Crisis, the worst global economic and financial crisis since the end of World War II. Furthermore, in 2024 and in 2025, the economic activity in Bulgaria recorded an annual growth rate very close to its potential, according to our estimates, as represented in the following figure.

Figure 3. GDP vs. Potential output in Bulgaria (annual rate) (%)

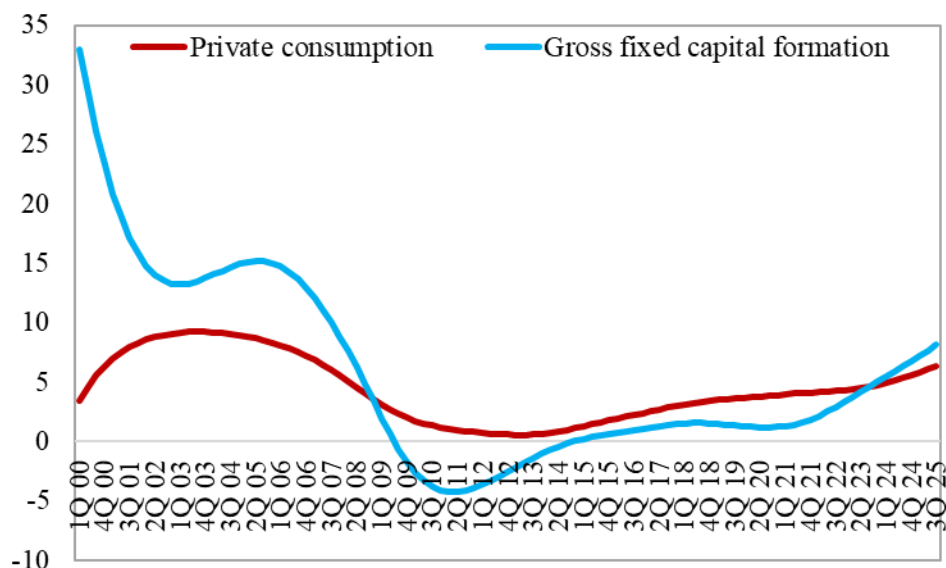
Source: representation of the author based on the econometric estimates using the database of Eurostat (2026).

This evolution has been mainly determined by the upward trend for the annual rate of gross fixed capital formation (the fixed investments). This represents the engine of the economy. According to our econometric estimates, the annual rate of the trend component of gross fixed capital formation in Bulgaria has recorded an acceleration path since 2021, reaching 8.1% in 3Q 2025. This is the highest level since the last quarter of 2007, as represented in the chart below (Figure 4).

It can be noticed the acceleration in recent quarters, determined by the prospects for Bulgaria to join the Eurozone. Therefore, the benefits of the euro adoption for Bulgaria's economy in terms of investments are confirmed. These are supported by the prospects for a better integration within the EU market, but also by the short-term outlook for the real interest rates. These are forecasted at negative levels, as inflation in Bulgaria is expected to exceed the monetary policy rate in the Eurozone in the coming quarters.

Furthermore, our econometric results also indicate an acceleration of the annual rate for the trend component of private consumption in Bulgaria (the main component as a share of the GDP, from the demand side perspective). Thus, the annual pace of the potential private consumption (the structural component of this indicator) has presented an acceleration trend since 2022, towards over 6.3% in 3Q 2025. This is the highest level since 2Q 2007, as can be noticed in the following chart.

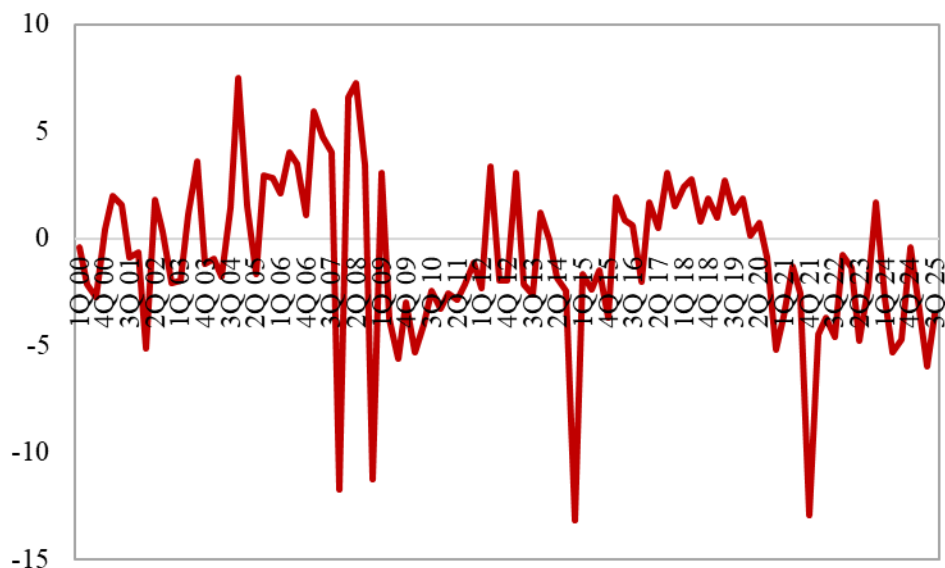
Figure 4. Gross fixed capital formation vs. private consumption in Bulgaria (trend/structural component) (annual rate) (%)



Source: representation of the author based on the econometric estimates using the database of Eurostat (2026).

On the other hand, we point out the downward trend for the annual pace of the volume of total exports (goods and services) in Bulgaria in recent years. According to our econometric estimates, this indicator hit the minimum since the beginning of the century in 3Q 2025. In other words, the international competitiveness of Bulgaria has been deteriorating in recent years, an evolution mainly determined by the consequences of the geopolitical tensions (the crisis in Ukraine), with a negative impact on access to energy resources and the price of energy. This deterioration in the annual rate of the trend component of the total exports represents an important challenge for the macroeconomic performance of Bulgaria after joining the Eurozone. However, we point out that the implementation of the new defensive industrial policies by the European Union and the prospects for Romania to resume the production of gas in the Black Sea in 2027 (Central Europe Times, 2025) are important factors that may determine the change of the trend for Bulgarian's exports in the coming quarters, in our view.

Last, but not least, the results of our analysis indicate the widening of the structural component of the budget deficit in Bulgaria in recent quarters, to levels above the threshold of 3% of GDP, as can be noticed in the following chart (Figure 5).

Figure 5. Structural component of public finance balance in Bulgaria (% GDP)

Source: representation of the author based on the econometric estimates using the database of Eurostat (2026).

4. Conclusions

The integration within the Eurozone represents a maturity test for Bulgaria, the largest country in Central and Eastern Europe that adopts the euro, from the demographic point of view, with a population of 6.4 million, according to Eurostat (2026). It is probably the most important maturity test for the economic policy implemented by the policymakers in Sofia.

According to the results of our econometric analysis, Bulgaria has recently been confronted with a deterioration in international competitiveness and the widening of the structural component of the budget deficit. In this respect, we emphasize that maintaining fiscal stability and continuing structural reforms (in an international context dominated by militarization) represent the main challenges for Sofia's administration in the coming years.

Among the needed structural reforms in Bulgaria, we mention those to integrate technological progress in a balanced and sustainable way, to improve the quality of regulation, and to develop the capital markets. These structural reforms would contribute to the improvement of the contribution of multifactor productivity to the potential growth rate, supporting the consolidation of the economic convergence process towards the EU average.

Furthermore, these elements are essential for Bulgaria to fully benefit from adopting the euro, strengthen its capacity to absorb external shocks in the future, and consolidate the process of European economic convergence. These

reforms are also needed in order to avoid the scenario of the Greek economy following the outbreak of the Great Financial Crisis.

Last, but not least, we point out that the adoption of the euro by Bulgaria should represent the most important example for the remaining countries in Central and Eastern Europe, members of the European Union, but not members of the Eurozone: Poland, Romania, Czechia, and Hungary.

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