Keynote Address by the Governor of the Bank of Uganda at the XVI Scientific Seminar at the Joaquim Chissano Conference Center on June 16, 2025: Capital Account Liberalization in Mozambique and the Challenges for Macroeconomic Management

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Esteemed colleagues, distinguished guests, ladies and gentlemen, good morning to you all.

As a preliminary step, I heartily congratulate you, Zandamela, the leadership, and the entire team at Banco de Moçambique on the recent momentous celebration of your 50th anniversary and the 45th anniversary of the Metical (the official currency of Mozambique). These milestones are a testament to your unwavering commitment to monetary stability and financial inclusivity.

I deeply regret that unforeseen last-minute commitments prevented me from joining you in person for the festivities, as I had eagerly anticipated. Please accept my sincere apologies—it was a privilege to have been invited, and I remain grateful for your kind hospitality.

It is a profound honour to stand before you today at the Banco de Moçambique Scientific Conference, addressing a theme as critical and timely as "Capital Account Liberalisation in Mozambique and the Challenges for Macroeconomic Management". I bring greetings from the Bank of Uganda (BoU) and, more importantly, insights from Uganda's own journey through the complexities of financial openness. Our experiences, though rooted in our unique history, may offer universal lessons for developing countries navigating the global financial landscape.

The Liberation Revolution: Why Uganda Embraced Financial Openness

Thirty years ago, Uganda faced a daunting economic reality. We had emerged from a prolonged period of civil strife and economic mismanagement, characterised by rampant inflation, a contracting productive base, and widespread "financial repression". Our financial landscape was a maze of structural weaknesses and policy failures, with high negative real interest rates, bureaucratic bottlenecks, and inadequate risk assessment stifling economic growth. Access to finance was severely constrained, hindering any real economic dynamism.

Compounding these domestic challenges, current and capital account transactions frequently occurred in informal or "parallel" markets. In Uganda, over half of the country's main export, coffee, was smuggled to Kenya, and agents engaged in arbitrage across official and parallel markets for financial assets, foreign exchange, and goods. This created immense efficiency losses for the economy, rendering the "control model" of the 1980s largely ineffective. Indeed, in many cases, current and capital account liberalisation became a formalisation of what was already occurring de facto, as full enforcement of existing controls proved impractical.

In 1987, Uganda initiated a comprehensive Economic Recovery Programme (ERP), which was supported by the International Monetary Fund (IMF) and the World Bank. This process began with the liberalisation of the domestic real and financial sectors, followed by the current account in 1993. A fully liberalised capital account was formally established in July 1997, allowing for the free flow of capital.

The primary motivation for the bold move to open up the capital account was clear: to close the persistent savings-investment gap and attract urgently needed resources for sustainable, long-term growth. Domestic private savings then stood at a meagre 1% of GDP, insufficient to sustain an investment rate of 11%. We recognised that an open capital account could facilitate the direct transfer of external resources to the domestic private sector, boosting investment, especially since there were "no savings to retain" domestically. Beyond this, liberalisation offered the promise of efficiency gains, better resource allocation, strengthened macroeconomic discipline, and institutional development.

This shift was also driven by significant structural changes in the world economy over the last two decades then, particularly the increasing globalisation of financial markets, facilitated by the relaxation of capital controls and new telecommunications and computer technologies that streamlined cross-border fund transfers and reduced transaction costs.

This strategic shift brought us face-to-face with a fundamental concept in open economy macroeconomics: the 'Impossible Trinity' or 'Trilemma'. This principle states that a country cannot simultaneously maintain a fixed exchange rate, pursue an independent monetary policy, and allow for free capital mobility. You can only choose two. For much of our post-independence era, Uganda reconciled this trilemma through capital controls. However, with the liberalisation of capital account transactions at the close of the 1990s, this choice became starker. Uganda resolved to adopt an open capital account and an independent monetary policy, consciously accepting the flexibility and, at times, volatility of the exchange rate. This choice enabled the Bank of Uganda to maintain autonomy in managing domestic liquidity and inflation, a crucial objective for attracting capital and promoting stability.

The Policy Package: An Ecosystem for Openness

Our journey taught us a critical lesson: sequencing matters. The path to capital account convertibility is typically a gradual process rather than a "big bang" approach, accompanied by broader fiscal and financial reforms. While Uganda's formal liberalisation in 1997 might appear as a "big bang" approach, it was, in fact, a journey that formalised the de facto real and financial sector activities domestically and externally, which had already emerged. This "speed versus stability tension" presented its own set of "growing pains," necessitating a broader package of reforms. Crucially, Uganda implemented domestic real and financial sector reform programs before formally opening the capital account, intending to ensure that these sectors were robust enough to withstand potential capital surges.

Key accompanying measures included:

- **Fiscal Discipline**: Uganda's commitment to fiscal discipline was a critical macroeconomic precondition for its broader liberalisation and the achievement of stability. Before the reforms, Uganda faced severe fiscal challenges, with budget deficits financed mainly by the central bank's money printing, leading to hyperinflation that reached 250% in 1987 and averaged 191% between 1986 and 1989. With strong political commitment, the government adopted the cash-budget approach in 1992/93, and the outcomes were transformative: annual inflation dramatically fell from a peak of 250% and average inflation was subsequently contained below 10% for several years starting 1992/93, reaching 5% by 1999/2000 and has averaged so since then. Far from impeding progress, this fiscal consolidation accelerated real GDP growth, which averaged 8% per annum in the five years following the reforms, laying the foundation for sustained growth of around 7% per annum since 1991/92. The consistent pursuit of prudent fiscal and monetary policies fostered significant confidence among domestic and international stakeholders, attracting vital foreign direct investment and the return of flight capital. This, in turn, became the cornerstone of macroeconomic stability in Uganda, enabling non-inflationary financing for continued growth.
- **Monetary Policy Autonomy**: The BoU was granted autonomy in conducting monetary policy, as well as supervising and regulating financial institutions, through revisions to the Bank of Uganda Statute in 1993. This shift from direct to indirect monetary controls aimed to improve efficiency in financial intermediation. Following liberalisation, the Bank of Uganda influenced interest rates using indirect instruments, including open market operations under the quantity-based Reserve Money Program (RMP). In July 2011, we transitioned to an Inflation-targeting Monetary Policy Framework, largely prompted by the difficulty

in controlling inflation due to the instability of money demand, which was partially caused by new financial innovations under the RMP. Under this framework, the BoU targets core inflation of 5% in the medium term (2-3 years). Over the last five years, Uganda's inflation has averaged 4.1%, which is well below the target, and has more recently averaged 3.4%. This robust monetary policy framework, combined with declining inflation, has been crucial for attracting foreign investment as investors seek markets with predictable and low inflation rates.

- **Financial Sector Reforms**: This involved the explicit removal of interest rate controls, with effective adjustments in nominal interest rates starting in July 1988 and full liberalisation by 1994. The aim was to enhance the intermediation efficiency of the sector by mobilising more savings and allocating to those sectors that were productive in a market environment. Direct government involvement in resource allocation and crop financing was restricted, alongside the divestiture of government ownership in commercial banking.
- **Prudential Supervision**: This process was complemented by parallel measures to strengthen bank supervision and foster financial discipline through new legislation and regulations. The Financial Institutions Statutes (FIS) and Bank of Uganda (BOU) Statutes were revised in 1993, granting the Central Bank autonomy in monetary policy, supervision, and regulation. This included enhanced capital adequacy requirements for all financial institutions. Banks were also required to establish systems and controls for foreign exchange risks, with overnight exposure limits set at 25% of core capital. These measures were necessary to enable banks to buffer the risks that came with the impact of capital account liberalisation.
- **Exchange Rate Liberalisation**: This shift contributed to financial deepening and sustained high output growth, besides underpinning the growth and diversification of the export base.

Benefits of Financial Openness and Market Development: The Payoff

Our commitment to these reforms has yielded substantial benefits, deepening and broadening our domestic financial markets to attract and manage capital flows effectively and specifically:

- **Ensured Macroeconomic discipline**: With a liberal capital account, sound macroeconomic policies are necessary. Capital flows respond to changes in economic policies; for example, outflows can occur due to deteriorating economic policies, which can have adverse effects on the economy. Since the opening up of the capital account, Uganda has maintained sound economic policies to avoid such reversals.
- **Increased Investment and Economic Growth**: Liberalisation led to a substantial increase in foreign capital inflows. We witnessed a discernible increase in private sector investment, rising from 11.5% of

GDP in FY 1996/97 to 12.8% in FY 1998/99 and to 17% in 2023/24, largely due to intensified investment in the oil sector between 2021 and 2024. The FDI flows have proven stable and beneficial, directly translating into fixed investment and bringing invaluable intellectual capital—technology, know-how, and managerial expertise. Equity investments also naturally share commercial and interest rate risks with the investor.

- **Financial Deepening and Efficiency**: Capital account liberalisation has promoted financial market and institutional development, better governance, and macroeconomic discipline. Overall, within the banking system, we have observed improvements in the allocation of firm capital, resulting in higher aggregate productivity. This has largely driven competition in the banking sector following the entry of foreign banks, leading to lower costs of financial intermediation and improved service quality through enhanced competition and the transfer of technology.

Challenges and Managing the Tremors of Openness

Despite the considerable benefits, the evolution of capital markets and the path to liberalisation have also introduced significant challenges and risks. These include:

- **Macroeconomic Management & Monetary Policy Conflicts**: Increased foreign exchange inflows under a liberal capital account presented challenges to foreign exchange market stability and complicated liquidity management. This often complicated the conduct of monetary policy, as sterilised foreign exchange interventions to contain inflation led to higher lending rates, crowding out the real sector and increasing the central bank's cost of policy implementation. Exchange rate movements sometimes trigger shifts in the currency positions in the banking sector, with a rising preference for foreign currency deposits, or dollarisation, when the currency depreciates over a sustained period, which further complicates liquidity management.
- **Vulnerability to Flow Reversals**: Liberalisation significantly heightened our vulnerability to sudden reversals in capital flows. Volatile aid and donor support flows, together with fickle yield-seeking portfolio flows, vividly demonstrate the vulnerability of capital account liberalisation when domestic capital markets lack sophisticated hedging instruments to protect against exchange rate movements. Portfolio flows have proved difficult to predict and manage. These short-term, foreign currency-denominated debt flows are notoriously volatile and prone to sudden stops. Uganda has experienced volatility, resulting in exchange rate fluctuations.
- **Foreign Exchange Reserve Management Challenges**: Amidst capital account liberalisation, Uganda's foreign exchange reserves experienced both growth and volatility. Liberalisation attracted increased foreign

direct investment and private transfers, leading to periods of robust reserve accumulation. However, the openness of the capital account also exposed reserves to new challenges: volatile short-term inflows, widening current account deficits, and heightened sensitivity to global financial shocks. More recently, shocks such as reduced external financing and global tightening have put pressure on foreign reserves.

- **Absence of Supportive Markets**: The absence of hedging instruments and markets often led to herding effects, which created self-fulfilling expectations in currency movements, thereby increasing exchange rate volatility.
- **Prudential Regulation and Supervision Challenges**: Liberalisation created new forms of risks for domestic banks, such as currency mismatch and the transfer of exchange rate risk into credit risk, which they had little experience managing. The large accumulation of short-term foreign liabilities by banks was a major source of distress in problem banks, with some classifying vast resources under off-balance sheet items. This highlighted the critical need for stronger regulation, reporting requirements, and data collection systems.

Uganda's Proactive Responses: Navigating Contemporary Challenges

Rather than resorting to outright capital controls, which we learned are costly and often ineffective to re-impose, Uganda developed a robust macro-prudential toolkit and continues to implement reforms to manage the inherent risks of capital flow volatility. These tools focus on mitigating risks while providing space for counter-cyclical monetary policies and addressing new challenges:

- **Macro-Prudential Tools**:
  - **Reserve Requirements on Foreign Currency Liabilities**: We implemented cash reserve requirements on all deposit liabilities, reservable in shillings, effectively controlling excess liquidity and mitigating systemic liquidity risks related to currency and maturity mismatches.
  - **Limits on Net Open Foreign Currency Positions**: We established and progressively tightened statutory limits on the net open foreign currency positions of financial institutions, which are crucial for controlling foreign exchange exposure.
  - **Enhanced Regulatory Frameworks (Basel Implementation)**: The Bank of Uganda has fully implemented Basel II and employs a Risk-Based Supervision (RBS) approach, which is being further enhanced with technical assistance from the IMF. More recently, the Basel III capital conservation buffer, counter-cyclical capital buffer, systemic risk buffer for Domestic Systemically Important Banks (DSIBs), and leverage ratio requirements were introduced for banks in Uganda through the Financial Institutions (Capital

Buffers and Leverage Ratio) Regulations, 2020. In addition, the Financial Institutions (Liquidity) Regulations 2023 were gazetted in August 2023, requiring banks to enhance their liquidity risk management and allowing for the use of the Basel III liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) as prudential measures.
  - **Increased Minimum Paid-Up Capital**: Minimum paid-up capital requirements for commercial banks was increased significantly from UGX 25 billion (about US$7 million) to UGX 150 billion (about US$ 40 million) by June 2024 to cushion against risks, including those related to increased transactions under the open capital account.
  - **Consolidated Corporate Governance Guidelines (2022)**: These guidelines were issued to close identified gaps in banks' corporate governance practices.
- **Combating Money Laundering and Terrorism Financing**: Uganda's placement on the FATF Grey List in 2020 exposed the country to increased due diligence by international financial institutions, which risked its access to global finance and damaged its reputation. Recognising these risks, Uganda committed to a comprehensive reform agenda, successfully addressing 20 of 22 key AML/CFT deficiencies by early 2024. This included strengthening legal frameworks, enhancing risk-based supervision, improving transparency of beneficial ownership, and fostering multi-agency collaboration. The BoU, alongside the Financial Intelligence Authority and other stakeholders, adopted international standards, built capacity, and introduced robust monitoring systems. These efforts culminated in Uganda's removal from the FATF Grey List in February 2024 and subsequent delisting by the European Union in 2025, restoring confidence in the financial system. To sustain compliance and prevent re-listing, Uganda continues to implement a strong multi-stakeholder approach, adapting to emerging risks such as digital finance and cyber threats, thereby safeguarding its financial integrity and maintaining its attractiveness as an investment destination within an open capital account framework. This requires continuously ensuring a robust and enforceable regulatory environment to address gaps created by technology in cross-border payments, which is critical.
- **International Recognition**: Uganda's consistent ranking in the ABSA Africa Financial Markets Index (AFMI)—maintaining its 4th position in Africa for the third consecutive year and ranking 2nd in the Macroeconomic Environment and Transparency pillar—reflecting our robust monetary policy framework, declining inflation, and commitment to transparent economic data. This recognition has significantly enhanced Uganda's visibility and attractiveness to international investors, largely driven by the growth and development of its financial markets.

- **Adoption of Modern Financial Instruments**: The adoption and development of modern financial instruments like FX swaps are crucial for managing exchange rate volatility and providing hedging mechanisms in an open capital account environment. To bolster confidence and support the wider adoption of such instruments, Uganda has secured the enforceability of close-out netting under international master agreements (GMRA, ISDA, GMSLA). Such legislative clarity is vital to reduce counterparty credit risk, lower transaction costs, and attract more offshore investment into Uganda by aligning its regulatory environment with international best practices.
- **Enhanced Financial Market Infrastructure**: Uganda is modernising its financial backbone by upgrading the Central Securities Depository (USD 11.5 billion in government securities) and integrating it with the Uganda Securities Exchange to boost retail investor participation and liquidity. Concurrently, we are advancing our Real-Time Gross Settlement (RTGS) system to ISO 27000 standards—ensuring robust performance, security, and stability—while adopting Refinitiv and ICAP trading platforms to diversify our fixed-income market access. These reforms collectively deepen market efficiency, resilience, and inclusivity.
- **Continuous Adaptation and Forward-Looking Reforms**:
  - **Enhanced Data Collection and Regulatory Framework for Capital Flows**: Uganda addressed the data gaps caused by capital account liberalisation primarily through mandated reporting requirements and strengthening its legal and regulatory framework. Before these reforms, the removal of official approval for capital transactions meant authorities relied on limited reporting and surveys, which were poorly developed, resulting in under-recorded inflows—especially private transfers amounting to around 4% of GDP. To address this issue, Uganda required banks to document and report all capital flows regularly to the BoU, enacted a comprehensive Foreign Exchange law detailing capital account transactions, and enhanced prudential supervision by revising financial statutes to empower the central bank with greater regulatory authority. Banks were also mandated to implement risk management systems, adhere to capital adequacy rules, and adopt international accounting standards to improve transparency. Efforts extended to strengthening financial reporting to reduce information asymmetry and educating the private sector on managing new risks from liberalisation. While challenges remain, these measures significantly improved data quality and the ability of policymakers to monitor and manage capital flows effectively.
  - **Comprehensive Foreign Exchange Reserve Management**: Given the volatility of financial account flows for reserve accumulation, we are strategically shifting towards reserve accumulation through the current account. Uganda has

responded proactively and innovatively to the challenges of foreign exchange reserves management in the context of capital account liberalisation. The BoU has maintained a prudent monetary policy, tightening the Central Bank Rate and Cash Reserve Requirements to anchor inflation and support the shilling. Forex market operations have been optimised, with the BoU intervening only to smooth excessive volatility and increasing dollar purchases during favourable market conditions to rebuild reserves. Diversification strategies, such as the Domestic Gold Purchase Program (DGPP), have been introduced to reduce reliance on traditional reserve currencies and leverage Uganda's natural resources. The government has also prioritised export promotion, import substitution, and deepening of financial markets—adopting modern trading platforms, strengthening market infrastructure, and aligning regulations with global best practices. These measures, combined with enhanced financial reporting, improved risk management, and targeted capacity building, have enabled Uganda to better safeguard its reserves, strengthen resilience to external shocks, and steadily move toward its reserve adequacy targets despite ongoing global and domestic pressures.

- **The Dynamic Nature of Prudential Management**: We learned that macro-prudential tools require constant monitoring and fine-tuning as investors continuously find ways to circumvent regulations. These tools are most effective when used as integral components of a comprehensive policy package.
- **Financial Institutions Regulations (2023)**: The Financial Institutions (Preference & Appraised Book Value) Regulations, 2023, have improved interbank trading and monetary policy transmission, enhancing the efficiency and stability of the financial system. To build on this progress, we are currently drafting a Netting Law that validates and enforces agreements to net financial obligations between parties. This will allow the aggregation of multiple payment obligations into a single net payment, reducing overall credit and settlement risk. This is expected to attract more non-resident financial flows into the economy.
- **Sustainability Integration**: Sustainability is no longer optional. At the BoU, we are embedding ESG principles into our policies and across supervised financial institutions. This includes launching an ESG framework for the banking sector and laying the groundwork for issuing green bonds, aligning our financial system with global sustainable finance trends and attracting socially conscious investors.
- **Addressing Tax Regimes**: We are engaged in discussions with the Ministry of Finance, Planning, and Economic Development

(MoFPED) to address high tax rates, such as the 15% dividend tax and the withholding tax on government securities, with the aim of enhancing Uganda's regional competitiveness and attracting more foreign investors.

This comprehensive approach, encompassing regulatory enhancements, inter-agency collaboration, and the leveraging of international technical assistance, is paramount for Uganda's financial system stability. By fostering deeper, more liquid, and resilient domestic financial markets, Uganda strengthens its capacity to absorb external shocks, manage macroeconomic conditions effectively, and sustain economic growth, ultimately preventing re-listing on the FATF Grey List and maintaining its credibility as an attractive investment destination.

These tools are not substitutes for sound macroeconomic policies and strong institutional fundamentals, but their effectiveness depends on robust administrative capacity and complementary policies. To date, there is smooth coordination between the BoU and the Ministry of Finance to maintain policy consistency. For instance, in the recent past, the BoU employed unorthodox policies to deal with price pressures arising from exogenous sources—such as a recent episode of exchange rate spiking following the World Bank's suspension of lending to Uganda and when a regional economy launched an attractive high-yielding and tax-exempt infrastructure bond driving forex inflows from Uganda—the MoFPED undertook a measured approach to funding releases to contain monetary conditions, thereby supporting monetary policy management. This staved off the need for more drastic action by the central bank to contain the inflationary impact of sharp exchange rate depreciation.

Lessons for Peer Countries: A Path Forward

Mozambique, like other developing countries, is charting its own course towards economic transformation. The Ugandan experience with capital account liberalisation could offer several critical takeaways for this journey:

- **Prioritise Sound Foundations**: Capital account liberalisation must be firmly embedded within a framework of strong macroeconomic policies. Fiscal consolidation, an independent central bank, and a flexible exchange rate regime are not mere aspirations but essential preconditions.
- **Embrace Orderly, Risk-Based Liberalisation with Development**: While liberalisation is increasingly inevitable, a cautious, risk-based approach remains prudent. The process should begin with the most stable capital flows—prioritising foreign direct investment and long-term equity investments. Crucially, liberalisation must be complemented by financial market development reforms that deepen and broaden domestic markets, enhancing their ability to attract, absorb, and manage

capital flows effectively. The IMF advises that full liberalisation should only be adopted when nations reach a certain threshold of financial and institutional development, advocating to "liberalise a little, learn, and then liberalise more." It is also generally agreed that current account liberalisation should precede capital account liberalisation.

- **Strengthen Financial Sector Oversight with Robust Risk Management**: Robust prudential regulation and supervision are paramount, focusing on currency and maturity mismatch monitoring, systemic risk assessment, and cross-border supervision.
- **Build Comprehensive Macro-Prudential Capacity Proactively**: Develop a complete toolkit of macro-prudential measures before you need them, including adaptive reserve requirements, position limits, composition tools, and dynamic adjustment mechanisms.
- **Invest in Data and Institutional Capacity**: Robust data collection systems for capital account transactions are vital. Furthermore, both regulatory institutions and market participants must develop sophisticated capacity to understand and manage the complex risks associated with capital account liberalisation. This includes:
    - Real-time monitoring systems for capital flows and their composition.
    - Early warning indicators for potential flow reversals or systemic risks.
    - Market education programmes to help banks and corporations understand and manage foreign exchange risks.
    - Hedging instrument development to provide tools for risk management.

For many economies in Sub-Saharan Africa, recourse to indirect instruments of monetary policy and hedging interest rate and exchange rate risk is constrained by the lack of depth in the financial market, limited market participants, a paucity of financial instruments, and inadequate financial infrastructure. This necessitates a new focus on managing capital account convertibility in such contexts.

- **Maintain Policy Flexibility and Avoid Irreversible Commitments**: In line with adaptive policy-making principles, it is essential to maintain policy flexibility by avoiding irreversible commitments that limit responsiveness. Rather than relying on rigid rules, focus should be placed on continuously managing the liberalised environment through the design of market-friendly instruments, deepening capital markets, and strengthening the financial system with robust legal frameworks and improved institutional capitalisation. This approach enables the timely implementation of temporary prudential measures during crises, allowing policies to be adjusted dynamically in response to evolving conditions and emerging risks.

- **Leadership and Governance: The Foundation of Success**: Above all, strong leadership and good governance are indispensable to ensure policy consistency, avoid reversals, restore confidence, and attract sustained capital inflows. The credibility of institutions and the predictability of policy frameworks matter more than the specific design of individual measures.

Conclusion

Uganda's journey has been one of continuous learning, adapting, and, ultimately, building a more resilient and prosperous nation. Our experience underscores that while capital account liberalisation presents significant challenges, it also offers immense opportunities to deepen financial markets, attract vital investment, and foster economic growth. The key insight from our three decades of experience is that the question is not whether to liberalise but how to liberalise wisely. This means understanding the different risk profiles of various capital flows, building sophisticated institutional capacity before you need it, and maintaining the flexibility to adjust your approach as you learn and gain experience.

The future of Mozambique, like that of Uganda, hinges on a bold vision, pragmatic action, and a relentless commitment to building robust institutions. As you deliberate on the intricacies of capital account liberalisation, I urge you to embrace the opportunities, manage the risks with foresight and sophisticated tools, and consistently strengthen the institutional foundations that will underpin your economic transformation. The path ahead is challenging, but with careful preparation, strong institutions, and the wisdom drawn from experiences like ours, Mozambique can navigate toward a more open, stable, and prosperous financial future.

Thank you, and God bless you all.