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The Right Rubicon

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* Europe takes a practical, no-return route to Euro resolution

* Euro resolution will ultimately allow normalcy in US interest rates

Churchill's famous phrase, suggesting that Americans do the right thing only after trying everything else, could now be applied to the club supporting the Euro's longevity by repairing its original flaw.

Last week's Brussels summit re-directed a badly aimed rescue package proposed just two weeks earlier. The European Stability Mechanism is now to be allowed pan-European entry directly into banks with its fleet of fire trucks. The original Spanish bank rescue in early June contemplated funneling $100 billion Euro through the Spanish government into a fund available to rebuild capital in Spanish banks. This was flawed in two ways. First it would add to Spain's sovereign debt, exacerbating its weakening creditworthiness. Second, it would be yet another sequential, special-case fire hose trained on a single country's banking problems, likely to be trained again elsewhere until all of Europe's financial system fires are extinguished.

This latest iteration in crisis containment may seem only another nuance to some, but it is much more likely to resolve the short-term uncertainties by making it clear to bank depositors and creditors that the full faith and credit of the European Monetary Union is behind its banking system, rather than its disparate political units. This is an important distinction. It reduces the moral hazard in supporting one country's fiscal problems over others. And similar to the pan-European deposit insurance scheme that was also mooted, it greatly limits the call on hard cash support that could mushroom into socializing private debt onto public balance sheets. (The U.S. full faith and credit backstopping the FDIC has successfully avoided bank runs and public funding since inception, while the FDIC reserves currently stand at a mere $15 billion and never exceeded $50 billion in size.)

The importance to the Euro cannot be overstated. People rarely run from their country, but they certainly have run from their banks. Effectively taking the risk of cascading bank runs off the table is an enlightened and powerful means of supporting the Euro itself, which can gradually restore its reserve currency credentials. The success of this plan will obviously hinge on the eventual implementation of a pan-European financial sector regulator. While cynics can rightly question the need for another regulator in a world chronically oversupplied, this one is clearly necessary.

Such a path not only improves short-term prospects for global capital markets, but it quite possibly sets Europe on the correct, longer term path to fiscal union, which was sadly and dangerously ignored at the birth of the Euro thirteen years ago. Regulatory centrality, commonality and responsibility, while destined for a rocky road to implementation, are essentially a back door to eventual fiscal convergence years from now. Once down this path within the financial sector, a return to sovereign bickering and disunity would be much harder to exploit.

The relevance to U.S. financials should not be overlooked. The over-arching strains on our financial industry stem primarily from global uncertainty and abnormally low interest rates. We have long argued that Europe's descent into disorder has caused a massive flight-to-quality favoring the U.S. dollar at a time when the dollar should be begging for attention. This has driven U.S. Treasuries to exceptional premiums and U.S. Treasury rates to exceptional discounts. Restoration of the world's second most important reserve currency, even in partial steps, will go a long way toward interest rate normalcy in the U.S. monetary system.

Higher U.S. interest rates can only further revive the top line revenue growth that we have been heralding as our central reason for being bullish again on U.S. financials, particularly banks. Any longer term Euro crisis resolution will aslo be a major positive for financials reliant on more vibrant capital markets.

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