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09KYIV1557

**Created**

2009-09-11 15:59:00

**Classification**

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**Origin**

Embassy Kyiv

**Cable title: NATIONAL BANK CAUGHT IN UKRAINIAN POLITICS**Tags: [EFIN](#) [EREL](#) [ELAB](#) [ECON](#) [ETRD](#) [PGOV](#) [PREL](#) [XH](#)  
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SUBJECT: NATIONAL BANK CAUGHT IN UKRAINIAN POLITICS

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1. (SBU) Summary. The ongoing dispute between Ukrainian government authorities and the National Bank of Ukraine (NBU) escalated this week, when the Ministry of Interior interrogated NBU deputy governor Anatoliy Shapovalov over recent fluctuations of the hryvnia exchange rate. Controversial Interior Minister Yuri Lutsenko accused the NBU of fraud in recent bank refinancing operations and currency auctions that involved hundreds of millions of hryvnia. He said that the NBU policy of maintaining a large discrepancy between the official and market exchange rates had encouraged currency speculation. Nonetheless, others have suggested that Lutsenko is instead acting to burnish his reputation as well as to protect Prime Minister Tymoshenko's political interests. End summary.

NBU INDISCRETIONS

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2. (SBU) Earlier this month, the NBU had reverted to conducting currency auctions at a subsidized rate, which in turn allowed for immediate arbitrage opportunities for undisclosed banks. The timing of the auctions coincided with the vacation of NBU governor Volodymyr Stelmakh, while deputy governor Shapovalov was acting in his stead. One editorial characterized Stelmakh's holidays as "traditional in times of turmoil in the currency market."

3. (SBU) Shapovalov's interrogation by the Interior Ministry was accompanied by the September 11 resignation of another NBU deputy Governor Oleksandr Savchenko, who is considered to be loyal to Prime Minister Tymoshenko. Savchenko immediately lobbed accusations at the NBU's senior leadership, suggesting that Shapovalov and others had allowed unnamed "speculators" to earn \$5-6 million in arbitrage on a daily basis.

4. (SBU) Nonetheless, Petro Poroshenko, an influential businessman and head of the NBU's council, criticized the media frenzy caused by the government's investigation. He defended the NBU, suggesting



that the central bank had already admitted to the "inefficiencies" of previous currency interventions. He pointed out that in two currency auctions this week, the NBU's intervention rate had been within close range of the interbank rate. He also said that all interested banks had been allowed to participate in the auctions.

5. (SBU) Via auctions on September 8 and 10, commercial banks bought \$63.7 million and \$105.4 million, respectively, at an average rate of UAH 8.3/\$1. Twelve banks were allowed to buy foreign exchange on September 8; the number of banks participating in the auction on September 10 was not disclosed. Furthermore, Stelmakh suggested that the NBU would be positioned to sell up to a billion more dollars before the end of September to stabilize the exchange rate. This statement, a sign that the NBU is willing to move dangerously close to its net international reserve floor set by the IMF, appears to have been the primary reason the hryvnia appreciated from 8.85-9/\$1 on the interbank market over the past three days.

#### ALL ECONOMICS IS POLITICS

6. (SBU) The announcement of the government's investigation came on the heels of Yushchenko blaming Tymoshenko for destabilizing the hryvnia, adding fuel to the speculation that the investigation was politically driven. Yushchenko had pointed to BYuT-supported plans for large-scale hryvnia emission to finance the budget deficit. Separately, the NBU's Stelmakh, a Yushchenko ally, said that the central bank would not finance a one-time payment of UAH 9.8 billion (\$1.2 billion) for Euro 2012 infrastructure projects from the NBU's 2009 profits, as required by recent BYuT-backed legislation. Both the President and the central bank commented that any monetization should come from the state treasury via domestic bonds that would be purchased by the NBU.

7. (SBU) Foreign bankers have told us that senior NBU representatives had bragged about their plans to avoid meeting the terms of the Rada legislation on Euro 2012 infrastructure financing. The NBU had preferred to buy GOU debt, in order to hold a government liability while collecting interest. NBU officials suggested to our contacts that this would enable the central bank to overcome the GOU's attempt to whittle away its independence.

8. (U) A major Kyiv daily newspaper alleged that the "information war" between the President and the Prime Minister had been launched by BYuT-faction leadership. It reported that Tymoshenko ally and Our Ukraine Rada deputy Mykola Martynenko had announced at a parliamentary coordinating meeting that millions had been channeled from the currency market to finance the Yushchenko's presidential campaign. Martynenko allegedly also stated that hryvnia destabilization may serve as a reason for Yushchenko to declare a

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state of emergency.

9. (SBU) In his press statement, Interior Minister Lutsenko also accused Yushchenko of covering up for the NBU's questionable actions. But Ukrainian commentators have wondered whether Lutsenko is trying to paint over his own recent scandals -- the case of his alleged intoxication at the Frankfurt airport in May and last week's mishandling of a high profile internal corruption case against a criminal gang of police. Since being bailed out by Tymoshenko after the Frankfurt incident, when many in Kyiv were calling for his resignation, Lutsenko has been considered a staunch friend of the Prime Minister.

NBU MURKINESS NOTHING NEW

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10. (SBU) Accusations of fraud have swirled around the NBU throughout the period of Ukraine's economic crisis, particularly regarding the NBU's handling of currency sales. In January 2009, Tymoshenko had criticized the NBU for non-transparent refinancing of Nadra Bank that allegedly took place in late 2008. Independently, a senior Nadra executive admitted to us that the shady refinancing scheme had been carried out during the period of October-December

2008. The Nadra representative also said that the NBU had agreed to restructure UAH 7.7 billion (\$920 million) in debt accrued by Nadra last year that would have been due in the fourth quarter of 2009.

11. (SBU) More recently, Lutsenko had expanded the GOU's allegations against the NBU, commenting that former managers of now nationalized Rodovid bank had been allowed to steal UAH 2 billion (\$240 million) in central bank financing. Tymoshenko has also accused the Viktor Yanukovich-led Party of Regions of misusing refinancing that had been extended to Ukgazbank.

#### COMMENT

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12. (SBU) The recriminations over hryvnia fluctuations and the NBU's independence harken back to those levied publicly between Tymoshenko and her rivals earlier this year. The bad blood appears to have intensified since the IMF mission left Kyiv last week, with Tymoshenko, Yushchenko, and their loyalists not holding back their sharpest criticisms and conspiracy theories. That the NBU has been unwilling to relinquish its independence by yielding to the BYuT-supported Euro 2012 financing plan, and that the NBU's shady dealings are undoubtedly filling rival campaign finance coffers, only heightens the acrimony. As it typically has done in such instances, the Party of Regions has refrained from offering substantial commentary, apparently content to let its rivals continue their bickering over failing economic policies.

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