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The Impact of Financial Investment Income on Household Consumption: An Empirical Analysis Based on CHFS Data

Zhaoqun He*

School of Economics, Beijing Technology and Business University, Beijing, 100048, China
**Corresponding author: molisoc@163.com*

Abstract: *Under the new development pattern, the expansion of consumption is one of the important means to promote the high-quality development of the economy. This paper is based on the perspective of financial investment income, utilizing data from the 2013-2019 China Household Finance Survey (CHFS) to study household consumption behavior. The results of the study indicate: first, financial investment income has a significant positive impact on household consumption expenditure, but to a lesser extent; second, financial investment income can improve the structure of household consumption; third, the positive impact of financial investment income on the consumption expenditure of lower-education and lower-wealth households is more significant, which is consistent with the theory of precautionary saving and liquidity constraints. The innovation of this paper lies in providing empirical evidence to support the establishment and enhancement of a long-term mechanism for promoting consumption through financial investment income, while also proposing new ideas to improve the welfare of low-income classes.*

Keywords: *Financial Investment Income, Household Consumption, CHFS Data*

1. Introduction

Expanding consumption is a necessary requirement to meet the growing needs of the people for a better life. Since the reform and opening-up, China's consumer market has been expanding rapidly, playing a significant role globally, and is one of the important driving forces for global economic growth. However, China's consumption level still lags behind that of other developed countries [1], indicating great potential for development. In 2023, the National Development and Reform Commission (NDRC) issued the Measures on Restoring and Expanding Consumption. The measures proposed 20 specific policy initiatives across six aspects, to expand domestic demand and enhance the fundamental role of consumption in economic development. It can be seen that unleashing the potential of consumption and promoting it as the main driving force of economic growth is a crucial task of macroeconomic regulation and control. Therefore, studying China's consumption problem has a realistic meaning.

Steadily increasing the disposable income of the residents is the fundamental way to promote the steady growth of consumption in China and to play the fundamental role of consumption in driving economic growth [2]. Therefore, how to raise residents' income in a high-quality way is the core issue of promoting consumption growth. The capital market is not only a pillar of real economic development, but also an important tool for residents' asset allocation, which is closely related to residents' wealth and consumption expenditure. However, at present, the proportion of financial assets in the total assets of Chinese residents is relatively low, and the level of financial investment income in China is significantly lower than that in Europe and the United States. Therefore, the "potential purchasing power" of China's capital market is huge. Enabling residents to earn money through stocks, funds, and other channels, and utilizing the capital market effectively are necessary measures to restore and expand consumption [3]. To summarize, the increase in financial investment income may be one of the important factors in promoting consumption. Therefore, it is of practical significance to study the impact of financial investment income on household consumption.

The paper's marginal contribution has two aspects: First, it presents a micro-level empirical study on the impact of financial investment income on household consumption expenditure and structure in China, thus adding to the existing literature. Second, the heterogeneity of household characteristics is used as an entry point to analyze its heterogeneous impact on the relationship between financial investment income

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and household consumption expenditure. The study tests for the existence of precautionary savings and liquidity constraint mechanisms, shedding new light on improving household welfare and promoting the stable development of household consumption.

2. Literature Review and Theoretical Assumptions

Scholars suggest that dividend and bonus income per capita have a significant positive impact on residents' consumption levels [4]. The differences in capital gains among various wealth groups are essential in understanding the shifts in overall savings and wealth distribution [5]. Scholars have also found that an increase in the share of household property income contributes to the upgrading of the consumption structure, and property income contributes more to the upgrading of rural households' consumption than that of urban households [6].

Previous literature has largely examined the impact of property income on consumption. Property income can be categorized into financial property income and non-financial property income [7], of which financial investment income is an important part of financial property income, but there is very little literature directly from the perspective of financial investment income, using microdata to study household consumption. Even when financial investment income is included in the scope of research, its impact on consumption structure is not further analyzed and its mechanism is not explored. Using 2013-2019 CHFS data, this paper examines the impact of financial investment income on household consumption expenditure, further testing the impact of financial investment income on the structure of household consumption, and also examining the role of education level and household wealth in the impact of financial investment income on household consumption expenditure.

Scholars have categorized psychological accounts into regular and unexpected income accounts through individuals' perceptions of income from different sources, which mainly maintain daily necessity consumption and enjoyment consumption, respectively [6]. Property income is often perceived on a psychological level as windfall income, which is mainly used for enjoyment consumption [6]. The increase in the proportion of consumption expenditure on enjoyment may improve the consumption structure [8]. According to the life-cycle hypothesis, household consumption decisions need to be made concerning life-cycle planning, and intertemporal smoothing of consumption can be achieved by reducing consumption fluctuations through savings or borrowing. Financial investments generate unanticipated income, which is a temporary income shock [9]. Temporary income shocks have a relatively small impact on consumption, while persistent income shocks can have a large impact on consumption [9]. Based on the above analysis, Hypothesis 1 is proposed.

H1: Financial investment income may improve the structure of household consumption with a small impact on total consumption expenditure.

According to the precautionary savings theory, a temporary positive financial investment income shock can significantly alleviate poorer consumers' concerns about income uncertainty, thereby reducing their precautionary savings intentions and exhibiting a higher marginal propensity to consume [10]. On the other hand, according to the liquidity constraint theory, in the face of a temporary positive financial investment income shock, consumers subject to a higher degree of liquidity constraint will be more inclined to spend more of their income on increasing current consumption, thereby increasing their overall level of utility and exhibiting a higher marginal propensity to consume [10]. Based on the above analysis, Hypothesis 2 is proposed.

H2: Financial investment income may contribute to household consumption through precautionary savings effects versus liquidity constraint effects.

3. Data and variables

3.1 Data

This paper uses the 2013-2019 China Household Finance Survey (CHFS) data from the Southwestern University of Finance and Economics (SWUFE), which had 28,141, 37,289, 40,011, and 34,643 respondent households in 2013, 2015, 2017, and 2019, in that order. The CHFS questionnaire contains demographic characteristics and household characteristics, and the sample is widely distributed across the country in several provinces and cities, which is representative of the whole country, provincial-level, and sub-provincial-level cities. The CHFS provides information on household income, consumption, and

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so on, which provides a data basis for this paper to study the impact of financial investment income on household consumption. In terms of data processing, to ensure data reliability, this paper excludes samples with household heads under 16 years of age and those with missing values, retaining only samples of households tracked for at least two consecutive years. To reduce the influence of outliers, this paper treats economic variables such as financial investment income and household consumption expenditure with extreme values of 1% up and down. Then, variables related to income and consumption are uniformly treated by adding 1 and then taking logarithms [11]. The final sample of 91,394 households is obtained.

3.2 Variables

The paper's dependent variable is household consumption, defined as the total expenditure on household consumption in the previous year [4]. It includes expenditures on food, durable goods, culture and recreation, transportation and communication, education and healthcare, etc. In further analysis, this paper subdivided household consumption into subsistence consumption (including expenditures on clothing, food, and utilities), developmental consumption (including expenditures on education, transportation, communication, and healthcare), and enjoyment consumption (including expenditures on culture and recreation, housekeeping, tourism, durable goods, housing maintenance, purchase of motorcycles) [12], and examined the impacts of financial investment income on household consumption structure.

The paper's independent variable is financial investment (FI) income, which is defined as the after-tax income earned by households from financial investments in the previous year [7]. It includes income earned from financial management products, stock spreads or dividends, fund spreads or dividends, bonds, and financial derivatives.

Regarding other variables, this paper uses household head characteristic variables, household characteristic variables, and regional characteristic variables as control variables [13-14]. Household head characteristic variables include age, age squared divided by 100, gender, marital status, years of education (values are 0 for no schooling, 6 for elementary school, 9 for junior high school, 12 for high school/middle school/vocational high school, 15 for junior college/higher vocational, 16 for undergraduate, 19 for master's degree, and 22 for doctoral degree), work status, health status (a dummy variable equal to 1 if self-rated health status is very good or good, and 0 otherwise), and risk attitude (a dummy variable equal to 1 if choose to invest in high-risk/slightly high-risk projects, and 0 otherwise). Household characteristic variables include family size, percentage of children under 14 years old, percentage of elderly over 65 years old, household housing, and household social network measured by household gift expenditure. Regional characteristic variables include province and urban or rural residence. Descriptive statistics are reported in Table 1.

Table 1: Summary statistics.

	Observations	Mean	Std.	Min.	Max.
ln(Total Consumption)	91,394	10.435	0.896	8.077	12.604
ln(FI_Income)	91,394	0.408	1.844	0	10.127
Age	91,394	54.476	13.608	17	117
Age_sq/100	91,394	31.528	15.078	2.890	136.890
Male	91,394	0.783	0.412	0	1
Married	91,394	0.869	0.338	0	1
Education	91,394	9.078	4.052	0	22
Work	91,394	0.665	0.472	0	1
Health	91,394	0.394	0.489	0	1
Risk Appetite	91,394	0.086	0.280	0	1
Family Size	91,394	3.429	1.634	1	20
P_Young	91,394	0.105	0.156	0	0.833
P_Elder	91,394	0.213	0.344	0	1
Homeowner	91,394	0.872	0.334	0	1
ln(Social Network)	91,394	5.457	3.642	0	10.127
Rural	91,394	0.367	0.482	0	1

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4. Model

This paper constructs the following model to investigate the effect of financial investment income on household consumption:

$$ln(Consumption)_{it} = \alpha + \beta_1 ln(FI\_Income)_{it} + X_{it}\beta_2 + c_i + \varepsilon_{it} \quad (1)$$

Where, $ln(Consumption)_{it}$ represent the logarithm of household *i*'s total consumption expenditure in period *t*. $ln(FI\_Income)_{it}$ is the logarithm of household *i*'s total income from financial investment in period *t*. X_{it} is the vector of control variables, including household head characteristic variables, household characteristic variables, and rural residence, etc. c_i represents the confounding variable that does not vary over time and ε_{it} is the error term.

5. Endogenous discussions

The empirical model may suffer from potential endogeneity problems. These problems may arise from two sources: first, the omission of confounding variables that affect both financial investment income and household consumption, such as household members' consumption habits and personality traits; second, the expectation of household consumption expenditure affects financial investment income, which creates a reverse causality problem. To deal with the potential endogeneity problem in the empirical model, this paper will use the panel data fixed effects estimation method to eliminate the impact of confounding variables that do not vary over time on the unbiasedness of the estimation results. It also uses household financial literacy as an instrumental variable for financial investment income to deal with the estimation bias caused by time-varying confounding variables and potential adverse selection problems. The household financial literacy is comprehensively assessed by the percentage of respondents correctly answering a series of questions, covering topics such as compound interest, inflation, and financial information [13][15].

6. Results

6.1 Baseline results

Table 2 presents the baseline results using Eq. (1). Columns (1)-(4) report OLS, 2SLS, FE, and FE 2SLS estimation results, respectively, analyzing the relationship between financial investment income and household consumption. Column (1) uses OLS estimation and shows an estimated coefficient of 0.0317, indicating that for every 1% increase in financial investment income, household consumption increases by 0.0317%, which is significant at the 1% level. Column (3) is estimated using FE, which eliminates confounding variables that do not vary over time. The results show an estimated coefficient of 0.0084, indicating that for every 1% increase in financial investment income, household consumption increases by 0.0084%, which is significant at the 1% level. Columns (2) and (4) conduct 2SLS estimation and FE 2SLS estimation of household consumption using household financial literacy as an instrumental variable for financial investment income, and the estimated coefficients of independent variables are both significantly positively correlated at the 1% level. The F-value estimated in the first stage of 2SLS estimation and the sufficiently large CD Wald F statistics and KP rk LM statistic can prove that the selection of the instrumental variable is reasonable, and there is no weak instrumental variable problem. Therefore, it can be concluded that an increase in financial investment income results in a rise in household consumption expenditure.

Although a significant positive correlation exists between financial investment income and household consumption, household consumption demonstrates weak sensitivity and small elasticity to financial investment income. Possible explanations for this phenomenon can be categorized into two aspects: investors' asset allocation and investment preferences. First is the asset allocation of investors, China's capital market is relatively new compared with developed countries. Investors may not know enough about financial products or have a strong awareness of risk, which inclines them towards preferring relatively stable investment methods like deposits over risky financial instruments. Income from bank deposits accounts for a significant proportion of residents' property income [4]. Therefore, Chinese households have less money for financial investment and lower participation in financial investment. Despite an increase in financial investment income, its effect on household consumption remains relatively constrained. Second, in terms of investors' preferences, most investors are keen on short-term trading, expecting speculative profits. Due to the short investment period, it is difficult to form a lasting

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profit. According to the life-cycle and permanent income hypotheses, temporary income shocks have little effect on consumption.

Table 2: Financial investment income and household consumption expenditure.

	(1)	(2)	(3)	(4)
	OLS	2SLS	FE	FE 2SLS
ln(FI_Income)	0.0317***	0.4033***	0.0084***	0.6688***
	(0.0013)	(0.0207)	(0.0013)	(0.2125)
Age	-0.0228***	-0.0271***	-0.0080***	-0.0075
	(0.0016)	(0.0021)	(0.0025)	(0.0048)
Age_sq/100	0.0148***	0.0174***	0.0034	0.0037
	(0.0015)	(0.0020)	(0.0023)	(0.0043)
Male	-0.0778***	-0.0371***	0.0127	0.0061
	(0.0071)	(0.0103)	(0.0099)	(0.0221)
Married	0.2196***	0.2049***	0.0968***	0.0762***
	(0.0096)	(0.0123)	(0.0140)	(0.0259)
Education	0.0467***	0.0195***	0.0083***	0.0066**
	(0.0009)	(0.0018)	(0.0017)	(0.0029)
Work	-0.1765***	-0.1660***	-0.0240***	-0.0376**
	(0.0070)	(0.0090)	(0.0084)	(0.0148)
Health	0.0050	-0.0192**	-0.0390***	-0.0433***
	(0.0055)	(0.0075)	(0.0061)	(0.0123)
Risk Appetite	0.1420***	-0.0818***	0.0366***	-0.0852*
	(0.0095)	(0.0199)	(0.0114)	(0.0483)
Family Size	0.1295***	0.1380***	0.1244***	0.1108***
	(0.0024)	(0.0029)	(0.0035)	(0.0066)
P_Young	-0.0820***	-0.0645**	-0.0070	0.0309
	(0.0216)	(0.0282)	(0.0315)	(0.0602)
P_Elder	-0.1006***	-0.1077***	-0.0574***	-0.0538
	(0.0124)	(0.0164)	(0.0175)	(0.0331)
Homeowner	0.0739***	0.0311***	0.0586***	0.0496**
	(0.0080)	(0.0112)	(0.0111)	(0.0220)
ln(Social Network)	0.0354***	0.0266***	0.0159***	0.0084***
	(0.0007)	(0.0011)	(0.0008)	(0.0029)
Rural	-0.4159***	-0.3394***	-0.0795**	-0.0506
	(0.0074)	(0.0090)	(0.0336)	(0.0433)
Household			Yes	Yes
Province	Yes	Yes		
Year	Yes	Yes	Yes	Yes
Observations	91,394	91,394	91,394	91,394
Adj. R-sq	0.3682	-0.2788	0.5776	-2.7445
F value at First-stage		598.299		598.299
Cragg-Donald Wald F		885.640		885.640
Kleibergen-Paap rk LM statistic		577.326		577.326

(1) ***, **, and * indicate significant at the 1%, 5%, and 10% levels, respectively, similarly hereinafter.
(2) To save space, "Control Variables" are used in the report below in place of the household head characteristics variable, the household characteristics variable, and rural.

6.2 Impact of financial investment income on household consumption structure

Further, this paper categorizes household consumption into subsistence, developmental, and enjoyment categories to examine the impact of financial investment income on consumption structure. The results are presented in Table 3. Columns (1), (3), and (5) show the FE estimation results of financial investment income on subsistence consumption, developmental consumption, and enjoyment consumption, respectively, with estimated coefficients of 0.0051, 0.0105, and 0.0575, all significant at the 1% level. Columns (2), (4), and (6) present the FE 2SLS estimation results with estimated coefficients of 0.5374, 0.9352, and 5.0278 respectively, all significant at the 1% level. It can be seen that higher financial investment income significantly increases household consumption for subsistence, developmental, and enjoyment. This implies that as the financial investment income of households increases, their consumption level also increases, but in a relatively limited way. Financial investment income has varying impacts on these three types of consumption, with the greatest effect on enjoyment

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consumption and the least on subsistence consumption. Consequently, the proportion of subsistence consumption in total consumption expenditure decreases, while that of enjoyment consumption increases, leading to an improved household consumption structure. One possible explanation is that financial investment income acts as a "windfall" for households, being temporary and volatile. This drives the more elastic consumption of enjoyment, while the less elastic consumption of subsistence, which is limited by the basic needs of households, is less likely to increase dramatically as a result of the increase in financial investment income. Based on the above results, Hypothesis 1 is examined.

Table 1: Financial investment income and household consumption structure.

	ln(Subsistence_C)		ln(Developmental_C)		ln(Enjoyment_C)	
	(1)	(2)	(3)	(4)	(5)	(6)
	FE	FE 2SLS	FE	FE 2SLS	FE	FE 2SLS
ln(FI_Income)	0.0051***	0.5374***	0.0105***	0.9352***	0.0575***	5.0278***
	(0.0011)	(0.1767)	(0.0025)	(0.3140)	(0.0069)	(1.5381)
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Household	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	91,394	91,394	91,394	91,394	91,394	91,394
Adj. R-sq	0.6390	-2.0892	0.4209	-1.6395	0.3002	-5.2771
F value at First-stage		12.132		12.132		12.132
Cragg-Donald Wald F		23.263		23.263		23.263
Kleibergen-Paap rk LM statistic		12.122		12.122		12.122

7. Heterogeneity analyses and mechanism tests

Table 2: Education, wealth heterogeneity in the impact of financial investment income on household consumption expenditure.

	Education		Wealth	
	(1)	(2)	(3)	(4)
	FE	FE 2SLS	FE	FE 2SLS
Low Education	-0.0273*	-0.0981***		
	(0.0163)	(0.0256)		
ln(FI_Income)*(Low Education)	0.0051**	0.0908***		
	(0.0024)	(0.0156)		
Low Wealth			-0.1525***	-0.1893***
			(0.0090)	(0.0140)
ln(FI_Income)*(Low Wealth)			0.0058**	0.1146***
			(0.0027)	(0.0160)
ln(FI_Income)	0.0056***	0.2524***	0.0055***	0.1097***
	(0.0018)	(0.0672)	(0.0014)	(0.0409)
Control Variables	Yes	Yes	Yes	Yes
Household	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes
Observations	91,394	91,394	91,394	91,394
Adj. R-sq	0.5774	-0.3247	0.5796	-0.0042
F value at First-stage		21.011		45.617
Cragg-Donald Wald F		99.165		149.627
Kleibergen-Paap rk LM statistic		20.890		45.305

This paper examines the heterogeneous effects of education level and household wealth on household consumption from the perspective of heterogeneous consumption behavior. First, households whose head has less than 15 years of education are defined as low-education households, and households whose household net assets are less than the average household net assets of the entire sample are defined as low-wealth households. Then, the model sequentially incorporates interaction terms of financial investment income with low education and low wealth, and the outcomes are presented in Table 4. Columns (1) and (3) are both estimated using FE and the estimated coefficients on the interaction terms are all significant at the 5% level. Columns (2) and (4) are both estimated using FE 2SLS and the estimated coefficients on the interaction terms are all significant at the 1% level. From the estimation results, it can be found that the estimated coefficients of the interaction term between financial investment income and low education in columns (1) and (2) are 0.0051 and 0.0908, respectively, and the estimated coefficients of the interaction term between financial investment income and low wealth in columns (3)

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and (4) are 0.0058 and 0.1146, respectively. The above results indicate that households with low education and wealth play a significant role in promoting the impact of financial investment income on household consumption expenditure.

At the aggregate level, households with low education and low wealth are relatively poorer groups that face greater liquidity constraints and exhibit a higher consumption expenditure. Based on the above analysis, Hypothesis 2 is examined, providing indirect evidence of the existence of precautionary savings and liquidity constraint mechanisms.

8. Robustness tests

To make the estimation results more robust, this paper conducts robustness tests on the results in terms of replacing the independent variables, and excluding financial practitioners respectively, and the results are presented in Table 5. The estimated coefficients on the independent variables in columns (1)-(4) are all significant at the 1% level. (1) Based on the baseline regression, this paper sets up the broad financial investment income, which is a variable that adds the income from gold assets and the income from non-renminbi assets based on the original financial investment income [7]. This enables a more comprehensive consideration of the impact of income derived from different types of financial assets on household consumption. The estimated coefficients are 0.0084 and 0.6688 in the estimation results of columns (1) and (2), respectively. (2) Based on the baseline regression, the sample of households whose head is a financial practitioner is excluded because financial practitioners may have more expertise and experience in financial investment, and their sources of income and consumption habits may differ significantly from those of non-financial practitioners. Excluding financial practitioners allows for a clearer study of the impact of financial investment income on consumption for households in general, making the findings more explanatory. The test results in columns (3) and (4) exhibit only minor variations in the estimated coefficients' magnitude compared to the baseline results, with no changes in their signs. The above tests show that financial investment income has a significant positive impact on household consumption expenditure, which is consistent with the results of the benchmark regression and proves that the results are robust.

Table 3: Robustness tests: Replace the original independent variable with broad financial income and exclude households with financial practitioners as heads.

	(1)	(2)	(3)	(4)
	FE	FE 2SLS	FE	FE 2SLS
ln(B_FI_Income)	0.0084***	0.6688***		
	(0.0013)	(0.2125)		
ln(FI_Income)			0.0081***	0.7104***
			(0.0013)	(0.2344)
Control Variables	Yes	Yes	Yes	Yes
Household	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes
Observations	91,394	91,394	90421	90421
Adj. R-sq	0.5776	-2.7445	0.5753	-2.9770
F value at First-stage		12.132		11.134
Cragg-Donald Wald F		23.263		21.341
Kleibergen-Paap rk LM statistic		12.122		11.126

9. Conclusions

Household consumption is the foundation of social consumption, and it has an important impact on releasing the potential of domestic demand and promoting high-quality economic development. A thorough understanding of the mechanisms influencing changes in residents' consumption facilitates the growth of residents' consumption. This paper utilizes data from the 2013-2019 CHFS to investigate the impact of financial investment income on household consumption expenditure. It further examines the influence of financial investment income on the structure of household consumption. Lastly, it analyzes the heterogeneous effects of education level and household wealth on household consumption expenditure and explores the underlying mechanisms. The benchmark results show that financial investment income has a significant positive but small impact on household consumption expenditure. Further analysis indicates that financial investment income has a significant positive impact on a household's consumption expenditure for subsistence, developmental, and enjoyment, particularly on

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enjoyment consumption expenditure, which improves the household's consumption structure. Heterogeneity analysis shows that low education and low wealth have a significant role in promoting the impact of financial investment income on household consumption expenditure. Thus, financial investment income promotes household consumption through the precautionary savings effect and liquidity constraint effect. The robustness test results confirm the robustness of the paper's findings.

According to the results, the main policy implication of this paper is that the China Securities Regulatory Commission (CSRC) should strengthen the protection of the rights and interests of small and medium-sized investors, improve the investment environment, and boost investors' confidence in the capital market. This will enable more investors to benefit from wealth appreciation in the capital market, thereby improving the level of household consumption and continuously optimizing its consumption structure. The second policy implication of the results is to encourage financial institutions to develop more financial products suitable for low-wealth households and lower the threshold for their participation in the capital market. Additionally, the government can organize regular financial literacy training courses for low-education and low-wealth households, effectively improving residents' financial literacy. This enables them to participate in and benefit from the capital markets, thereby better leveraging the role of financial investment income in driving consumption expenditure for households with low education and wealth, ultimately improving their welfare levels.

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