IDEAS | PEOPLE | TRUST

BDO Outlook 2026

Contents

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.

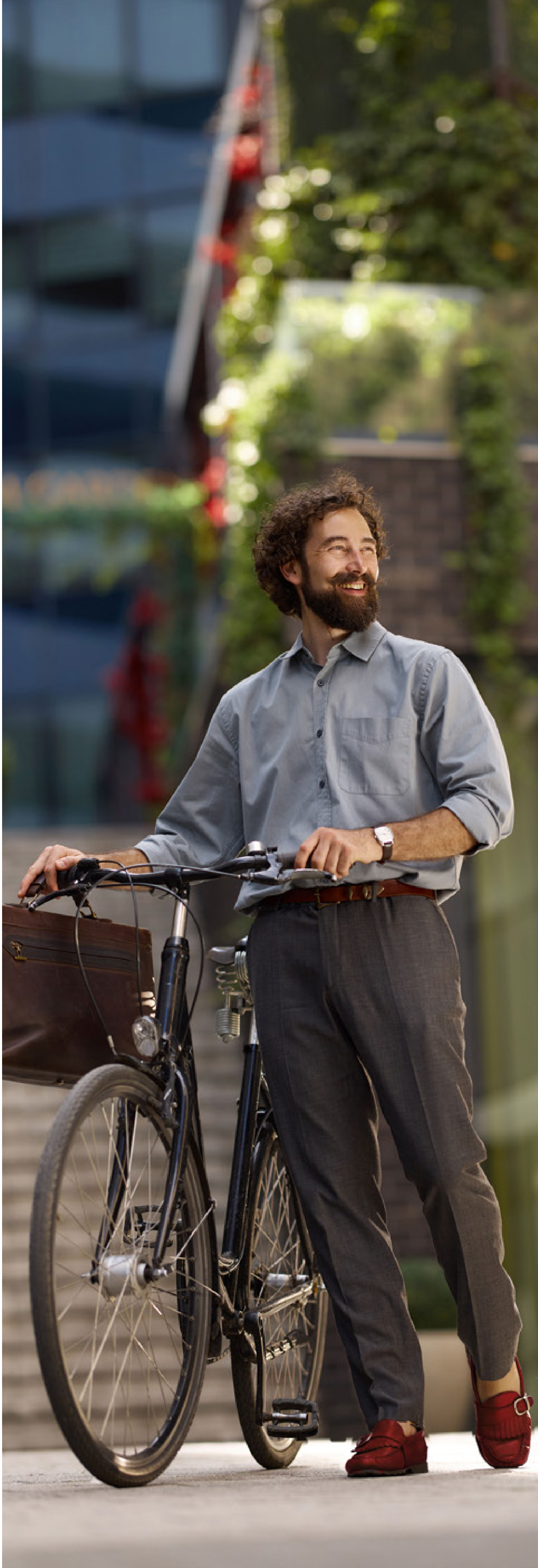
Workforce conditions remain tight. The unemployment rate was 4.4 per cent in June 2026, while employment increased by 76,300 and the participation rate rose to 67 per cent. While these conditions are good for workers, it means Australia must manage major project pipelines and an ageing population without 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 aging 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.



New South Wales

New South Wales (NSW) sits close to the Australian average on Gross State Product (GSP) per capita, reflecting both its economic diversity and its weight within the national economy. Over the past decade, however, its total GSP growth has been slightly below the national rate, while population growth of around 11 per cent has also lagged Australia and the other large east-coast states. Labour productivity has also been subdued. GSP per hours worked is only around 4 per cent higher than a decade ago, and some of the gains achieved before COVID have since been unwound as hours worked increased faster than GSP. The result is an economy that remains large, diverse and close to the national benchmark, but without a strong recent productivity or per-capita growth story.

NSW increasingly functions as Australia's gateway economy. It continues to attract the largest inflow of overseas migrants and investment opportunities, yet also records the nation's largest interstate migration outflow as households seek lower-cost locations elsewhere. The challenge for NSW is to convert its advantages in scale, talent and connectivity into stronger productivity growth rather than relying on continual inflows of people and capital.

NSW is entering a period where several long-discussed projects are becoming very real. Western Sydney International Airport opens this year, new metro connections are changing the shape of Sydney's transport network, Renewable Energy Zones are expanding, and Snowy 2.0 and the broader energy transition remain central to the State's economic outlook. At the same time, NSW continues to host major international events while exploring transformative projects such as high-speed rail between Sydney and Newcastle.

Housing development is a major component of NSW's investment pipeline, with significant growth occurring across Western Sydney, Newcastle, the Hunter, Central Coast and Illawarra. Alongside major infrastructure projects, housing is playing a critical role in supporting the state's population and economic growth.

The contrast in NSW is that a relatively strong labour market and major infrastructure and energy investment sit alongside subdued household spending, as high housing costs and larger mortgages leave households particularly exposed to interest rates.

For business leaders, that means the economy is likely to remain a tale of two markets. Business investment, infrastructure and professional services should remain supported, but consumer-facing sectors may continue to face pressure as households manage high housing costs. Understanding whether your business is exposed to investment-driven demand or household-driven demand will be important.

New South Wales *continued*

Local experience, national support, global network

BDO in Sydney

Sydney is renowned for its strong economy and global significance as a major world city. As Australia's gateway for international business, Sydney is a major hub for foreign investment driven by government policy, industry activity and local companies wanting to expand overseas. Based in Sydney's CBD, our team understand the need to be competitive and meet the fast-paced demands of today's business environment.

Our partners take the time to get to know your business, and our innovative and tailored services can take you closer to achieving your goals more quickly - across the state and around the globe. Our close alliances with our member firms across BDO ASEAN and BDO International mean we can support you wherever you want to do business in the world.

BDO in Greater Western Sydney

Greater Western Sydney is the third largest economy in Australia, behind Sydney and Melbourne, and is tipped to be Australia's fastest growing economy over the next two decades. With one of the youngest and most diverse populations in the nation, the region presents exciting opportunities for business. Our office in Parramatta, in the centre of the Greater Western Sydney region, means we are well placed to help guide your business.

We're proud to work with diverse clients. From multinationals to entrepreneurs, our team has the technical capability to address your unique accounting, tax and advisory requirements; and respond to evolving business needs.

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