

The political and fiscal vice in which Malcolm Turnbull is now caught was neatly illustrated by a coincidence of timing in these early post-election days.

One of Turnbull's first meetings was with Nick Xenophon, whose team has won three senators and one lower house seat. Turnbull was taking out insurance in case the Coalition entered minority government, but Xenophon would have power even if there was a Coalition majority, because his Senate votes will be crucial. The South Australian senator's agenda is populist and protectionist, and he'll be in search of trade offs that cost money.

Just a day after Turnbull met Xenophon, the ratings agency Standard and Poor's revised Australia's credit outlook from "stable" to "negative". This wasn't a downgrading of the AAA rating but a stern warning Australia is on notice.

The agency was blunt, saying "ongoing budget deficits may become incompatible with Australia's high level of external indebtedness and therefore inconsistent with a 'AAA' rating".

The negative outlook reflected S&P's view that prospects for budgetary improvement had weakened after the election. There was a one in three chance of a downgrading within two years, S&P said; it would monitor over the next six to 12 months the new government's success or otherwise in passing revenue and expenditure measures through both houses.

The present ugly fiscal reality is a far cry from the Coalition's rhetoric of three years ago.

The Abbott government arrived promising to attack debt and deficit, then botched things not least because it ignored the need for fairness. It was forced to retreat by the Senate and public opinion and, deeply burned, it pushed budget repair into the far distance.

Now the disastrous election result under Turnbull is likely to impede the fiscal work even further. The government is set to survive but it has been extensively injured. The question is whether it will be crippled.

Grattan on Friday: Coalition gets nasty reminder debt and deficit are important, like it once said

Written by Michelle Grattan, Professorial Fellow, University of Canberra

Turnbull can expect little mercy. Standard and Poor's is not in the mercy business. Crossbenchers will want to deliver to their voters and exercise bragging rights for whatever they extract. Labor will probably seek to frustrate at every pass.

Some in the government hope the S&P warning might impose a degree of discipline on the Senate. Optimistic, one would think.

Those Liberals looking for comfort in history note that Robert Menzies, after a lashing at the 1961 election off the back of a credit squeeze, operated with a working majority of two. By 1963 he was taking his government to a big election win.

Turnbull, however, doesn't have certain advantages Menzies enjoyed. Although he'd lost control of the Senate at the election, the upper house was far less difficult in those days; the Liberals were more ideologically united; Labor was riven. Menzies also commanded the authority of being his party's founder who had led it to more than a decade of consecutive wins.

Turnbull's dilemma is that the Liberals' advocacy (if not practice) of budget discipline is out of sync with what's driven the vote of many electors this time.

Think about getting back those voters, and you see dollar signs. How to reassure people who feared for Medicare? The tempting answer is, change some unpopular measures. That would be a big call, with Standard and Poor's and the other agencies on high alert.

Indeed the threat hanging over the AAA rating could spark division within the government over whether a new tough round of savings was needed, bringing more electoral pain.

As they continue to reel from their shock, the Liberals are inclined to still fight the election campaign, declaring it will be Labor's fault if budget savings can't be got through parliament. But blame-shifting won't cut it with the public.

John Howard on Thursday had a couple of prescriptions for the government's situation. He said there needs to be "a return to the reform task" - in taxation, industrial relations and fiscal repair. He also advised unhappy Liberals – ie disgruntled conservatives – not to leave the party but "stay in and fight".

Mostly the discontented will stay, and that's not going to be easy for Turnbull. In the short term, the same-sex marriage plebiscite, even though it was a device to pacify the conservatives, will be extremely testing for him and distracting for the government. At the same time Labor could be emboldened to try in parliament to derail the plebiscite and bring on a parliamentary vote, which could in turn prompt a battle in the Liberals.

As for revisiting the wells of tax and industrial relations reform, Turnbull has no appetite for either. Even if he had, he's hamstrung by election commitments.

He has said he will re-present the industrial bills that he used as his double dissolution trigger, even though no one believes the numbers would be there to get them through a joint sitting. Bob Katter, who on Thursday guaranteed supply and confidence to a Turnbull government, had a warning for the Prime Minister. Katter said he wouldn't be giving any support to bashing the unions.

After the double dissolution, Turnbull finds Katter is his new best friend – sort of. One of Katter's own very good friends is the Construction, Forestry, Mining and Energy Union, which describes him on its Facebook page as a "legend". The double dissolution legislation to resurrect the Australian Building and Construction Commission was substantially aimed at the CFMEU. What do they say about degrees of separation?

Michelle Grattan does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

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