

## Bulgaria: A new blueprint for EUR adoption

European leaders have given the green light to Bulgaria's participation in the Exchange Rate Mechanism II, a vital step towards the country eventually adopting the euro, but there are new requirements that go beyond the original nominal Maastricht criteria



### Bulgaria's first steps to adopting the euro

The new requirements for Bulgaria in its ERM II participation include joining simultaneously the Banking Union and “thoroughly implementing the reforms monitored by the Commission under the Cooperation and Verification Mechanism in the areas of judicial reform and the fight against corruption and organised crime”. Institutional quality and governance seem to be the focus of the new requirements and EUR adoption is linked to a positive assessment of these milestones with the aim to achieve “a high degree of sustainable economic convergence by the time the euro will be introduced”.

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important weight in accepting new members into the EUR club. This may sound like changing the rules during the game, but look necessary after the European debt crisis. Eventually, Bulgaria will likely fulfil the requirements for joining the Banking Union and ERM II simultaneously. However, we have doubts given the track record that satisfactory progress will be made on the recommendations coming under the Cooperation and Verification Mechanism (CVM) and a reasonable level of real economic convergence would be achieved in order to limit the time spent within ERM II to minimum two years.

## **Many hurdles ahead**

Bulgaria's hurdles to EUR adoption and a new set of requirements related to both institutional and real convergence should become relevant for authorities in Romania and Croatia which expressed their intentions to join the currency bloc. Romania has a soft target to adopt the single currency by 2024, while Croatia intends to apply for ERM II in 2020. Linking the EUR adoption to fulfilling the CVM recommendations is relevant only for Romania.

We doubt that Croatia would meet the nominal debt to GDP criteria of below 60% by 2020. We believe that Romania is unlikely to meet most of the nominal criteria by 2022. Romania is unlikely to sustainably achieve below 3.0% of GDP budget deficit and, if the economic cycle changes, we see risks to debt sustainability arising as well given the structure of the public spending, low tax revenues as a percentage of GDP and the low tax base. Inflation and long-term interest rate are also likely to remain above the Maastricht criteria in Romania by 2022.