

Digital Financial Inclusion and Household Consumption: Evidence from Chinese City-Level Panel Data

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Abstract

Digital financial inclusion may allow underserved areas to leapfrog the fixed costs of brick-and-mortar banking and expand household consumption. This paper studies this possibility in China by combining a two-agent New Keynesian (TANK) model with city-level evidence from 298 prefecture-level cities over 2011–2023. In the model, digital financial inclusion relaxes payment and credit frictions mainly for hand-to-mouth households, predicting a positive consumption response and stronger effects where traditional bank access is limited. Empirically, we measure digital financial inclusion using the Peking University Digital Financial Inclusion Index of China (PKU-DFIIC) and proxy consumption by log total retail sales. We combine two-way fixed-effects regressions, Bayesian structural equation modeling, and heterogeneity-robust difference-in-differences checks. The baseline estimates show that a one-unit increase in DFIIC raises log total retail sales by approximately 0.006 log points, with the effect robust across specifications. The effect is stronger in cities with sparse bank-branch networks, consistent with a financial-access substitution mechanism. Bayesian SEM further isolates the consumption-relevant latent component of DFIIC, helping identify which dimensions of digital finance are most relevant for policy implementation. Overall, the results suggest that digital financial inclusion supports urban consumption by easing financial frictions, especially where traditional banking infrastructure is limited.

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