

Speech by Ms Nina Stoyanova, BNB Deputy Governor in charge of the Banking Department, at the Bulgarian School of Politics “Dimitry Panitza”, Borovets, 2 July 2023

Dear Mr. Nachev,

Dear participants,

I thank the Bulgarian School of Politics “Dimitry Panitza” for the invitation to the Bulgarian National Bank (BNB). It is a great pleasure for me to be here today with you – the young leaders of Bulgaria – and to welcome the participants in the third course of the „Management Skills“ National Program. Today’s topic also gives rise to discussion, which I hope we will have, namely: Is the decision to adopt the euro political or economic? What are the requirements for its introduction?; What are the benefits our country could get?; as well as to comment on some of the more common criticisms.

Participation in the euro area – the final stage of European integration

Joining the euro area is a clear expression of a country's geopolitical orientation. It is a necessary and logical continuation of the participation in the European Union (EU), which Bulgaria joined more than 15 years ago. Then, all political forces were united around this cause, which led to the successful conclusion of the negotiations and the accession of our country to the EU on 1 January 2007.

European and democratic values have always found broad support in the Bulgarian society. There has never been any doubt that joining the EU was the right decision and that it brought many benefits to our country – both politically and economically. Today we are a full participant in all EU institutions and bodies, we are part of the decision-making process and our voice weighs as much as that of the other countries. The membership in EU has also brought us many economic advantages. Bulgaria is part of the EU single market. The freedom of movement of people, goods and capital, as well as the harmonised legal framework of the Member States in the most important areas for economic life, contribute to economic growth, convergence and integration.

If we compare the data before our country's accession to the EU and now, we will find that for the period from 2006 to 2022 the gross domestic product has grown by 3 times¹, and the average income from wages per household person has grown by nearly 4 times². Our country continues to be a net beneficiary of European funds, with current and capital transfers received exceeding by several times the amount of our contribution to the EU budget. These data demonstrate the positive impact on our economy from EU membership, and our participation in the euro area is a natural extension of Bulgaria's European path.

Participation in the euro area is the final phase of our European integration in its highest form – the Economic and Monetary Union – and we have already started this process with the following important steps:

- the Bulgarian lev joining the European Exchange Rate Mechanism in July 2020 while maintaining the fixed exchange rate of the lev to the euro of BGN 1.95583 for one euro. This rate has not changed since 1997 when the Currency Board was introduced in the country and the lev rate was first fixed to the German mark, and when the euro was introduced in

¹ from BGN 53.6 billion in 2006 to BGN 165.4 billion in 2022 at current prices

² from BGN 1222 as of 2006 to BGN 4851 as of 2022 on an annual basis

Germany, it was recalculated according to the official rate at which the German mark was converted to the euro. There is no reason to change this course in the future. The commitment of the Bulgarian authorities for our country to join the euro area at the current fixed exchange rate has been confirmed both in the National Euro Changeover Plan of the Republic of Bulgaria, adopted by the Council of Ministers in May 2022, as well as in the Decision of the National Assembly of October 2022, with which the Bulgarian institutions were tasked with accelerating the consultations and continuing the technical preparation for the adoption of the euro in the country;

- since October 2020, Bulgaria is a participant in the Single Supervisory Mechanism (the so-called Banking Union) and the Single Resolution Mechanism. At the moment, we are the only country outside the euro area that participates in these mechanisms. This means that the significant banks in the country, which are part of large European banking groups, are already under the direct supervision of the European Central Bank (ECB), and with regard to the remaining banks, the BNB complies with the guidelines issued by the ECB and undertakes the necessary measures to implement the legal acts of the ECB, according to the applicable legal framework. Participation in these basic structures of the euro area gives more stability and confidence in the banking sector in our country;

- in December 2022, Bulgaria signed with the European Commission (EC) and the chairman of the Eurogroup a Memorandum of Understanding for the production of euro coins³. The document allows our country to carry out all the necessary activities to prepare and start production of euro coins upon receiving approval to join the euro area.

Criteria for the introduction of the euro

According to Art. 140 of the Treaty on the Functioning of the EU (the Treaty), at least every 2 years or at the request of a Member State with a derogation (an EU Member State that has not yet adopted the euro but has such an obligation), the ECB and the EC prepare separate reports to the Council of the EU, through which the progress of the Member States with a derogation is assessed in terms of fulfilling the criteria for economic and legal convergence. In the next regular reports due in the spring of 2024, 6 countries will be evaluated⁴. Achieving nominal and sustainable convergence is a condition for membership that our country must fulfil.

In the legal field, subject to assessment are topics related to the independence of national central banks in its four aspects: functional, institutional, personal and financial independence. Object of study is also compliance with the ban on monetary financing and privileged access of the public sector to financial institutions, as well as ensuring the legal integration of the relevant national central banks in the Eurosystem, expressed by meeting certain requirements in their organisational laws.

In the economic field, criteria defined in the Treaty, also called the “Maastricht Criteria”, named after the city in the Netherlands where the Treaty was signed, are subject to assessment, namely:

³ https://www.bnb.bg/AboutUs/PressOffice/POPressReleases/POPRDate/PR_20221206_BG

⁴ Bulgaria, the Czech Republic, Hungary, Poland, Romania and Sweden. Of the EU Member States that have not yet adopted the euro, only Denmark, which has agreed not to participate in phase three of the Economic and Monetary Union and thus has no obligation to adopt the euro as its national currency, is not assessed in the reports

- Price stability, with the average annual rate of inflation for the last 12 months not exceeding by more than 1.5 percentage points that of the three Member States with the best results in the area of price stability;
- The budget deficit should not exceed 3% of GDP;
- State debt should not exceed 60% of GDP;
- The average nominal long-term interest rate, measured by the yield of ten-year government bonds denominated in the national currency, for a period of 1 year before the assessment should not exceed by more than 2 percentage points the average value of the indicator for the three Member States with the best results in the area of price stability;
- Participation of the national currency in the Exchange Rate Mechanism II for a period of at least 2 years before the assessment, without depreciation compared to the central rate to the euro.

The fulfilment of the specified criteria is an expression of the degree of economic convergence and financial stability of a given country. A country that meets the mentioned economic requirements has a sufficient degree of readiness to join the euro area. Bulgaria has been fulfilling the criteria for joining the euro area for a long period of time. The benchmark for inflation, for which data will be finally reported for the last 12 months before the next regular convergence reports in spring 2024, remains problematic.

Advantages of introducing the euro

Today, the euro is the national currency of 20 of the 27 EU Member States, among which are the most developed European economies, and of more than 346 million Europeans. The single European currency was introduced on 1 January 1999, initially in electronic form used in banking operations, and from 1 January 2002 – also in the form of banknotes and coins representing the national currency of 12 countries. In the following years, also as a result of the EU enlargement, 8 more countries successively joined the euro area, the last of which is Croatia as of 1 January 2023. The territory that the single European currency covers is expanding, and this allows to fully use all the advantages of the single market with a more integrated European economy and financial markets.

More than 20 years after the introduction of euro banknotes and coins, the euro retained its position as the second most important currency in the world last year. This is confirmed by the data in the 22nd annual review of the international role of the euro published by the ECB, which analyses various financial indicators of the share of use of the euro outside the euro area, presented in June 2023 by the President of the ECB, Ms. Christine Lagarde⁵.

The positive effects of the introduction of the euro have been repeatedly pointed out by the Bulgarian institutions, including the governor of the central bank, as well as by leading economists and business leaders in the country.

In 2022, the Economic and Social Council to the National Assembly adopted an analysis of the impact of Bulgaria's accession to the euro area on the economic development, inflation and income in the country. The conclusion of the Economic and Social Council, which represents broad circles of the civil society, is that the benefits of the country's membership in the euro area are much more than the risks or costs.

⁵ <https://www.ecb.europa.eu/pub/ire/html/ecb.ire202306~d334007ede.en.html>

Also in 2022, the Sofia University published a collective monograph “Challenges to the Bulgarian economy on the way to euro area membership” on the occasion of the 120th anniversary of the Department of Economics at the Faculty of Economics and Business Administration of Sofia University – the oldest Department of Economics in Bulgaria. One of the main conclusions of the monograph is that the Bulgarian economy has a high degree of readiness for adoption of the euro.

The Bulgarian business supports Bulgaria's accession to the euro area and this position is clearly expressed by the nationally represented employers' organisations. A sociological survey carried out by the Alpha Research agency in November 2022⁶, commissioned by the Ministry of Finance, shows that 2/3 of entrepreneurs support the introduction of the euro, while among the citizens, approval was expressed by 1/3 of the respondents. The most widespread fears are related to concerns of rising prices and inflation, due rather to a lack of awareness.

The chairman of the Association of Banks in Bulgaria, Mrs. Petya Dimitrova, recently confirmed the readiness of the banks in the country to join the single European currency⁷. The main message of the chairperson of the banking association is that joining the euro area is a long-awaited process that will positively affect the country's economy and will be a driver for accelerating reforms, reaching European standards of living and a more favourable business environment.

Some of the advantages of the introduction of the euro can be summarised in the following areas:

- joining the euro area creates greater stability and trust in the respective country, which improves the investment environment and creates prerequisites for economic growth;
- the countries that joined before us have seen an increase in their credit rating, which, among other advantages, is a prerequisite for increasing investments, as well as for reducing the costs of issuing public debt and a lower debt premium;
- price stability – the main objective of the Eurosystem is to maintain price stability, preserving the value of the euro. Despite the global economic difficulties caused by the COVID pandemic and the war in Ukraine, average annual inflation in the euro area is currently declining and remains at much lower levels than inflation in other European countries that are not part of the euro area. If we compare the current data on annual inflation, measured by the harmonised index of consumer prices as of May 2023, in the euro area it is 6.1%, while the highest levels in the EU are reported for Hungary (21.9%), Poland and the Czech Republic (12.5% in both). For the same period in Bulgaria it was 8.6%;
- financial stability – the banking sector is more stable thanks to the participation in the Single Supervisory Mechanism and the Single Resolution Mechanism, which Bulgaria already joined in October 2020. In addition, banks and financial institutions will have access to the integrated and developed financial markets of the euro area. Bulgarian banks will have access to collateral-based financing from the ECB through its open market operations, which the BNB does not currently carry out due to the currency board regime. The expected effect is lowering of interest rates on loans after joining the euro area;

⁶ <https://www.minfin.bg/bg/news/2022-12-19>

⁷ <https://bta.bg/bg/news/economy/bg/476943-petya-dimitrova-asotsiatsiyata-na-bankite-v-balgariya-shte-raboti-aktivno-za-po>

- more opportunities for Bulgarian business – companies will have an opportunity for easier, cheaper and risk-free trade in the common European economic area. The introduction of the euro eliminates conversion costs and reduces transaction costs for foreign currency transfers, improving conditions for international trade and business. In 2022, 43.9% of the exports of Bulgarian enterprises are directed to the euro area, and 36.5% of the imports are from trading partners from the euro area. This is important for tourism as well, since in 2022 our revenues from trips were BGN 6.3 billion, of which BGN 3.1 billion or almost half are from EU citizens⁸;

- for citizens – economic stability and growth lead to an increase in employment, productivity and incomes. Data for some of the last countries that joined the euro area – Lithuania, Latvia and Estonia, in the period 2011-2015, show that before joining the euro area, the average salary was in the range of EUR 700 - 800, while in 2022 the average salaries are in the range of EUR 1400 - 1900, which is an increase between two and three times – from 92% for Latvia to 164% for Lithuania compared to the corresponding year before the introduction of the euro;

- a country that is a member of the euro area has access to the European crisis response mechanisms, which creates a prerequisite for great stability and smooth passing through periods of turbulence.

Last but not least, the adoption of the euro as the national currency represents a way out of the currency board regime, introduced in our country more than 25 years ago – in 1997 as a consequence of the financial and banking crisis at that time. Today, Bulgaria remains the only EU Member State with a currency board regime. This regime severely limits the powers that central banks traditionally have in conducting monetary policy operations. The Bulgarian National Bank does not have such powers, and to the extent that the value of the Bulgarian lev is tied to that of the euro through a fixed exchange rate, the effects of the ECB's monetary policy are passed on to our economy, but without us being able to participate in the decision-making process.

The alleged risks of the introduction of the euro are not proven by the data and facts available to us:

- Increase in inflation. Eurostat data for some of the countries that recently joined the euro area show negligible inflation differences for the year of the adoption of the euro, within the range of 0.3 - 0.7 % for Estonia and Latvia, while in Lithuania even a deflation is observed when comparing the harmonised index of consumer prices for the year of adoption of the euro compared to the average annual value for the previous 12 months. This trend is also confirmed by the experience of Croatia, which joined the euro area from the beginning of 2023. For the first 5 months of the adoption of the euro, monthly inflation in Croatia shows a permanent decrease – from 12.7% in December 2022 to 8.3% for May this year;

- Loss of monetary sovereignty. In fact, after the introduction of the currency board in 1997 and the pegging of the exchange rate of the Bulgarian lev first to the German mark and later to the euro, the BNB does not carry out monetary policy operations typical of central banks. When the euro is introduced, the BNB will participate in making decisions related to the monetary policy of the euro area, of which we will be a part, and will not just passively accept their consequences. This is the necessary and reasonable way out of the currency board.

⁸ Based on balance-of-payments data

Joining the euro area will allow us to be part of the shared sovereignty of the central banks⁹ whose currency is the euro;

- Other EU Member States have not yet adopted the euro. The reasons for this vary. Some of the countries do not fulfil the economic criteria for the introduction of the euro, and in others the Eurosceptic sentiments of the political parties have an influence. The essential difference between Bulgaria and the other Member States that have not yet adopted the euro is that the Bulgarian National Bank does not have the standard instruments for monetary policy due to the currency board regime, while the central banks of the remaining countries outside the euro area conduct their own monetary policy, which they believe is better targeted to the specifics of their economies and business cycle. The success of the euro as a single European currency is leading to a renewed discussion of this topic. For example, in March 2023, the Romanian Minister of Finance announced that the government would aim to introduce the euro by 2026, instead of 2029, as was the plan previously¹⁰. In a speech by the Chairman of the Fiscal Council of Hungary of May 2023, the possibility of introducing the euro in Hungary in 2027 was considered against the background of high inflation in the country and the devaluation of the national currency¹¹. A poll conducted in November 2022 shows that business leaders in Sweden support the introduction of the euro¹².

In conclusion, the data and experience of the countries that joined earlier than us show that the introduction of the euro has had a positive impact on their economy. Full participation in the Economic and Monetary Union creates prerequisites for deriving the maximum potential from participation in the single European market, accelerating real convergence and convergence with average European incomes. This convergence is accelerated when the country is a participant in the euro area.

⁹ <https://www.bta.bg/bg/news/bulgaria/351028-preminavame-ot-rezhim-v-koyto-lipsva-parichen-suverenitet-kam-rezhim-na-spodel>

¹⁰ <https://www.euractiv.com/section/politics/news/romania-wants-to-push-euro-adoption-by-2026/>

¹¹ <https://dailynewshungary.com/new-euro-introduction-date-set-in-hungary-it-is-surprisingly-close/>

¹² <https://www.thelocal.se/20230302/new-poll-swedish-business-leaders-in-favour-of-joining-the-euro>