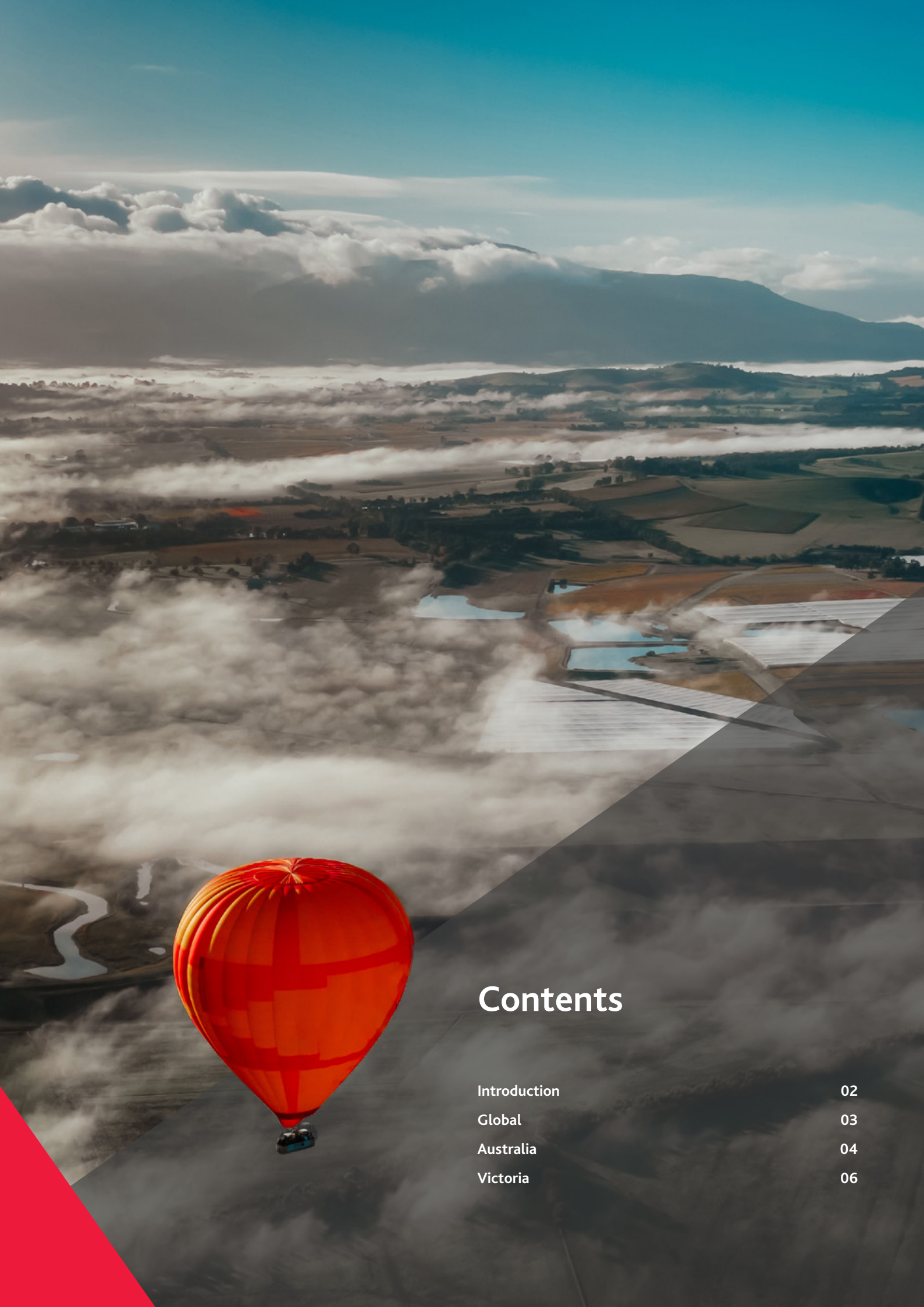


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BDO Outlook 2026

IBDO



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Growth across advanced economies has slowed over recent decades as governments have prioritised social outcomes, risk controls, and more recently, economic security. Public spending has risen, regulation has expanded, and financial and political capital has been directed towards resilience rather than productivity. The result has been slower economic growth. There is nothing inherently wrong with choosing to prioritise these things over economic growth, but the trade-off needs to be recognised. When they aren't, new challenges emerge.

In my view, Australia has fallen into that trap. We continue to spend as though the economy is growing at 3 per cent, when in reality, growth is closer to half that rate. This is the challenge the Reserve Bank of Australia (RBA) has described as Australia exceeding its economic 'speed limit'. When spending exceeds the economy's capacity to grow, we effectively fund the gap by borrowing from future generations through higher debt and by eroding current living standards through inflation. For example, during the COVID period real wages fell by around 6 per cent due to inflation and have yet to fully recover.

These pressures are unlikely to improve quickly. Community preferences and an aging population continue to drive higher social spending, while geopolitical fragmentation is directing investment towards resilience and security. Artificial intelligence (AI) offers some hope for boosting productivity, but the scale of investment it requires may also crowd out other economic activity and concentrate growth in a narrow range of sectors, increasing vulnerability. Without stronger productivity growth, high public debt and elevated interest rates are likely to remain features of the economic landscape for some time.

However, slow growth does not mean limited opportunity. The economy is changing rapidly, creating new demands, markets and competitive advantages. Those businesses who anticipate and respond to these shifts will be well positioned.

Anders Magnusson
Chief Economist





Global

The global economy remains resilient, but growth is increasingly dependent on a narrow set of drivers. The International Monetary Fund expects world output to expand by 3.0 per cent in 2026 and 3.4 per cent in 2027. Emerging and developing economies are forecast to grow by around 3.8 per cent in 2026, compared with 1.7 per cent for advanced economies. Beneath these headline figures, four megatrends are reshaping the outlook: AI, demographics, geopolitics and, in advanced economies, productivity.

Megatrends are trajectories of globally significant change that unfold over decades.

AI investment has become a significant source of activity. Global corporate AI investment more than doubled in 2025, mostly in the United States. AI-enabling products such as computer chips also supported trade in 2025 and early 2026. This expansion faces physical constraints with electricity generation for data centres projected to rise from 460 TWh in 2024 to 1,300 TWh by 2035. The risk here is that underperformance of AI companies leads to a downward reassessment of expected returns by investors, weakening financial markets through a painful correction. However, revenues are starting to cover AI company operating costs as businesses integrate AI into their operations and annual operating budgets. Asset prices have also moderated gently in recent months, rather than collapsing.

Demographic pressures differ sharply across the globe. Advanced economy populations are growing but aging, with tighter labour supply and rising health, aged care and pension costs. China's population fell by 3.4 million in 2025 and births dropped to a record low. Projections suggest its population could decline by around 250 million by 2050. The story is very different in the developing world, where about 1.2 billion young people are expected to reach working age between 2025 and 2035. This could be an economic boost if sufficient productive jobs are created, or a social risk from high unemployment.

Geopolitical fragmentation is becoming structural. Supply chains are being redesigned around resilience, friend-shoring and strategic capability, while volatile tariffs, export controls and sanctions are increasing uncertainty. Real world merchandise trade growth is projected to slow from 4.7 per cent in 2025 to around 2.0 per cent in 2026, with AI-related sectors masking weaker momentum elsewhere. Global military expenditure reached US\$2.9 trillion in 2025, 41 per cent above its level a decade earlier, and NATO Allies have committed to annual defence and defence-related spending of 5 per cent of GDP by 2035. This will create opportunities across defence, cyber, energy, advanced manufacturing, critical minerals and infrastructure, although more duplicated and regionalised supply chains will raise costs.

Productivity growth is necessary if economies are to pay for healthcare, aged care, pensions, defence spending, and other social priorities. However, productivity growth has been slow lately in advanced economies, with the OECD average growth in GDP per hour worked slowing from around 2 per cent historically to about 0.8 per cent in the past decade, due to a combination of reduced innovation and investment. Without stronger productivity growth, adjustment must come through higher debt, taxes or inflation, or compromising on public services. Global public debt was just under 94 per cent of GDP in 2025 and is projected to reach 100 per cent by 2029.

Australia

Australia has moved beyond the immediate energy shock, only to find the structural pressures evident since COVID remain. Inflation is still too high, productivity growth is weak, public spending is expanding, and the economy has limited spare capacity. At the same time, AI is moving from experimentation into business as usual, changing workflows, investment decisions and required skills.

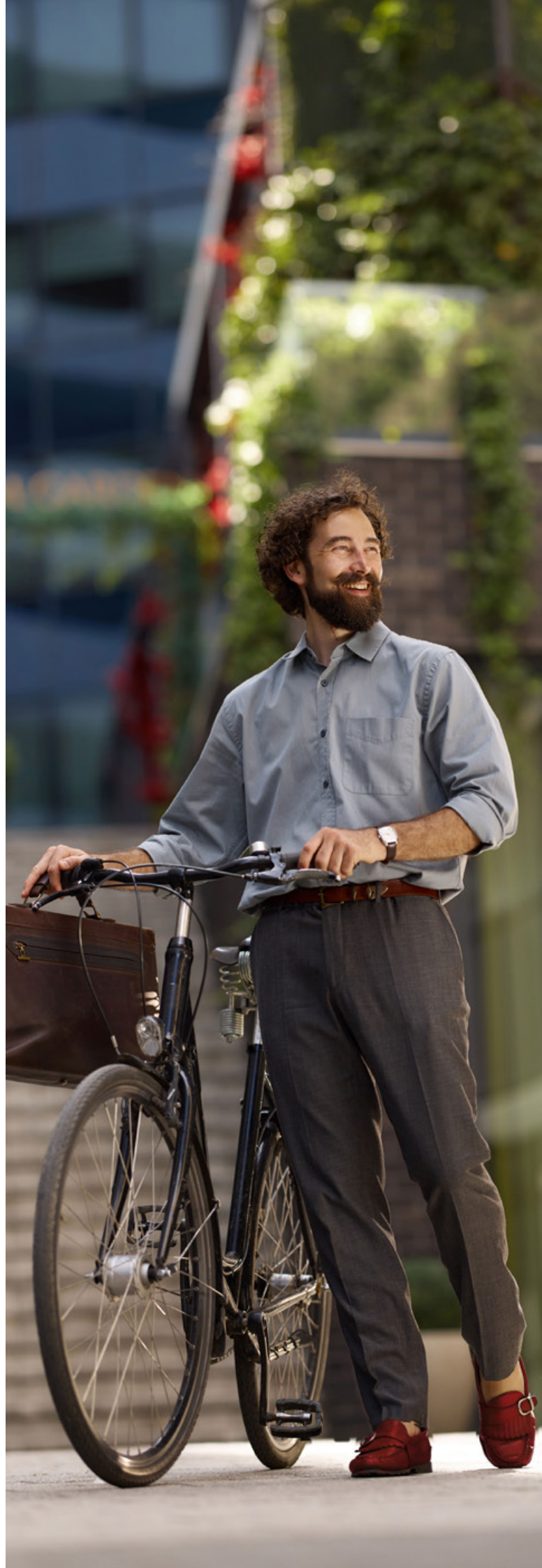
Workforce conditions remain tight. The unemployment rate was 4.4 per cent in June 2026, while employment increased by 76,300 and the participation rate rose to 67 per cent. While these conditions are good for workers, it means Australia must manage major project pipelines and an ageing population without a large pool of unused labour. AI is beginning to change the composition of work, but the evidence points more to churn than to widespread job destruction. Jobs and Skills Australia found that generative AI is more likely to augment workers than replace them, and that workers are moving from AI-exposed roles into other positions, rather than exiting the workforce. Our challenge is to facilitate this rebalancing, while using labour-saving technology to offset the challenge of an ageing population.

Living standards will depend on whether Australia can reverse its productivity slowdown. Labour productivity has barely increased in the past ten years. Weak productivity growth limits the sustainable growth of real wages and makes higher living standards harder to achieve. Australia needs stronger business investment, innovation and competition, but firms face a policy environment that can make active risk-taking less attractive. AI offers a potential productivity lift, although the gains will depend on businesses redesigning work rather than simply adding new technology to existing processes. Tax and regulatory settings should encourage active investment in productive assets.

Australia *continued*

Public finances face growing pressure as more services are provided where households make spending decisions and government pays the bill. This spending is called 'social transfers in-kind' and includes programs such as the NDIS, aged care, and PBS. They deliver substantial value to recipients, but it is important to also understand that they weaken important price signals in the economy and encourage inflation. The 2026–27 Budget identifies the NDIS as Australia's largest social program outside the Age Pension, with budget measures targeting savings of \$37.8 billion over four years. These types of pressures will intensify as the population ages with the number of Australians aged 65 and over projected to more than double in the next 40 years, and labour force participation projected to decline. Sustainable public finances will likely need to rely less heavily on taxing the relatively smaller working-age population and more on consumption taxes or other sources.

The near term is likely to show an economy that is resilient but unexciting. Unemployment was 4.4 per cent in June, headline inflation was 3.5 per cent over the year to July and the RBA held the cash rate at 4.35 per cent in August. The immediate energy shock from the Middle East has been less severe than expected, but trimmed mean inflation remains elevated, businesses are still passing higher input costs into prices, and the labour market remains tight. The RBA forecasts inflation to only return to the midpoint of its 2–3 per cent target range by early 2028. With three cash rate increases already delivered in 2026 and monetary policy already restrictive, another move this year is unlikely unless inflation shifts materially. Households and businesses should plan for interest rates, labour constraints and cost pressures to remain elevated while weak productivity continues to limit the economy's growth.





Victoria

Victoria's (VIC) economy has expanded slightly faster than Australia's over the past decade, supported by population growth broadly in line with the national rate. That population growth has been driven heavily by overseas migration, which has more than offset a small interstate migration outflow. However, growth in the size of the economy has not translated into strong improvements in Gross State Product (GSP) per capita or labour productivity. GSP per capita was below the national decade average and, after increasing while borders were closed during COVID, it has eased as migration returned to trend. Over the decade, GSP per hour worked increased by only 3 per cent, with those gains occurring before COVID. Since COVID, hours worked have risen faster than GSP. VIC has therefore generated growth mainly by adding people and labour, rather than by producing more from each hour worked. VIC lacks a high-value resources specialisation, but its broad economic base provides great diversification and resilience.

VIC's story over the next few years will be about transition. On one hand, the State is still working through one of the largest infrastructure programs in the country, with North East Link, Suburban Rail Loop tunnelling and Melbourne Airport's third runway reshaping how people, freight and businesses move around the state. On the other hand, VIC is approaching some significant turning points. Yallourn Power Station is scheduled to close in 2028, offshore wind development is beginning to move from ambition to delivery, and the State heads to an election later this year against a backdrop of rising debt and a gradually moderating infrastructure pipeline. At the same time, VIC continues to attract strong overseas migration and is positioning itself as a leading AI and digital infrastructure hub.

For business leaders, VIC remains a growth market, but the opportunity is increasingly about transition rather than a broad-based boom. Growth will concentrate where population demand, new infrastructure, energy transition and digital investment intersect, while rising debt and a moderating public infrastructure pipeline will make project timing and government priorities more important. Businesses that can identify those points of intersection early will be better placed than those relying on economy-wide growth.

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