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THE BULGARIAN ECONOMY PRIOR TO EURO AREA ACCESSION: MACROECONOMIC CONVERGENCE, INFLATIONARY DYNAMICS, FISCAL DEVELOPMENTS AND SECTORAL ADJUSTMENT[7]

Economic activity in Bulgaria in 2025 continues to increase, but with stronger dependence on domestic sources of growth and a weakening external position. Growth is sustainable in pace but unbalanced in structure, with final consumption leading, net exports deteriorating and investment still insufficient for a productivity-led trajectory. Inflation is primarily internally generated, and its reduction requires higher productivity, competition and budget discipline, not only temporary price measures. Low unemployment conceals labour shortages, so activation of inactive persons and upgrading of skills are central to growth potential. Fiscal risks are increasing as the key problem is not the debt level, but recurrent expenditure financed by new debt amid weak public-investment efficiency. The external sector becomes a main macroeconomic risk, while banking stability is high, but rapid credit and housing-market dynamics require preventive supervision. Euro area accession marks a major institutional shift, ending Bulgaria's currency board arrangements and integrating it into ECB monetary policy. Yet membership does not automatically boost growth, investment, or external sustainability, especially as domestic prices

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and costs are rising faster than in many trading partners. Therefore, policy should shift from stimulated demand to sustainable growth based on productivity, skills, investment and high-value exports.
Keywords: Bulgarian economy; euro area accession; macroeconomic convergence; fiscal sustainability; external and banking sector
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1. Introduction

The paper assesses the state of the Bulgarian economy in 2025, identifies main risks and constraints, and outlines medium-term trajectories under euro area membership, a changing external environment and geopolitical challenges. It examines macroeconomic processes, sectoral and policy factors, develops a medium-term framework under different assumptions and formulates policy guidelines. The real sector and labour market are analysed through growth, inflation, convergence, productivity, labour reserves and skills. The analysis shows that Bulgaria continues to catch up with European Union (EU) income levels, but growth remains dependent on consumption and constrained by low investment, negative net exports, inflation and a shrinking labour resource. The external sector is assessed through trade, foreign direct investments (FDI), balance of payments, debt and import dependence. The forecast's three scenarios indicate that Bulgaria enters 2026 with stronger domestic demand, a clearer investment impulse, and active credit growth, but a weaker external position.

2. Real sector and labour market

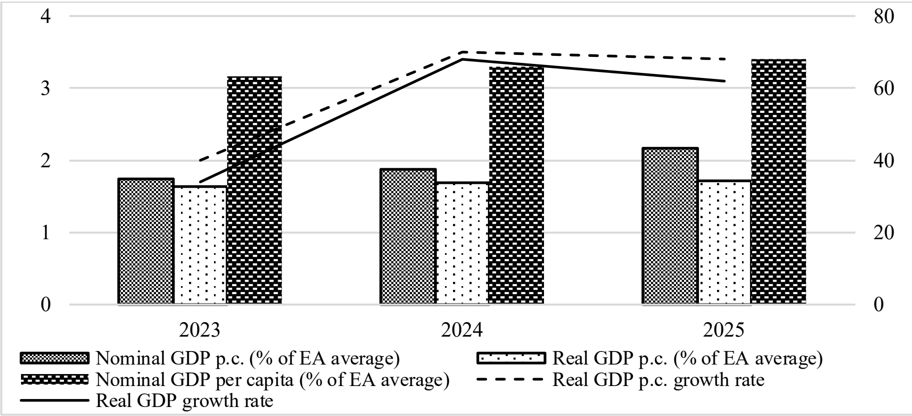
2.1. Economic growth and income convergence

Economic activity in Bulgaria in 2025 grew at a slightly slower pace than in 2024, but income convergence continued. Nominal gross domestic product (GDP) rose by 10.7% and nominal GDP per capita (p.c.) by 11.1%, reaching 43.4% of the EU average and 40.2% of the euro area average, with the gap narrowing by 2.7 percentage points (pp). Although Bulgaria remained with the lowest value of this indicator among EU countries, its relative position improved compared to almost all of them, with the exception of Ireland.

Real GDP growth reached 3.1% and was more than twice the average pace in the EU and the euro area. Real GDP p.c. grew slightly faster, reflecting the declining population, but its level remained only 34.3% of the EU average and 31.3% of the euro area average. Thus, real convergence continued, although at a more moderate rate than in 2024, and Bulgaria still lagged behind all EU Member States while improving its relative position in most bilateral comparisons (Figure 1).

Because price levels differ across countries, GDP in purchasing power standard (PPS) p.c. remains the preferred measure of income convergence. In 2025, it amounted to 68.1% of the EU average, with a catching-up rate of 2.2 pp, slower than the 2.7 pp in 2024 (Figure 1). For the first time since EU accession, Bulgaria came very close to Greece, where the indicator was 68.4%, which reflects sustained Bulgarian convergence and the long divergent trend in the Greek economy after 2009 that ended only after 2020 (Rangelova, Bobeva, Zlatinov, 2021).

Figure 1. GDP per capita and economic growth rates (%)



Source: National Statistical Institute (NSI), Eurostat and own calculations.

The main driver of growth in 2025 was final consumption stemming mainly from household consumption and supported by real income, employment and credit, while individual government consumption also reached its highest contribution in 2023-2025 (Table 1). Collective consumption increased more moderately, but the accelerating contribution of both types of government consumption in 2024-2025 shows the growing sensitivity of growth to fiscal policy.

Table 1. Contributions of final use components to the GDP growth rate

	2023		2024		2025	
	Growth rate	Contribution	Growth rate	Contribution	Growth rate	Contribution
	%	pp	%	pp	%	pp
Final consumption	1.1	0.8	4.6	3.5	7.6	5.9
Individual	1.1	0.7	4.8	3.2	8.2	5.6
of households	1.1	0.6	5.0	2.8	7.8	4.5
of Non-Profit Institutions Serving Households (NPISHs)	-1.0	0.0	1.7	0.0	10.4	0.0
of government	1.5	0.1	4.2	0.4	10.3	1.1
Collective	0.7	0.1	3.0	0.3	3.2	0.3
Gross capital formation	-12.8	-2.9	5.3	1.1	7.8	1.6
Gross fixed capital formation	10.2	1.7	1.5	0.3	11.4	2.1
Change in inventories	n.a.	-4.6	n.a.	0.8	n.a.	-0.5
Net exports	n.a.	3.8	n.a.	-1.2	n.a.	-4.4
Exports	0.0	0.0	1.8	1.1	-2.1	-1.2
Imports	-5.5	-3.8	3.9	2.3	5.9	3.2
Total	1.7	1.7	3.4	3.4	3.1	3.1

Source: NSI and Eurostat.

Gross capital formation expanded, but remained below its 2022 real level. Gross fixed capital formation grew at the fastest rate since 2008 and contributed just over 2/3 of real GDP growth, while inventories had a negative contribution. Investment was supported by domestic demand, credit, housing loans, renewed FDI inflows, public investment and expectations related to euro area accession. Yet gross fixed capital formation was 20.1% of GDP, below the 2004-2015 levels and insufficient for higher and more stable growth, while uncertainty, delayed Recovery and Resilience Plan (RRP) payments, postponed reforms, limited labour supply and rising labour costs continued to dampen investment.

Net exports had a strongly negative contribution to growth, close in absolute terms to the positive contribution of household consumption. It reflected the first decline in exports since 2020 and a faster rise in imports. Exports were constrained by weak activity in key partners such as Germany, Romania and Italy, by the strong increase in labour costs, the rise in the real effective exchange rate and specific company-level problems in the export sector. Imports rose with domestic consumption and investment, more strongly from non-EU countries.

Table 2. Contributions of economic activity groups to the GDP growth rate

Economic sectors and economic activity groups	2023		2024		2025	
	Growth rate	Contribution	Growth rate	Contribution	Growth rate	Contribution
	%	pp	%	pp	%	pp
Agriculture, forestry and fishing	-15.3	-0.6	7.3	0.2	1.4	0.0
Industry (except construction)	-5.3	-1.2	-7.2	-1.4	-1.4	-0.6
Construction	3.8	0.1	11.0	0.4	6.5	0.3
Wholesale and retail trade, transport, accommodation and food service activities	5.8	1.1	9.6	2.0	2.1	0.4
Information and communication	4.3	0.3	1.6	0.1	4.2	0.3
Financial and insurance activities	-0.5	0.0	6.0	0.3	3.6	0.2
Real estate activities	8.0	0.6	-2.6	-0.2	5.8	0.4
Professional, scientific and technical activities, administrative and support service activities	3.8	0.2	3.8	0.2	2.2	0.1
Public administration, education, human health and social work activities	2.9	0.4	5.1	0.8	6.3	1.0
Arts, entertainment and recreation; other service activities; activities of household and extraterritorial organisations and bodies	-3.0	0.0	2.8	0.0	3.8	0.1
GVA total	1.0	0.9	2.8	2.4	2.6	2.2

Source: NSI and Eurostat.

Real gross value added (GVA) grew 0.5 pp more slowly than real GDP. The highest contribution came from “Public administration; education; human health and social work” due to its weight and high growth rate, followed by “Wholesale and retail trade, transport, accommodation and food service activities" and "Real estate activities". Construction and information, and communication also had a positive impact, as did financial and insurance activities. The only activity group with a negative contribution was industry, except construction, where GVA declined for a third consecutive year, although at a slower pace (Table 2).

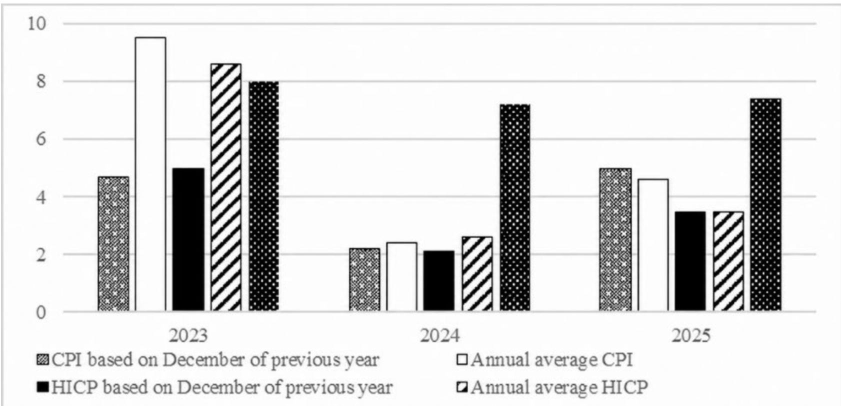
The achieved sectoral structure is not particularly conducive to food security or faster real convergence. The very low share of agriculture, forestry and fishing in GDP (2.8%), despite EU agricultural subsidies, increases dependence on imports amid external instability and stronger competition. The industry's share of GDP (24.4%) is below the long-run average and behind the share in the fastest-growing EU economies, which limits the potential for technology-based growth.

At a more disaggregated level, the faster growth of public administration, education, health and social work could support human capital if it reflects more efficient spending on education and health care. Construction remained dynamic, although less than in 2024, while the renewed growth of information and communication points to a possible positive effect from high-tech activities.

2.2. Inflation

In 2025, inflation in Bulgaria accelerated according to all major price indices (Figure 2). Consumer price index (CPI) based on December of the previous year and annual average CPI rose by 5% and 4.6%, respectively, while both Harmonised Index of Consumer Prices (HICP) measures increased by 3.5%. With the exception of the December-based CPI, price growth was lower than in 2023, especially in annual average terms.

Figure 2. Annual inflation rates (%)



Source: NSI and Eurostat.

The GDP deflator increased for a second consecutive year at the highest rate, 7.4%, driven by all domestic demand components. The fastest growth was in the deflator of gross capital formation (9.2%) and in collective and individual government consumption (9.1% and 9.0%).

The household consumption deflator rose by 4.9%, while export and import deflators posted their first annual increases since 2022.

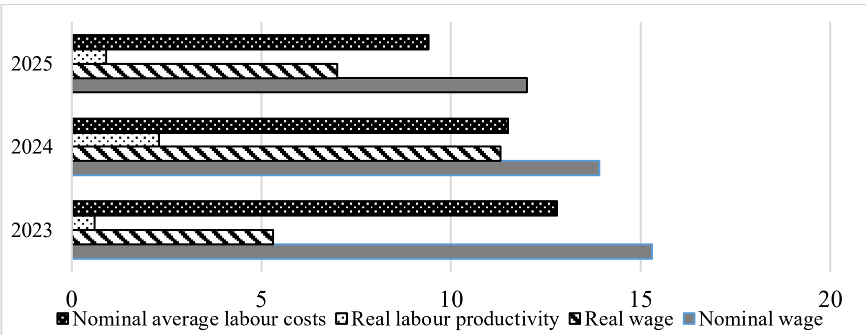
Average annual HICP inflation exceeded the EU level by 1 pp, and the euro area by 1.4 pp. Bulgaria ranked sixth in the EU, together with Latvia, and after several Central and Eastern European countries. Since the group includes both euro-area and non-euro-area members, price dynamics appear to depend more on common and country-specific factors than on participation in the currency union.

The rise in inflation reflected accelerated prices in 7 of 13 aggregate groups. Food and non-alcoholic beverages made the largest contribution (37.1%) because of their high weight in the HICP. Restaurant and hotel prices rose most strongly (8.4%) and contributed 20%, as did housing, water, electricity, gas and other fuels. Alcoholic beverages and tobacco products, and recreation, sports and culture, followed with 11.4% each.

The increase in inflation was driven by several factors, among which domestic factors played the dominant role. This is indicated by the much faster increase in the GDP deflator than in HICP and CPI and by the very limited rise in import prices. The return to the standard 20% value added tax (VAT) rate on bread and flour and restaurant services stimulated prices in early 2025. A poorer agricultural harvest, rising production costs, persistently high demand and higher excise duties on tobacco products also contributed.

Energy products recorded their first increase in 2023-2025, but at only 0.5% on average and with less than 3% contribution to HICP growth. The rise in electricity, gas, solid fuels and heat energy was partly offset by lower liquid fuel prices. Administrative prices increased by 2.1%, the lowest rate in 2023-2025, and contributed 9.1% to average annual HICP growth.

Figure 3. Annual growth rates of wages, nominal average labour costs and real labour productivity (%)



Source: Eurostat and own calculations.

Inflation was also influenced by wage growth, although it slowed compared with 2023 and 2024 (Figure 3). Higher public-sector wages, social benefits and household credit supported consumption. The average annual wage rose by 12% and corresponded to an increase in nominal average labour costs, which, given the relative stability or weaker impact of markups and other production costs, exerted upward pressure on prices (Kasabov, 2024). The real wage increased by 7% and real labour productivity by only 0.9%, sustaining supply-side price pressure and the rise in producer prices.

Inflation expectations before euro area accession also affected the second half of 2025. Speculation about the initial price impact of the euro and the government's intentions to strengthen control raised demand at that time, while some suppliers increased prices in advance by passing on ongoing and expected costs, turning expectations partly self-fulfilling.

2.3. Key indicators of the labour market in Bulgaria

In 2025, the labour market remains in relatively good shape, but its sustainability is maintained against a shrinking labour force. According to the NSI Labour Force Survey, the active population aged 15-64 amounts to 2,913,800 and the activity rate to 73.5%; employment is 2,809,300 (70.9%), and unemployment is 104,500 (3.6%). The key challenge is therefore not unemployment, but the limited capacity to expand the labour force. Low unemployment is both a positive outcome and a signal that human resources reserves are limited, so future growth will depend more on activation of inactive groups, longer participation in employment, labour imports and productivity gains.

Workforce contraction is concentrated among younger generations. In the 15-24 group, active persons fall from 123,200 in 2023 to 116,300 in 2025, and the activity rate from 21.4% to 19.1%, reflecting longer education, demographics and limited part-time work. The 25-34 group also decreases from 534,900 to 492,400 people, which is critical because these cohorts form the gateway to active working life and reproduce the labour force.

Older age groups show greater stability and some increase in participation as employment among persons aged 65 and over rises from 110,200 in 2023 to 120,800 in 2025. This partly compensates for the shortage of younger workers, but cannot fully offset the declining entry of new generations. Workforce restructuring should therefore be viewed not as a temporary demographic phenomenon but as a key factor for the long-term potential of the labour market and the economy.

Although overall unemployment remains low, youth unemployment is still a vulnerability. In 2025, unemployed persons aged 15-24 are 15,200, and the unemployment rate reaches 13.1%, the highest among all age groups and 1 pp above 2023. The transition from education to employment therefore remains a critical point for timely and sustainable employment.

For other age groups, the picture is more favourable, as unemployment among those aged 25-34 falls from 4.4% in 2023 to 3.9% in 2025. Yet low unemployment does not mean the absence of problems: for some groups, it reflects limited labour supply and strong demand, making it increasingly important to identify those outside the labour market who could be activated.

A significant part of unused labour potential is not among the officially unemployed, but outside the labour force. In 2025, persons aged 15-64 outside the labour force are 1,049,900, up from 1,041,200 in 2023, which shows that even favourable market conditions do not automatically mobilise labour reserves, and more targeted activation policies are needed.

Table 3. Selected labour market indicators

Indicator	Measure	2023	2024	2025	Change 2023-2025
Labour force (aged 15-64)	thousand	2,951.4	2,945.6	2,913.8	-37.6 thousand
Economic activity rate (aged 15-64)	%	73.9	74.0	73.5	-0.4 pp
Economic activity rate (15-24 years)	%	21.4	19.7	19.1	-2.3 pp
Economic activity rate (25-34 years)	%	82.6	84.4	81.7	-0.9 pp
Employed persons (aged 15-64)	thousand	2,821.7	2,820.8	2,809.3	-12.4 thousand
Employment rate (aged 15-64)	%	70.7	70.9	70.9	+0.2 pp
Unemployed persons (aged 15-64)	thousand	129.7	124.8	104.5	-25.2 thousand
Unemployment rate (aged 15-64)	%	4.4	4.2	3.6	-0.8 pp
Employed persons (aged 65+)	thousand	110.2	112.1	120.8	+10.6 thousand
Employment rate (aged 65+)	%	7.3	7.3	7.8*	+0.5 pp
Persons outside the labour force (aged 15-64)	thousand	1,041.2	1,033.3	1,049.9	+8.7 thousand
Proportion of inactive people who want to work	%	11.9	9.3	8.3	-3.6 pp
Discouraged persons (aged 15-64)	thousand	37.0	23.2	16.5	-20.5 thousand

** Data for 2025 are an average of Eurostat's quarterly observations.*
Source: NSI, Labour Force Survey, Eurostat.

2.4. Skills supply and demand

With a shrinking labour force, the key issue is whether available skills match the changing economy. Cedefop Skills Forecast 2025 projects that by 2035, around 50% of new jobs will require medium qualification, 44% high and only 6% low qualification. Employment growth is expected mainly in business services, while the primary sector will decline, confirming a shift towards services, knowledge and higher skill intensity. Bulgaria remains closer to more traditional economies, and the share of highly educated people is expected to rise to 38% by 2035, still below that of high-tech EU economies.

Eurostat data on overqualification show that in 2025, 20.7% of employed persons aged 15–64 worked in jobs requiring a lower level of education than they possessed. High rates were recorded in administrative services, accommodation and food service, agriculture, transport, and manufacturing. Human capital is therefore often absorbed by activities of lower complexity and productivity. The structural problem is not only a skill shortage, but also insufficient high-quality jobs and a mismatch between educational provision and labour demand.

Data for 2024 from Cedefop's Labour and Skills Shortage Index [8] show that shortages are not concentrated primarily in highly skilled occupations, but are more pronounced in lower- and medium-skilled ones. The highest shortage is in elementary occupations, followed by skilled non-manual and skilled manual occupations, while it is lower for highly skilled non-manual occupations. Labour-market tensions therefore remain concentrated mainly in operational, service, and routine activities. The data reveal a dual structure: in highly skilled occupations, shortages are driven by rising demand, whereas in low-skilled occupations they are linked mainly to a shrinking labour force.

[8] Higher values of the index indicate more pronounced labour and skills shortages. The index is measured on a four-level scale, where 1 indicates a low shortage and 4 indicates the highest indicative shortage.

NSI data for 2024 show that for 82.5% of employed persons aged 15-34, education matches the position, and for 80.5%, skills match the job. The field-of-study match is weaker – 58.5% work in corresponding roles, 27.3% report a partial match and 10% report no match. Young people are absorbed more through general qualifications and transferable skills than through specific specialisation, indicating weaker links between education and career outcomes.

2.5. Employment structure and Bulgaria's positioning in higher value-added activities

Skill mismatches cannot be explained only by a quantitative shortage or surplus of workers. They are also linked to the structure of the economy and employment, which determines what skills are actually demanded and how existing qualifications can be used.

Higher labour productivity is concentrated in a narrow range of sectors (Table 4), including electricity, heat and gas supply, financial and insurance activities, mining and quarrying, and information and communications. These sectors have high GVA per employee but low employment shares. By contrast, much more labour is concentrated in manufacturing, trade and agriculture, where productivity is lower. Bulgaria therefore has pockets of higher value added, but they are still too small to shape the overall employment profile.

Table 4. Employment share and labour productivity by sector, Bulgaria, 2024

Economic activities	Employment (%)	GVA per employee (€ thousand)
Manufacturing	16.0	23.3
Wholesale and retail trade	15.4	27.1
Agriculture, forestry and fisheries	13.9	5.0
Human health and social work	6.4	23.6
Construction	5.8	21.5
Information and communications	4.2	52.8
Financial and insurance activities	2.0	86.1
Production and distribution of electricity, heat and gas fuels	0.8	86.7
Mining and quarrying	0.6	66.6

Source: Eurostat (nama_10_a64; nama_10_a64_e), own calculations. Selected sectors.

Employment in knowledge-intensive activities rises from 28.3% in 2015 to 31.9% in 2025, slightly faster than in the EU-27, but the gap remains almost unchanged. In the high-tech core, Bulgaria rises from 3.7% to 5.3%, near the EU average of 5.1%. This suggests restructuring potential, although knowledge-intensive employment remains limited.

2.6. Technological and digital penetration in the Bulgarian economy

To assess the lower technological and digital penetration in Bulgaria, it is necessary to distinguish whether the constraint comes mainly from slower technology adoption by enterprises or from insufficient digital readiness and skill shortages in the workforce. In 2025, only 8.6% of enterprises in Bulgaria used at least one artificial intelligence (AI) technology, compared with 20% in the EU. Only 4.9% have ever considered AI, and 2.1% use technologies developed by their own staff, which shows reliance on external solutions. Cloud adoption is 17.8% (EU – 52.7%), 60.65% of firms have very low digital intensity, and robotisation is about half the EU average. The lag reflects weak digitalisation, strategic implementation, organisational readiness and internal technological capacity.

Digital skills are also a serious constraint. In 2025, only 38.3% of people have at least basic digital skills, compared with 60.4% in the EU, and above-basic skills remain at 11.8% against 31.4%. The lower reported difficulty in recruiting information and communication technologies (ICT) specialists reflects not better conditions but more limited demand, because technologies are adopted more slowly. Digital penetration is therefore constrained by both skill shortages and insufficient firm demand.

3. Public Finances and Fiscal Sustainability

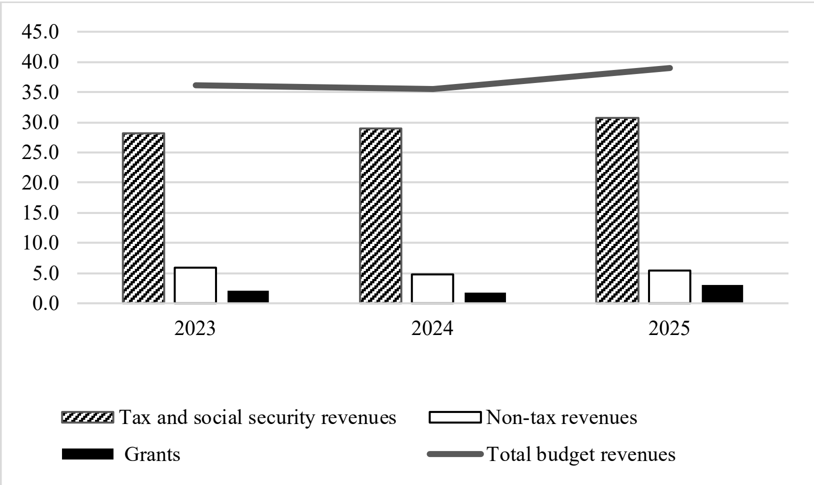
In recent years, adoption of state budget laws has often been postponed because of early parliamentary elections and the inability of the National Assembly to agree on new public finance policies. The 2026 budget was not adopted after prolonged protests against the policies and debt increase in the draft, and two extended budgets were adopted until the extraordinary parliamentary elections in April 2026. Budget 2025 was nevertheless crucial for fulfilling Bulgaria's fiscal Maastricht criteria before euro area accession on 1 January 2026. Following the 2025–2028 National Medium-Term Fiscal and Structural Plan (MTFSP) and the 2025 Bulgaria-specific convergence reports by the EC and ECB, the EU institutions approved Bulgaria's euro-area accession, with the final decision adopted on 8 July 2025 for euro adoption on 1 January 2026.

3.1. Budget revenues and tax policy

Total budget revenues rose by 3.2 pp of GDP in 2025, driven by tax and social security revenues, non-tax revenues and EU grants. Planned tax revenues were underperformed by about BGN 3.6 billion, mainly because indirect taxes were overstated in the medium-term budget forecast (ERI at BAS, 2025). Raw-material prices and the weaker US dollar also reduced VAT on imports. Taxes on profit and income, however, exceeded annual targets by BGN 0.3 billion.

The nominal increase in direct tax revenues in 2025 reflected the 15.4% rise in the minimum wage, higher public-sector wages and the maximum social security contribution base. These factors supported direct tax receipts, while some tax reliefs served social or regional goals, including small and medium enterprises (SME) incentives in municipalities with high unemployment. Revenues also reflected the national additional tax for multinational groups under Council Directive (EU) 2022/2523. Indirect taxes increased with economic growth, rising incomes, stronger consumption before the euro area entry and measures against the shadow economy. The restoration of VAT rates for tourism, bread and restaurants contributed to equal treatment, while the permanent 9% rate for books and baby goods preserved social functions. VAT, excise and social security revenues rose with consumption, excise convergence, income growth and measures against hidden activity. Non-tax revenues came mainly from municipal property and other taxes, while energy-sector excess-profit contributions declined after reclassification. Bulgaria received €1.9 billion under the Recovery and Resolution Mechanism (RRM) in 2025, but absorption of remaining funds by August 2026 may require national financing and pressure the next budget.

Figure 4. Budget revenues for 2023-2025 (% of GDP)



Source: Ministry of Finance.

Measures against the shadow economy supported tax and social security revenues, but anti-corruption results remained insufficient. Bulgaria recorded 40 points in the Corruption Perceptions Index for 2025, ranking 84th out of 182 countries and showing its weakest result since 2012.[9] The phased implementation by 2028 of the Financial Action Task Force Action Plan against money laundering, tax fraud and tax evasion was linked to removal from the MONEYVAL "grey list", but reporting to the public remained insufficient to improve the perception of fairness.[10] Digital public services and electronic services of the revenue administrations are expanding and should be developed further through Egov.bg, virtual POS payments and incentives for citizens and businesses, helping both compliance and optimisation of public administration.

3.2. Budgetary expenditures and expenditure policy

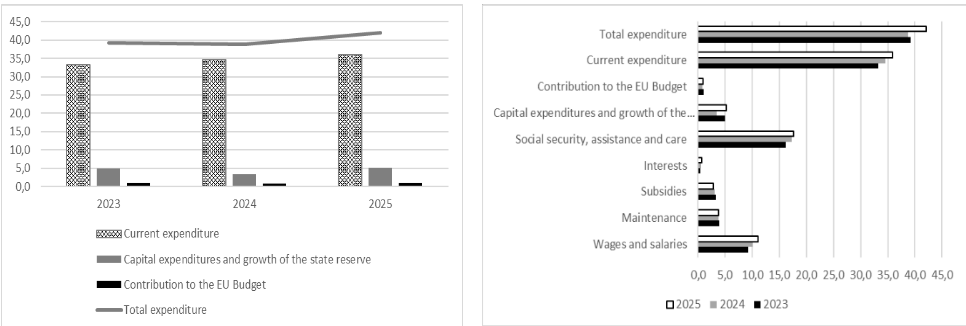
For the first time in recent years, in 2025, total budget spending exceeded 40% of GDP, although nationally financed spending was 38.7% of GDP and slightly below the Public Finance Act limit. Better implementation of EU-financed projects raised capital spending, while personnel and social security expenditure continued to increase in 2023-2025, expanding fixed current expenditures and weakening the strict fiscal discipline observed for

[9] Transparency international. (2025). https://transparency.bg/cpi-2025-results-10-february-2026-coming-soon/.
[10] Ministry of Finance. (2025). Updated Medium-Term Budget Forecast 2025-2028, https://www.minfin.bg/bg/legislation7/556.

a decade. Social expenditure rose with demographic trends and pension catch-up, and the EU budget contribution remained 0.9% of GDP.

Current expenditures increased by 2.7 pp in 2023-2025 to 35.9% of GDP, including personnel expenditure of 11% of GDP. Social spending reached 17.6% of GDP, signalling weaknesses in pension-system financing. The gradual increase in social spending and pensions toward average European standards should be compensated by adequate revenue measures, because population ageing requires sustainable social security revenues for medium-term fiscal stability. Subsidies were 2.8% of GDP, slightly below 2024, financing transport, hospitals, and EU-funded projects of state-owned and private enterprises.

Figure 5. Budget expenditures for the period 2023-2025 (% of GDP)



Source: Ministry of Finance.

Interest payments increased to 0.7% of GDP in 2025. The investment credit rating of Baa1 with a stable outlook continued to ensure low rates for euro issues, and euro area membership may reduce the risk premium. Nevertheless, rising interest payments reduce fiscal resources for other priorities.

Projects financed by the National Recovery and Resolution Plan (NRRP) and the Partnership Agreement 2021-2027 improved capital spending, which increased by 1.8 pp to 5.2% of GDP. During the remaining EU programming period, public investment projects should be implemented rapidly, and the capital programme should be optimised. Limiting in-house procurement, strengthening institutional control over project quality and introducing sanctions for poor implementation would improve the allocation of public resources. Green public procurement, sustainability and Environmental, Social and Governance (ESG) assessment can also increase the efficiency of capital spending.

Research by the Economic Research Institute at the Bulgarian Academy of Sciences (ERI at BAS) provides recommendations for structural reforms in public finances that would support convergence and sustainable growth (ERI at BAS, 2022, 2023, 2024). These studies emphasise the quality of human capital, financing of education and health care and changes in social policies (Zareva, Kirova, 2024; Velkova, Kirilova, 2025; Peneva, 2024; Shopov, Salchev, Peneva, 2025). A positive step is the continued increase in funds for education, research institutes and remuneration of teachers and university lecturers. Green policies in education, waste recycling control by municipalities and green macroeconomic budgeting should support the transition to a circular economic model (Bobeva et. al., 2023; Ivanova, 2022; Zhelyazkova, 2017).

3.3. Challenges for the implementation of the National Recovery and Resilience Plan and the Partnership Agreement

After the snap elections in late 2024, the government presented a modified NRRP in April 2025. In June 2025, the EC approved the revised plan for €6.17 billion in grants, covering 50 reforms and 51 investments with a deadline of August 2026. The revision was needed because the country lagged behind in reforms and required a RePowerEU chapter. The number of payments was reduced from 9 to 5.

At the end of 2025, contracted funds under the RRM amounted to 108.8% of the total budget, but actual paid amounts were only 33.6%, a low level given the short eligibility period to end August 2026. After renegotiation, expenditure under the mechanism increased to BGN 2.8 billion, about twice the absorption of European funding in the previous two years. Payments are distributed in three groups: first tranche – €1.37 billion in December 2022; second and third tranches – €1.9 billion in 2025; and fourth and fifth tranches – about €3 billion by August 2026.

In 2025, expenditure on RRM and Partnership Agreement 2021-2027 projects amounted to 3.4% of GDP. By the end of 2025, agreed funds were 90.6% and paid amounts 50.4% of the total budget. European-funded projects support transport connectivity, environment, business conditions, human capital, innovation, infrastructure, border protection and poverty reduction. Prioritising infrastructure, competitiveness, innovation and the digital transition to 2030 would accelerate growth, expand digital public services and improve public administration efficiency.

3.4. Fiscal deficit and public debt

The budget deficit for 2025 was 3.0% of GDP on a cash basis and 3.5% on an accrual basis, exceeding the Maastricht reference, while the primary deficit was 2.4% of GDP. Constant deficits and the maintenance of fiscal-reserve buffers explain the lack of consolidation. According to the April 2026 fiscal notification, the General Government deficit was 3.5% of GDP under EU methodology, exceeding the criterion by 0.5%.[11] The excess reflects military aircraft expenses paid in 2019 but recorded in the year of delivery, 2025.

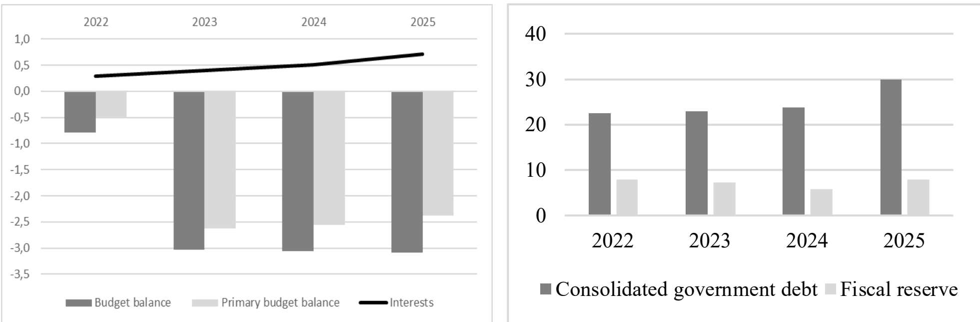
General government debt increased significantly in nominal terms and as a share of GDP, driven by constant deficits and debt-financed investment projects. In 2025, government debt rose by 6 pp, showing the effect of populist policies amid frequent government changes. Consolidated government debt reached 29.9% of GDP, still among the lowest in the EU and

[11] Eurostat. (2026). Press release EDP Notification Tables (April 2026), https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-22042026-ap.

far below the 60% reference, but it will burden future budgets through higher interest payments. Local Government and Social Security Funds' debt remains small because of legal restrictions. Dependence on international capital markets is increasing, and while new debt is inevitable to cover deficits, maturing obligations and fiscal-reserve needs, the deficit should gradually decline through limits on fixed expenditures in normal business-cycle periods.

The fiscal reserve increased to BGN 17.5 billion, or 7.9% of GDP, by end-2025, returning to its historical level. Its mandatory minimum provides buffers in crises and liquidity when state guarantees are activated. State-guaranteed debt reached 0.6% of GDP, mainly for strategic energy projects, Bulgarian Development Bank financing for EU-funded projects and educational infrastructure. It remains a conditional obligation until guarantees are activated.

Figure 6. Budget balance, consolidated government debt and fiscal reserve for 2022-2025 (% of GDP)



Source: Ministry of Finance.

Given rising social and defence spending, the budget deficit is expected to remain around 3% of GDP in 2026 and then decline gradually if fiscal discipline is restored. Higher defence spending under global uncertainty will weigh on both the deficit and debt, requiring optimisation of other expenditures. Fiscal policy should limit fixed current expenditure as a share of GDP to levels consistent with earlier periods of strict discipline.

3.5. Fiscal sustainability and policy priorities for 2026-2028

Fiscal policy should move from pro-cyclical to counter-cyclical in order to restore fiscal discipline before 2020. Increasing public spending above 40% of GDP without corresponding changes in tax, social security or expenditure policies is harmful in the medium term. Revenue and expenditure measures should be balanced and linked to growth and convergence.

Fiscal sustainability requires the deficit and debt to follow the MTFSP targets for 2025-2028, with permanent nationally financed primary expenditure growth limited to 4.9% to reach a structural primary deficit of 1.8% of GDP by end-2028. Income policy tied to productivity would reduce pressure on current spending, consumption and inflation. Public administration should be optimised through structural review, wider eID use, digitalisation, limits on cash payments, and electronic procurement with sustainability and ESG assessment to improve investment efficiency and constrain the shadow economy.

Fiscal policy should increase tax and social security revenues and tackle the shadow economy. A review of tax policy, recommended by the OECD, World Bank and IMF, should be analysed in the medium-term framework to support a fairer distribution of public resources and lower inequality. The Financial Action Task Force measures by 2028 should be combined with digital reporting and minimal contact with the tax administration. A higher maximum social security contribution base and social security contributions would gradually strengthen pension-system revenues.

In 2026, NRRP implementation enters its crucial stage, with the fourth and fifth tranches expected and projects to be completed by August 2026. This is a major challenge for beneficiaries and requires administrative support. Although the Partnership Agreement 2021-2027 allows implementation until 2030, loss of RRM resources would burden the next budget period. The state budget laws for 2026 and 2027 should therefore provide national funding if agreed-upon projects are not completed by the end of August 2026.

4. External Economic Environment and External Sector

4.1. Foreign trade dynamics and global economic development

In 2025, the external environment combines slower world growth, intensified trade protectionism and important institutional changes for Bulgaria – full Schengen participation from 01.01.2025 and euro area accession from 01.01.2026. World trade in goods and services continues to grow to about USD 36.2 trillion, confirming that after the COVID-19 pandemic, it is increasingly driven by tourism, transport, digital, ICT and business services, not only industrial chains. Trade disputes between the United States, the EU and China, more tariffs and non-tariff restrictions and geopolitical conflicts keep uncertainty high, so world trade enters 2026 more fragmented and sensitive to political decisions.

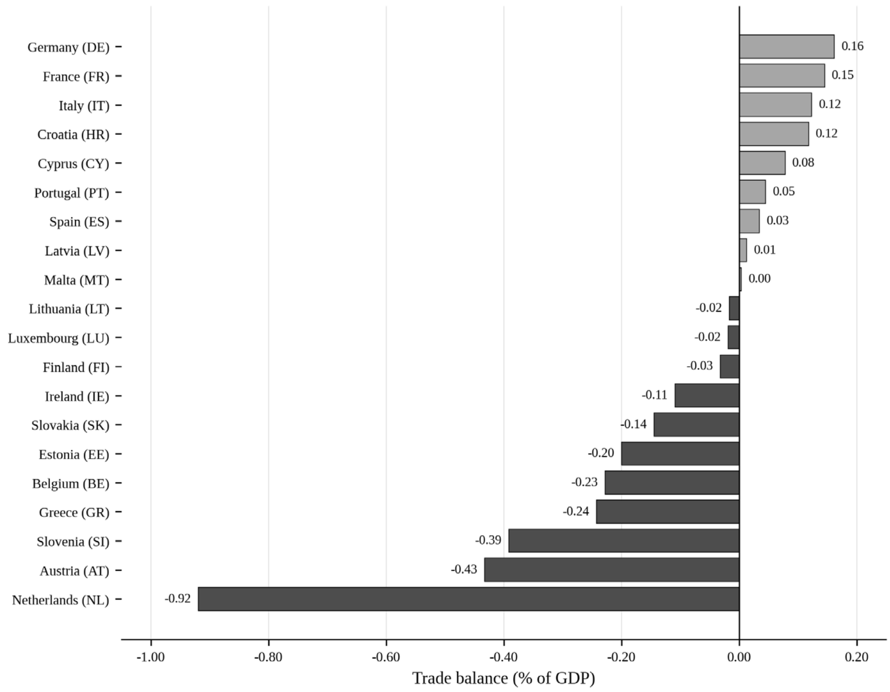
Foreign trade dynamics reflect the growing divergence between leading economies. World growth is 2.8%, while the EU and euro area grow by 1.2% and 0.8%, respectively, which is too weak to create strong demand for Bulgarian industrial exports. The slowdown of Bulgarian exports results from weak European industry, tariff uncertainty between the EU and the United States, more Asian goods on the European market and Bulgaria's specialisation in groups with lower price and technological resilience.

Weaker growth among main trading partners, continuing disinflation and higher fragmentation define Bulgaria's foreign trade environment. It is less favourable for export-oriented industries, but better for services, tourism and regional sectors. Bulgaria benefits from regional integration, Schengen and the euro area, but faces weak industrial markets and stronger price competition from redirected trade flows.

4.2. Analysis of Bulgaria's foreign trade in goods

The external sector moves from a surplus of 2.5% of GDP in 2024 to a deficit of around 1% in 2025, as exports decrease by 0.3% and imports rise by 6.5%. The deterioration reflects lower export volumes and orders, together with strong domestic demand for imported consumer, investment and energy goods. The negative contribution of net exports to GDP is therefore a structural signal, not only a cyclical deviation.

Figure 7. Balance of foreign trade with euro area member states, 2025 (% of GDP)



Note: Positive values indicate a trade surplus; negative values indicate a trade deficit.
Source: Eurostat.

Foreign trade specialisation remains concentrated in a few commodity groups. Machinery, equipment and vehicles have the largest export share but also the largest deficit, because imports reach 13.2% of GDP. Bulgarian industry is integrated into European production chains but is highly dependent on imported components and equipment, which makes exports sensitive to the business cycle in Germany and other industrial economies.

The largest negative trade contribution in 2025 comes from machinery, equipment and vehicles, followed by mineral fuels, chemical products and raw materials. Together, they form a negative balance of about 10.3% of GDP, offsetting the surpluses in other groups. This confirms high energy dependence and limited domestic processing of both imported and local raw materials. Therefore, improvement requires a structural expansion of domestic industrial processing, rather than relying only on price factors.

Price dynamics in goods trade change in a more favourable direction, and part of the improvement in exports comes from better price realisation in a limited number of groups rather than higher volumes. Import pressure is mainly from energy and some agricultural raw materials. Bulgaria's risk from Euro-Atlantic trade uncertainty is indirect, through fewer orders for European firms in whose value chains Bulgarian companies participate[12].

Trade with euro area countries remains key, especially Germany and Romania[13], but no longer stabilises the goods balance. Exports to the euro area fall by 10.5%, while imports shrink by only 0.8%, turning a EUR 1.1 billion surplus in 2024 into a deficit of about EUR 1 billion in 2025. This shows that euro-area integration alone does not guarantee a positive trade balance under a weak industrial cycle and high import dependence.

The positive global trade impulse is not automatically transmitted to Bulgarian goods exports because Bulgaria is positioned mainly in European, not Asian-American, high-technology chains. Schengen and euro area membership reduce transaction and logistics costs, but do not remove high import dependence for investment and energy goods, the weakening labour cost advantage and limited presence in fast-growing segments of world trade. Bulgaria is strongly integrated but peripheral in high-technology value chains and must use European integration for reorientation toward higher value added.

4.3. Analysis of Bulgaria's international competitiveness

International competitiveness in 2025 shows ambiguous dynamics. The terms of trade improve, and the goods deficit remains limited as a share of GDP, but the real effective exchange rate continues to rise, and labour costs grow much faster than in the EU and the euro area. Thus, competitiveness partially stabilises without overcoming accumulated imbalances, because the terms-of-trade improvement is insufficient against dependence on imported machinery, energy resources and chemical products.

Nominal labour cost growth slows from 12.8% in 2023 and 11.5% in 2024 to 9.4% in 2025, but remains almost three times higher than in the EU and the euro area. This moderation cannot neutralise the accumulated increase in labour costs. The euro removes currency risk with euro-area countries, but not real appreciation when domestic prices and costs rise faster than those of trading partners.

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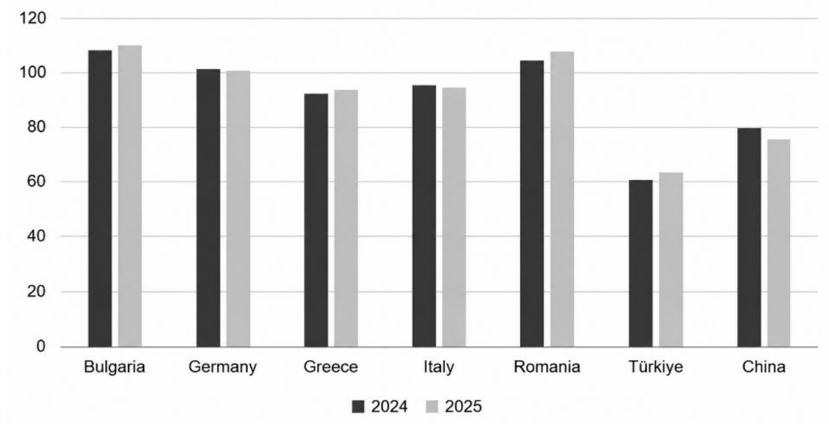
[12] Estimates of the effects of tariff changes and the introduction of new tariffs on Bulgarian exports to the United States are provided in Bobeva-Filipova et al. (2025). The results show that the impact of the new tariffs on Bulgarian exports to the United States is significant. The estimated losses range between EUR 412.91 million and EUR 466.75 million, corresponding to between 29% and 32.68% of exports to the United States, while the expected impact on GDP remains limited, between -0.24% and -0.27%. This indicates that the effect is substantial at the level of bilateral trade.

[13] This perspective is complemented by the analysis of Rangelova and Bilyanski (2020), which examines foreign trade not only as a channel of market integration, but also as a factor influencing Bulgaria's economic growth and structural transformation after its accession to the EU.

Figure 8. Real effective exchange rate, deflated by the consumer price index, 2024-2025 (index 2015=100; 21 trading partners)

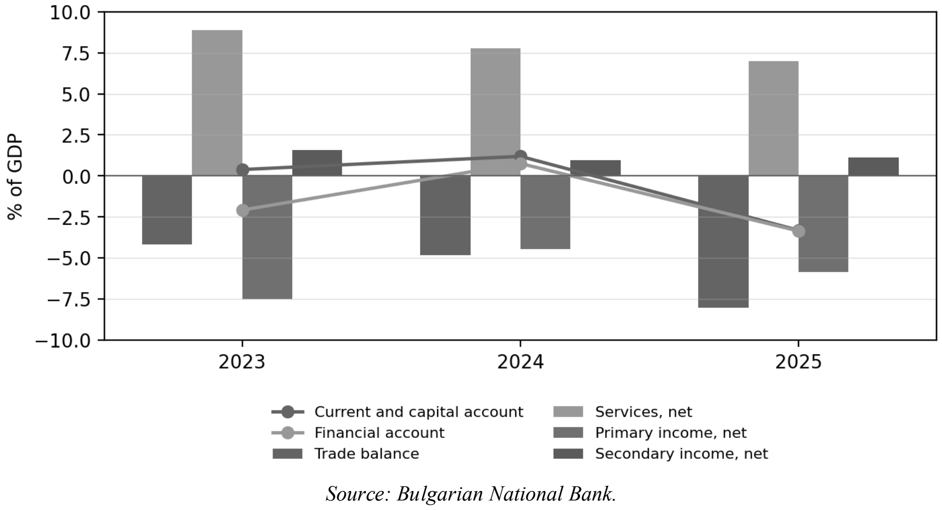


Note: A positive change in the index value reflects a real appreciation of the respective currency.
Source: Eurostat.

4.4. Balance of payments and external debt

The current and capital account balance deteriorates sharply in 2025 to a deficit of about 3.3% of GDP. The main reason is the widening trade deficit of about 8.2% of GDP, which the services surplus cannot fully offset. The current account turns to a deficit of 5.9% of GDP, while the capital account only partly mitigates the pressure. Therefore, the external sector becomes a main source of macroeconomic risk for the Bulgarian economy.

Figure 9. Main Balance of Payments Indicators, 2023-2025 (% GDP)



Source: Bulgarian National Bank.

The net surplus in services remains the main buffer, but falls to about 7% of GDP. Services still compensate for part of the goods deficit, but their capacity is weakening. FDI covers only part of the current account deficit, and investments are not sufficiently directed to sectors with direct contribution to external sustainability – export-oriented manufacturing, logistics, energy efficiency, digital services and higher technological complexity

External debt remains manageable, but fiscal financing, defence expenditures and investment needs increasingly affect the external position. BNB currency reserves provide significant protection against short-term shocks. The risk is therefore not short-term liquidity, but whether the economy can generate sustainable export revenues and sufficiently high-yielding external assets. This makes the outlook for foreign trade central to external sustainability. Bulgaria remains integrated into European value chains and, from 2026, operates within the euro area, but its external position is increasingly sensitive to the European industrial cycle, US customs policy, price pressure from China, and geopolitical risks around energy and transport. Production policy should therefore move from quantitative export expansion to a more competitive and resilient position in value chains. For 2026-2028, priorities include diversification of export markets, reduction of energy and import intensity, development of export-oriented services, and reorientation toward more complex functions in value chains.

5. Banking Sector

Bulgaria joined the euro area at the beginning of 2026, after entering the Exchange Rate Mechanism (ERM) II in July 2020 and the Banking Union under close cooperation in October 2020. With euro area accession, the currency board arrangement established in 1997 comes to an end, while domestic monetary conditions become directly shaped by the decisions of the ECB Governing Council. Public opinion around accession was dominated by an optimistic narrative about a “civilizational choice”, credibility dividends, lower transaction costs and access to European capital markets. This framing is not incorrect, but incomplete, because the change involves loss of autonomous monetary instruments, exposure to asymmetric shocks without a national adjustment mechanism and limited voice in ECB governance. Against this backdrop, the banking sector should be assessed not only by current stability but also by risks carried into the post-accession period.

In 2025, Bulgarian banks operated amid escalating geopolitical risks. The conflict in Ukraine, US-China trade tensions, retaliatory tariffs and erosion of the World Trade Organisation (WTO)-based system reinforced external instability. Negative effects can be transmitted through solvency, demand and inflation channels. The solvency channel affects enterprises integrated into international production networks, especially automotive and machinery firms, through disruptions to inputs and finished goods and weaker debt-servicing capacity. Enterprise closures in 2025, including SE Bordnetze, MD Electronic and Leoni, illustrate these pressures. The demand channel works through euro area slowdown, which reduces orders for Bulgarian exports and profits, while the inflation channel raises fuel and input costs for households and businesses, erodes real disposable income and limits debt-service ability.

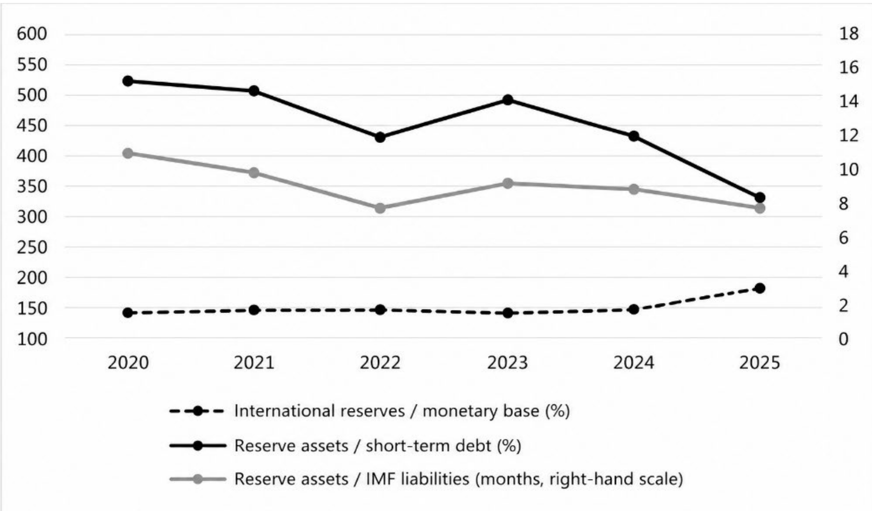
5.1. Monetary aggregates, reserve requirement reform and capital base

Monetary aggregates in 2025 were dominated by pre-conversion behaviour. Overnight deposit growth rose sharply in the second half of the year as households withdrew cash and moved funds into bank accounts before automatic conversion on 1 January 2026, explaining the accelerating contraction of currency outside banks.

The harmonisation of minimum reserve requirements from 12% to the Eurosystem's 1% standard releases substantial liquidity. Most reserves remain undeployed because of the ECB deposit facility, but the reform removes a stabilising mechanism: previously, banks held large balances at the BNB, available under stress. Under the new regime, this buffer shrinks, while the BNB loses a direct instrument for managing the credit cycle and must rely on slower macroprudential tools.

Own funds of the banking system reached BGN 27.4 billion at end-2025, up 30.5% year-on-year. The increase mainly reflects a BGN 4 billion state-budget capital injection into the Bulgarian Development Bank (BDB), rather than retained earnings. Excluding BDB, private banks' capital grew broadly in line with risk-weighted assets.

Figure 10. Key indicators of the currency board arrangement



Source: Bulgarian National Bank; own calculations.

Total risk exposure rose by 11.6% to BGN 103.1 billion, while credit risk-weighted assets increased by 9.2% to BGN 93.6 billion, reflecting strong credit growth with adequate collateralisation at current asset prices. The regulatory capital for operational risk surged under Regulation (EU) 2024/1623. The aggregate capital adequacy ratio rose to 26.56%, but this was almost entirely due to BDB capitalisation, while the change for private commercial banks was negligible.

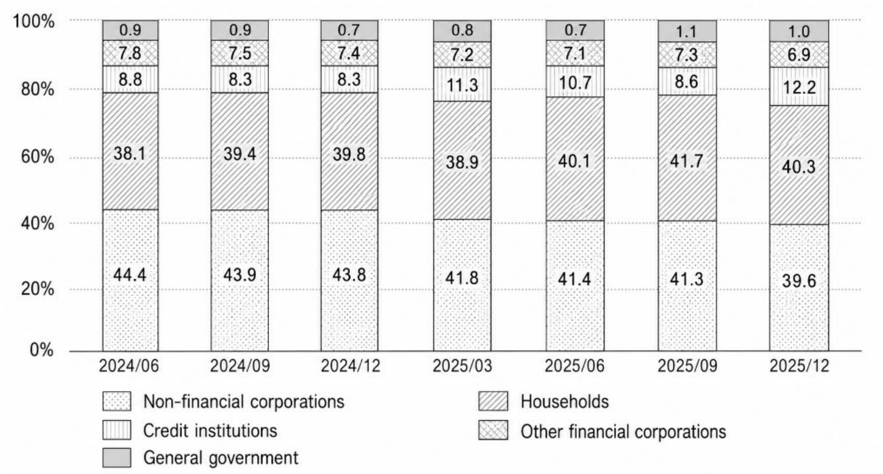
5.2. Liquidity buffers, credit dynamics and concentration risks

The liquidity coverage ratio increased from 241.1% at end-2024 to 280.6% at end-2025, driven by massive pre-conversion deposit inflows. Household deposits rose by BGN 11 billion in the fourth quarter alone. This surplus is largely mechanical and temporary, and the liquidity coverage ratio (LCR) is expected to return to more sustainable levels in 2026 while remaining above the 100% floor.

A more acute concern is normalisation during market stress, such as withdrawal of institutional deposits, rising loan impairments or compression of real deposit returns from fuel-driven inflation. In such circumstances, the liquidity position of individual banks may be weaker than the aggregate indicator suggests, especially in banks with short-term corporate funding and lower household deposits.

Gross loans grew by 20.1% year-on-year in 2025, or 15.1% excluding interbank exposures. Household lending was the main driver as mortgage loans exceeded BGN 35.8 billion and new business in this segment rose by 33.1%. The average household loan increased by nearly one quarter, showing that growth came from larger loans rather than more contracts.

Figure 11. Distribution of gross loans before impairment by segment (%)



Source: Bulgarian National Bank; own calculations.

Corporate credit growth is concentrated in energy, real estate and construction, which together account for more than half of the increase in non-financial corporations (NFC) exposures. Energy loans have very large average tickets and create concentration risk in a subsidy-dependent sector. Construction and real estate reach 9.4% of total credit, while both sectors approach a cyclical peak in turnover and prices.

The 76% increase in interbank claims to BGN 17.6 billion reflects one-off technical factors related to euro area accession, including correspondent balances, reserves for TARGET2/ TARGET Instant Payment Settlement (TIPS)/TARGET2-Securities (T2S) and intragroup transfers by euro-area banking groups. This effect is expected to partly unwind in 2026.

5.3. Interest rates, credit quality and profitability

The ECB cut key rates by 200 basis points by June 2025, reaching a deposit facility rate of 2.0%, and then held rates steady. Fuel-price pressure from the Hormuz Strait blockade led market participants to expect possible rate increases in 2026. Interest rates on new BGN mortgage loans, 2.48% at end-2025, remain among the lowest in the euro area, reflecting excess liquidity and strong price competition. From 2026, mortgage borrowers are directly exposed to ECB decisions through the replacement of LEONIA Plus by EURIBOR in most floating-rate contracts. Expected ECB tightening and interest convergence toward the euro-area average imply upward pressure of 50-90 basis points, raising debt-service burdens and moderating new demand.

Performing loans stood at 96.9% at end-2025, but the aggregate indicator conceals an early warning signal. NFC loans overdue by up to 90 days rose by more than one quarter in Q4, from BGN 992 million to BGN 1,254 million, far faster than gross NFC loan growth. This reversal, together with strong unit labour cost growth and lagging productivity, indicates increasing pressure on corporate margins.

Loan impairment charges rose by 14.2% to BGN 753 million in 2025, with second half of the year (H2) charges double those in the first half of the year (H1). Structural risks include exposure to traditional manufacturing under labour-cost and EU Emissions Trading System (EU ETS) pressure, construction firms relying on optimistic residential valuations and infrastructure contractors facing reduced public-investment flows without an approved 2026 budget.

Residential collateral covers a growing share of portfolios as property prices rose strongly in 2024 and 2025. Provisioning based on peak prices means effective protection against loss is smaller than reported. A 10-15% price correction under higher rates or slower growth would require additional provisioning when margins are already under pressure.

Net profit of the banking system was BGN 3.62 billion in 2025, slightly below the record 2024 level. Net interest and fee income increased, but profit declined because of lower dividend income, reduced trading gains, higher administrative expenses related to euro accession and higher impairment charges. This ended the uninterrupted upward trend.

Return on assets fell from 1.92% to 1.60% and return on equity from 15.92% to 12.25%, with the latter influenced by BDB capitalisation. Recent profitability reflects conjunctural factors such as inflation, income growth and the property cycle and a structural asymmetry between low deposit rates and stickier lending rates. This asymmetry is unlikely to be sustainable.

ECB supervisory priorities for 2026-2028 emphasise resilience to geopolitical and macrofinancial risks and operational and IT resilience. They will add costs through supervisory fees, enhanced Supervisory Review and Evaluation Process (SREP) processes, possible higher Pillar 2 requirements, Minimum Requirement for Own Funds and Eligible Liabilities (MREL), Digital Operational Resilience Act (DORA) implementation and ESG reporting, compounding cyclical pressure on earnings.

5.4. Outlook for the banking sector in 2026 and the short-term perspective

The analysis identifies several medium-term risks for banking-system indicators. The macroeconomic framework remains fragile, with effective demand outpacing productive capacity, generating inflationary pressure and weakening price competitiveness. The extension of emissions trading after 2026 will further reduce real disposable income and debt-service capacity.

Banks are exposed to energy and climate risks through corporate portfolios, especially firms without viable decarbonisation plans. Residential mortgage lending is a major systemic risk, as rapid growth in 2025 creates preconditions for a price bubble and may overstate collateral protection. A market correction would require additional provisioning and compress capital amid narrowing interest margins.

Credit quality shows early signs of deterioration, with sharply rising NFC loans overdue by up to 90 days and H2 impairments twice as high as in H1. Liquidity buffers, temporarily inflated by pre-conversion cash deposits, are expected to decline after normalisation in H1 2026, exposing weaker banks in case of market stress.

Additional risks stem from rapid financing growth to non-bank financial institutions and euro area accession. While transaction costs decline, Bulgaria loses the ability to influence the money supply through reserve requirements, and released liquidity could amplify the credit cycle. The main accession risk derives from the unfinished EU's Economic and Monetary Union architecture and limited influence in ECB decision-making.

6. Forecasts for the Development of the Bulgarian Economy until 2028

The forecast is based on assumptions about the international environment, external demand, prices, financial conditions and the fiscal policy path for 2025-2028, with information available as of 31 March 2026.

Forecasting the Bulgarian economy in 2025 proved difficult. As Table 5 shows, most institutions deviated from reported or expected outcomes, especially for growth, inflation and the current account. Relatively accurate unemployment forecasts do not change the conclusion that geopolitical uncertainty and policy shocks were difficult to quantify ex-ante.

Table 5. Comparison of different forecasts with reporting results

	Report / estimated	ERI at BAS	Ministry of Finance	Bulgarian National Bank	International Monetary Fund	European Commission
Economic growth (%)	3,2	2,2	2,8	2,8	2,5	2,0
Inflation, annual avg. (%)	3,5	3,9	2,4	3,8	3,7	3,6
Unemployment (%)	4,2	4,0	4,1	4,0	4,1	4,0
Current account (% of GDP)	-5,9	-0,8	-2,0	-2,3	-1,5	-1,1

Forecast errors reflected two factors. Exogenous assumptions differed from outcomes, as oil and gas prices were lower and global activity stronger than expected. Domestic transmission also differed. Foreign trade was weaker because of weak European partners and competitiveness constraints, while domestic demand, investment and credit were stronger. This justified risk scenarios for 2026-2028.

The period 2026-2028 is unusually complex. The war in Ukraine, US protectionism, renewed Middle East tensions, and euro area membership interact with weaker global trade and changing EU priorities. The world economy is not in classical recession, but growth is lower and more volatile, increasing the pass-through of shocks to prices, investment and confidence.

US tariffs affect Bulgaria mainly indirectly through weaker EU demand, value-chain disruptions and investor caution in export-oriented sectors. The war in Ukraine continues to affect Europe through energy, fiscal and defence channels. EU restrictions on Russian gas reduce shortage risks for Bulgaria but raise price uncertainty and infrastructure needs, while a Middle East energy shock would increase inflation and reduce EU growth.

For Bulgaria, these external risks coincide with euro area membership and domestic political uncertainty. Early data do not suggest a strong one-off euro-related price shock, but imported energy inflation may still affect domestic prices. The forecast is therefore a conditional assessment under high uncertainty with optimistic, baseline and pessimistic scenarios.

6.1. Methodology and scenario assumptions

The forecast uses a semi-structural macroeconomic model with behavioural equations, transition mechanisms and accounting identities linking the real sector, prices, external demand, financial conditions and public finances. The model links the interest rate, prices, external demand, employment, wages, inflation, consumption, investment, imports and GDP with fiscal and external-sustainability identities for the budget, debt and current account. Each forecast year is solved iteratively.

Table 6. Assumptions in different scenarios

Admission	Unit	Optimistic scenario			Baseline scenario			Pessimistic scenario		
		2026	2027	2028	2026	2027	2028	2026	2027	2028
Euro area growth/ external demand	%	0.8	1.0	1.2	0.2	0.3	0.8	-0.8	-0.5	0.0
Brent Oil price	USD/barrel	90.0	80.0	75.0	100.0	90.0	80.0	120.0	100.0	90.0
World food prices	Index 2020=100	125.5	128.8	131.4	140.0	148.0	145.0	148.0	152.0	149.0
External inflation	%	2.2	2.0	2.0	3.5	3.8	3.2	4.0	4.2	3.8
ECB interest rate	%	3.3	2.8	2.5	4.0	4.5	4.2	4.5	5.0	4.7
Banking/Risk spread	pp	0.5	0.2	0.5	1.0	1.5	1.2	1.5	1.8	1.5
Real effective exchange rate	Index 2020=100	116.0	117.0	120.0	116.0	118.0	117.0	119.0	117.0	116.0
Net income and transfers from abroad	% GDP	0.8	1.1	1.2	0.5	0.6	0.7	0.4	0.5	0.6
Effective interest rate on government debt	%	3.2	3.1	3.0	3.5	3.8	3.9	4.1	3.9	3.8

Source: IMF, WEO update January 2026.

The optimistic scenario assumes better external demand, lower energy prices, easing inflation and declining interest rates. It represents controlled normalisation, supported by public investment and EU funds. The baseline scenario combines weaker external demand, higher energy and food prices, tighter financial conditions and more limited public spending. It captures a mixed adverse macroeconomic shock. The pessimistic scenario assumes a deeper and more persistent deterioration in external demand, reinforced by less favourable price, financial and fiscal assumptions. It is a broader externally driven weakening of activity, not only a trade shock.

6.2. Forecast results for 2026-2028

The optimistic scenario gives the most favourable medium-term profile. Real GDP growth rises from 2.9% in 2026 to 4.6% in 2028, while HICP inflation declines from 3.4% to 2.4%. Private consumption remains resilient, investment leads growth, and exports gradually recover. Unemployment falls to 3.2% by the end of the horizon. The fiscal position is manageable as the deficit narrows from 2.8% to 2.2% of GDP, although public debt still increases slightly. The current account also improves, which indicates a gradual correction of external imbalances.

Table 7. Prediction results

Indicator	Unit	Optimistic scenario			Baseline scenario			Pessimistic scenario		
		2026	2027	2028	2026	2027	2028	2026	2027	2028
GDP growth	%	2.9	3.9	4.6	1.6	2.5	3.5	0.9	1.5	2.3
HICP inflation	%	3.4	2.7	2.4	3.7	2.9	2.4	3.3	2.6	2.1
Consumption growth	%	4.3	3.1	2.7	4.1	2.6	2.3	4.1	2.6	2.2
Export growth	%	1.1	2.8	3.9	-0.2	1.7	3.4	-0.6	0.3	1.7
Import growth	%	4.3	3.7	3.6	3.7	2.8	2.6	3.5	2.5	2.1
Investment growth	%	8.1	9.1	10.2	5.4	4.8	5.6	4.3	3.2	3.5
Unemployment	%	3.4	3.4	3.2	3.9	4.0	4.3	4.0	4.3	4.8
Budget balance	% of GDP	-2.8	-2.4	-2.2	-3.0	-2.9	-3.0	-3.1	-3.1	-3.3
Government debt	% of GDP	28.3	29.0	29.4	29.4	31.7	33.6	29.7	32.6	35.3
Current account	% of GDP	-4.8	-3.5	-2.4	-5.0	-4.0	-2.9	-5.0	-4.1	-3.0

The baseline scenario is less favourable. GDP growth reaches 1.6% in 2026, 2.5% in 2027 and 3.5% in 2028. Compared with the optimistic path, the economy loses roughly 1-1.5 pp of annual growth. Inflation declines more slowly, reflecting the combined effect of higher energy and food prices and tighter financial conditions. Investment and exports are the most affected components. The unemployment rate increases to 4.3% in 2028, while the budget deficit remains around 3% of GDP and public debt rises to 33.6% of GDP. This scenario has a moderate stagflationary profile, marked by weaker growth and slowly receding inflation.

The pessimistic scenario is most adverse for real activity. GDP growth is only 0.9% in 2026, 1.5% in 2027 and 2.3% in 2028. Export growth is weakest, investment slows markedly, and unemployment rises to 4.8% by 2028. Inflation is lower at the end of the horizon, not because of improved price stability, but because weak demand dominates the initial cost shock. The fiscal cost is substantial – the deficit deteriorates to 3.3% of GDP, and public debt reaches

35.3% of GDP in 2028. The scenario therefore represents recessionary disinflation rather than benign cooling.

The scenarios cannot capture all changes in expectations, capital flows, compensatory fiscal measures or second-round effects on electricity and food prices. They should be interpreted as internally consistent scenarios, not precise point forecasts.

6.3. Risks, limitations and policy implications

The scenario comparison highlights ***Bulgaria's central vulnerability – dependence on the external environment through exports, investment and financial conditions***. Even the optimistic scenario does not automatically stabilise public debt, while the baseline and pessimistic scenarios show how quickly weaker growth can affect fiscal and external balances.

Risks are asymmetric and point mainly to lower growth and initially higher inflation. Middle East escalation would raise oil, gas and food-related costs, passing through energy, transport, food and services. Fiscal policy is the second major risk. If wages, pensions, energy compensation or defence spending are not matched by revenue or efficiency gains, the deficit and debt path may worsen even without a further external shock.

Bulgaria retains capacity for medium-term growth but is highly sensitive to external conditions. Policy should strengthen export resilience, preserve investment under tighter financial conditions and maintain fiscal space. Fiscal prudence, energy-shock buffers, and close monitoring of inflation, interest rates and debt are essential.

7. Conclusion

The analysis shows that Bulgaria's medium-term development requires a shift from policies supporting short-term demand to policies that strengthen productivity, export capacity and structural resilience. Euro area membership may reduce transaction costs and improve financial integration, but it cannot by itself resolve low investment efficiency, import dependence, labour shortages and insufficient technological upgrading.

A key priority is a stronger medium-term fiscal framework, linking permanent expenditure to sustainable revenues and assessing budgetary effects on inflation, imports and the balance of payments. Fiscal consolidation should redirect resources toward public investment with measurable productivity and export effects, including infrastructure, digitalisation, energy efficiency, education, innovation and industrial zones. Revenue collection should be strengthened through digital monitoring, risk-based control and measures against the informal economy.

Industrial, energy and investment policies should support activities with higher technological complexity and export potential, including engineering, electronics, automotive components, chemicals, green technologies and defence production. Reducing energy and import dependence requires incentives for energy efficiency, renewable capacities, storage, technological modernisation, supply diversification and stronger local supplier networks around large investors, universities and research organisations.

Sustainable growth also depends on the labour market, education and external competitiveness. Income growth should be linked to productivity, unused labour reserves should be activated, and vocational education should be aligned with priority sectors. Higher value-added exports, export-oriented services, ICT, logistics, transport, tourism and business services should be supported through R&D incentives, automation, digital infrastructure and a more quality-oriented FDI policy.

Financial stability should be preserved through preventive macroprudential policy, including capital buffers, loan-to-value limits and debt-to-income requirements. Bank financing should support productive investment in SMEs, digitalisation, energy efficiency, technological renewal and exports, while non-bank intermediation requires stronger reporting and supervisory coordination.

The main policy conclusion is that successful euro area integration depends not only on nominal convergence and institutional alignment, but also on the capacity to transform the structure of the economy. Sustainable growth requires fiscal discipline, productive investment, technological modernisation, higher labour productivity, stronger export orientation and a financial system that supports the real economy rather than amplifies cyclical and asset-market risks.

Contribution of individual authors

Dimitar Zlatinov has contributed to the preparation of the introduction, the analysis of the external sector, the formulation of the concluding section, and the overall editing and harmonisation of the manuscript.

Victor Yotzov has been responsible for the macroeconomic forecast and the development of the medium-term projection framework.

Grigor Sariiski has contributed to the analysis of the banking sector, with particular emphasis on financial stability, credit dynamics, liquidity, profitability and the bank risks associated with euro area accession.

Iana Paliova has been responsible for the analysis of public finances and fiscal sustainability, including budget revenues and expenditures, public debt, the fiscal deficit, and the implementation of European funds.

Stela Raleva has contributed to the analysis of GDP dynamics, income convergence and inflationary developments, including the assessment of factors underlying economic growth and price dynamics.

Yordan Dimitrov has been responsible for the analysis of the labour market, including employment, unemployment, labour-force participation, skills supply and demand, and the structural challenges related to demographic change and human capital.

Conflict of Interests

The authors declare that they have no conflicts of interest related to this manuscript.

Declaration of Generative AI and AI-assisted technologies in the writing process

During the preparation of this work, the authors used AI solely to translate, refine the wording of the text and improve its academic tone. After using this tool, the authors reviewed and edited the content as needed and take full responsibility for the content of the publication.

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