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THE PROCESS OF INTEREST RATE LIBERALIZATION IN CHINA: EVOLUTION, CURRENT SITUATION AND TREND

Abstract: With the development of China's economic system and economic management level, the important role of the market in the allocation of resources has been gradually established in China. Reform and vicissitudes have also been experienced many times in China's interest rate management system. Interest rates from the characteristics of the strict control has been gradually transformed into certain characteristic of the market. At the same time, there are market risks in the process of interest rate liberalization reform, and the accumulation of risks should be reasonably controlled to further deepen the reform process. Starting from the process of interest rate liberalization reform, this paper focuses on the analysis of the current situation of interest rate liberalization, analyzes the problems existed in open market interest rates, and finally looks forward to the further development of interest rate liberalization reform.

Key words: interest rate liberalization, system evolution, development trend.

Language: English

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Introduction

Interest rate marketization refers to all kinds of financial transactions subject for different money transactions, reduce government money transactions by administrative interference effects, thus forming a determined by market supply and demand of different period, different risk characteristics of the price of money, on the basis of the central bank's benchmark interest rate, the mediation of short-term financial market interest rate market interest rate system and according to the market demand determine financial

organ's interest rate formation mechanism in the process of the loan interest rate. In the process of China's current reform and opening up, China's interest rate liberalization has adopted a gradual reform approach. The marketization of interest rate gives full play to the market function, improves the efficiency of capital allocation, and thus contributes to the improvement of the real economy and the economic efficiency of the use of financial capital. Studies by relevant scholars show that interest rate liberalization has positive significance for economic

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growth (Li P, Feng M., 2016) and is conducive to weakening credit discrimination (Ma G, Yu W., 2016). In recent years, with the gradual liberalization of the upper and lower limits of loan interest rates, the marketization of loan interest rates plays an important role in alleviating the financing constraints of SMEs (Wang D, Zhang X., 2007). At the same time, the interest rate liberalization reform process can reduce the debt financing cost of listed companies (Zhang, W., et al., 2018).

Since the founding of new China, China has experienced a huge change from restraining finance to interest rate liberalization. China has basically completed the market in the form of interest rates. However, the "dual track system" is still an obvious feature of China's interest rate system, and the restricted interest rate within the banking system coexists with the market interest rate outside the banking system.

Interest rate liberalization is the core part of China's financial system reform. In order to deeply understand the current goal of China's financial system reform, we must review and reflect on the formation process of China's interest rate liberalization and explore the development direction of China's interest rate liberalization. Therefore, this study first summarizes the current situation of China's interest rate liberalization, then starts from the evolution process of China's interest rate liberalization, reflects on the advantages and disadvantages of China's interest rate liberalization, and finally summarizes the development path of China's interest rate liberalization reform.

II. Interest rate marketization in our country present situation analysis

According to the financial development and reform the 12th five-year plan "in" more open and get into shape, won the "principle of market-oriented interest rate reform, in July 2013 and October 2015 in our country were decontrolled loan interest rate and deposit rate limit, has realized the deposit and lending rates" more open "milestones, to adapt to the marketization of interest rate formation and the establishment of the regulatory mechanism as the core of deepening the reform of the new stage. Since October 2015, China's benchmark deposit and lending rates have not been adjusted. Considering the monetary control measures and the interest rate pricing power of financial institutions, the People's Bank of China announced that the benchmark deposit and lending rates will be a transitional arrangement and intends to cancel them when conditions are ripe. For a long time, the bank deposit and lending pricing is mainly decided by the lending and deposit rates, according to the lending and deposit rates to carry out the internal interest rate management (internal funds transfer pricing, FTP), the market interest rate pricing mechanism and self-discipline macro-prudential

policy evaluation (MPA), and other interest rate management also mainly depends on benchmark deposit and lending interest rates, and interest rates still is our country at present are applicable facts (Xu, Z., et al., 2018). In recent years, China has continuously lowered the RRR, increased open market operations and liquidity supply, and reduced the level of interest rates in the financial market, but the impact of market interest rates on loan rates is relatively limited. Since 2018, the risk-free interest rate in China's financial market has dropped significantly, but the real economy has not really felt the reduction of loan costs. The trend of the two has diverged for many times, and the loan interest rate is "easy to rise but hard to fall", which weakens the counter-cyclical regulation effect of monetary policy. The efficiency of monetary policy transmission mechanism is limited because of the dual interest rate system, and the policy transmission chain of interest rate to the real economy is hindered. How to make the loan base interest rate more sensitive to the macro economy, market liquidity and risk situation is the most urgent practical problem at present, that is, to improve the effect of interest rate liberalization. Therefore, while reforming the LPR system directly, the central bank chose to set a new price setting benchmark based on the interest of loans at the same time, all in order to solve this problem. Such a benchmark interest rate would not only be in line with the overall situation of the financial market, but also better communicate the monetary policy intentions of the central bank. (Xiang W, Yan B., 2020). Since 2019, China has taken an important step in unblocking the transmission mechanism of monetary policy and deepening the reform of interest rate liberalization with the LPR reform as the breakthrough point. Now, although the upper and lower limits of China's lending interest rates have been opened, the central bank still maintains the benchmark interest rates of deposits and loans as one of the means of monetary policy. The marketization of interest rates includes not only the liberalization of lending rates, but also the development of necessary financial infrastructure such as gradual transition to price monetary control, adjustment of interest rate transmission mechanism, establishment of deposit insurance system, and interest rate risk management tools. Therefore, China has formed a complex multiple interest rate mechanism system, a macro-economic environment is extremely sensitive, complete market bond market and short-term lending market interest rate, a theoretical completely flexible commercial bank interest rate and a bank also control the benchmark interest rate of monetary policy standby tool. Therefore, how to effectively solve the problem of interest rate marketization is an important subject of promoting the reform of China's financial system and accelerating the development of the socialist market economy with Chinese characteristics.

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III. Evolution process of interest rate marketization in our country

China's interest rate liberalization reform has a profound historical background and institutional roots. There is no special legislation on interest rate liberalization in China, but relevant laws and policies have regulated and adjusted it. These laws and policies are timely adjusted according to the state's control of interest rate liberalization. China's gradual establishment of the important role of the market in resource allocation and the shift of macroeconomic regulation from direct to mainly indirect means are in response to the country's political and economic development. China's interest rate management system has also gone through many reforms and changes, and the interest rate that was under strict control has gradually changed into the interest rate that has begun to take on market-oriented characteristics. The continuously innovative interest rate marketization in China began in 1996 with the unified establishment of the interbank lending market. In China, the reform of interest rate marketization, which has gone through 25 years and made great progress, is advancing steadily. In the financial market, such as the bond market and the money market, the interest rate is almost market-oriented. However, the interest rate of the pre-loan market as the most important financial area of the field marketization has not yet been realized. It can be divided into three stages according to the reform of China's interest rate management system.

Stage 1 (1979-1992): The embryonic stage of interest rate liberalization

The issue of reform of the interest rate system was raised immediately after the implementation of the reform and opening up policy in the late 1970s. In order to improve the efficiency and economy of capital, it is necessary to use the interest lever to raise the level of interest rate to solve the problem. Raising bank deposit rates is the first step, followed by raising bank lending rates. Later, in the reform of the financial system, various financial institutions demanded higher interest rates in order to expand financing and improve the efficiency of loans. With the continuous advancement of China's market economy construction, the emergence of more and more serious incongruity in other economic variables, is due to the highly concentrated interest rate restrictions and price level changes and the flexible change of market laws. Since the reform and opening up, there has been an "illegal" interest rate that avoids restrictions. Therefore, it is necessary to carry out interest marketization according to the free management interest system. In 1983, according to the notice of the State Council approving the report of the People's Bank of China on the transfer of the working capital of state-owned enterprises to the unified management of the People's Bank of China, the People's Bank of China decided to grant the right to fluctuate the

interest of 20% from the top to the bottom of the People's Bank according to the benchmark lending rate. The Provisional Regulations of the People's Republic of China on the Management of Banks issued by the State Council in 1986 stipulated that the short-term loans and interest rates of funds were decided by the lenders in order to enable specialized banks to lend funds to each other. Since then, the national interbank lending business has been launched. In 1990, the Interim Measures for the Administration of Interbank Lending was issued, and the first rule for the systematic use of the interbank lending market was formulated. This regulation stipulated the management principle of the upper limit of interbank lending rates. In 1991, this kind of underwriting issue with market factors has been adopted by the issuance of national debt.

Stage 2 (1993-2011): Steady Advancement Stage of Interest Rate Liberalization

In 1993, the 14th National Congress of the Communist Party of China put forward the basic conception of interest rate marketization reform. Based on the supply and demand relationship of market funds, the central bank's benchmark interest rate was put forward as the control center. Various interest rate levels were determined according to the supply and demand of market funds, and the market interest rate system built the market interest rate management system. In 1996, the central bank established the national unified interbank lending exchange, which formed the interbank lending exchange, thus the formal reform of interest rate liberalization was launched. In the same year, the interest rate ceiling of interbank lending was opened by the People's Bank of China, which became the breakthrough point of interest rate liberalization reform. The condition for interest rate reform was the opening up of interest rates in the interbank market. The Ministry of Finance realized the marketization of national debt through the market platform of the stock exchange, and the interest rate of China's bond issuance began to be marketized. The repurchase rate on interbank bonds was liberalized in 1997. In 1998. Discount and rediscount rates and the cash rate were liberalized. The mechanism of the discount rate is based on the reform of the People's Bank of China on the rediscount rate and the discount rate. The monetary policy is aimed at the necessary rediscount rate, which is formed by the central bank as an independent monetary policy tool. In 2000, China liberalized interest rates on foreign exchange loans and large foreign exchange deposits of more than \$3 million (including \$3 million). The interest rates on small foreign exchange deposits of less than US \$3 million are under the unified management of the People's Bank of China. In 2003, the general idea of China's interest rate liberalization reform was elaborated by the People's Bank of China in the 2002 China's Monetary Policy Implementation Report.

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First borrow foreign currency, then borrow RMB, save money. First, long term, large, then short term, small. The goal of China's market reform is that in the market interest rate, if the deposit of financial institutions is not endowed with the interest rate formation mechanism to determine the level of loan interest rate, the central bank monetary policy means to control the market interest rate and guide the market mechanism is the main position in the allocation of financial resources. In 2004, financial institutions fully lifted the ceiling on RMB lending rates. The People's Bank of China has twice expanded the range of interest rates on loans offered by financial institutions. On the basis of this, the system, which was based on the nature and scale of enterprise ownership, was abolished. We will expand the power of commercial banks to set prices independently, and make lending rates more market-based. The maximum range of interest rates on corporate loans will be raised to 70%, and the maximum range of interest rates on corporate loans will be kept at 10%. In the same year, a ceiling on lending interest rates of financial institutions (except urban and rural credit cooperatives) and a floor on deposit interest rates were opened. These important measures have epoch-making significance in the process of China's interest rate liberalization, which signify that China's interest rate liberalization has successfully achieved the phased goals of "the lower limit of loan interest rate and the upper limit of deposit interest rate". In 2006, the interest rate of commercial individual housing loan increased to 0.85 times of the benchmark interest rate. In 2007, the Shanghai Interbank Offered Rate (SHIBOR) was officially launched, which was helpful to the increase of the basic interest rate in the money market of financial institutions, the improvement of the monetary policy transmission mechanism, and the cultivation of independent pricing ability. Interest rates in the interbank bond market, including non-financial corporate debt financing vehicles, were liberalized in 2008.

Stage 3 (2012-present): Accelerating phase of interest rate liberalization

Interest rates were further widened by the central bank in 2012. 1.1 times of the benchmark interest rate is the floating range of deposit interest rate adjusted, and 0.8 times of the benchmark interest rate is the lower limit of the adjusted range of loan interest. In addition, the floor for the range of changes in lending rates has thus been adjusted to 0.7 times the benchmark rate. In order to further promote China's interest rate liberalization reform, the financing interest rate limit of financial institutions was fully opened in 2013. The lower limit of 0.7 times of the financing interest rate of financial institutions was abolished, and financial institutions independently decided the financing interest rate according to commercial principles. In addition, the limited discount rate on bills was abolished, and the old

method of determining the discount interest rate by the discount interest rate was changed, leaving financial institutions to decide on their own. In 2015, the People's Bank of China formulated the Interim Measures for the Administration of Large Certificates of Deposit in order to standardize the development of the business of large quantities of transferable certificates of deposit, which came into force as of the date of promulgation. At present, only the interest deposit interest rate of RMB is still in a semi-restricted state, that is, the deposit interest rate of financial institutions can replace the financial commodities in each period of the deposit, which means that there is a 1.5 times upper limit. Because the certificates of deposit can be transferred, they are more flexible than the deposit and financial management. In the same period, the People's Bank of China decided not to set an upper limit on deposit interest rates for commercial banks and rural cooperative financial institutions, and was eager to improve the market-oriented formation of interest rates and the adjustment mechanism. The initial realization of deposit interest rate marketization in China comes from the implementation of price setting for various financial commodities according to market subjects through independent negotiation. The lifting of deposit interest rate ceiling in 2015 marked the realization of interest rate marketization in the sense of policy in China, and promoted the transformation of monetary policy regulation from "quantitative" to "price" into a new stage. (Li W., 2019) The focus of interest rate liberalization, starting from the stage when supervisory organs independently abolished interest rate restrictions, gradually shifted to the stage when market subjects participated in the formation of market benchmark interest rate and interest rate structure (Deng H., 2013). The wholesale business interest rate between financial institutions has also been gradually liberalized, the interest rate range managed by the People's Bank of China has been increasingly narrowed, and the types of interest rate management have been gradually reduced, the corresponding structure of interest rate management term has been continuously simplified, and the interest rate with a market-oriented degree has been continuously improved. At the Boao Forum for Asia 2018, Yi Gang, governor of the People's Bank of China, stressed that China still has a "dual-track system" of interest rates. Interest rate integration is of great significance to the improvement of China's financial market mechanism and the optimization of monetary transmission mechanism. Although China is still in the transition stage of interest rate liberalization, great progress has been made in the reform of interest rate liberalization. The following figure shows the process of interest rate liberalization in the past 25 years (data from Wind, research department of CITIC Securities)

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IV. The current interest rate marketization in China is facing a problem

Although it has been continuously promoted over the years, the interest rate problem in China's interest rate liberalization reform has not been solved, and the reform has entered the "attack and defense" stage. Whether from the point of view of improving the effectiveness of monetary policy or deepening financial reform, it is necessary to communicate the way of interest rate transmission through deepening reform, and reduce the loan interest rate by setting the loan interest rate as "two tracks in one track" (Yi, X., 2020).

First, we will energize the real economy. Since 2019, the downward pressure on the world economy has intensified, and developed countries such as the US and Europe have shifted their financial policies towards easing. China's major macroeconomic indicators have remained within a reasonable range, but due to the impact of China-US trade frictions, domestic industrial restructuring and other factors, China is facing new risks and challenges, and the domestic economy is under increasing downward pressure. The epidemic of Covid-19 has dealt a huge blow to the production and operation of some industries, especially small and medium-sized enterprises, making their operation difficulties more serious. In this context, seize the time window financing rates "joining together of two rail track", timely and useful, timely help effect of monetary policy of credit market transmitting monetary policy, so as to make the enterprise's actual interest rates decline, financial support efforts to enhance and strengthen the micro main body activity, accelerate the enterprise production, COVID - 19 outbreak of the war victory, provides support for the real economy energy recovery.

Second, the stagnation of interest rate transmission impedes the effect of policy. Before the market price is (LPR) reform of interest rate loans, loans benchmark interest rate is the main reference pricing when bank financing, especially some Banks through certain times of the benchmark lending interest rate (0.9 times) cooperative behavior, set the loan interest rate lower limit of negative, hindered the adjustment of market interest rates, disadvantage in market interest rates overall downward phase lower lending rates. If the traditional method is used to directly reduce the financing benchmark interest rate and send out strong policy adjustment signals, the risk of real estate bubble may arise, and a new potential lower limit may be formed again. The effective transmission of market interest rate will be blocked.

Third, the key to deepening the reform of interest rate liberalization is to promote the revision of the financing rate track. Bank credit monetary system refers to the system that banks create deposit money by expanding loans and other assets. The direct restriction of bank money creation is loan demand,

and the main reason for determining deposit interest rate is loan interest rate. With the advance of the marketization of loan interest rate, the central bank can change the loan interest rate by adjusting the policy interest rate, which affects the loan demand, and then affects the deposit interest rate. Eventually, both the deposit interest rate and the loan interest rate will be marketized. Therefore, the loan interest rate is the key to "affect the whole body". In order to promote the marketization of loan interest rate, the first step to solve the "double track" problem of loan interest rate is to establish and use a more marketable loan price to set the benchmark, and then gradually reduce the loan benchmark interest rate. Therefore, it is a scientific way to promote interest rate marketization to focus on loan interest rate and deposit interest rate and supplement the reform of LPR formation mechanism (Du R, Sun T., 2020).

V. The trend of interest rate liberalization in China

The reform of interest rate liberalization is not a simple interest rate issue. It is closely related to the development degree of financial market, domestic and international macroeconomic environment, financial supervision system and other factors. Further market-oriented interest rate reform, which is beneficial to further adjust the capital market and goods market operation supporting facilities, city field at the same time, improve the marketization operation laws and regulations, establish a financial market system, and let go of foreign currency interest rates on the market and the relaxation of the capital flow management reform process such as matching, thus effectively guard against and defuse financial risks and maintain financial stability, promote the healthy development of the economy.

First, we should constantly improve the interest rate transmission mechanism. The long-term goal of China's interest rate liberalization reform is to strengthen the construction of the benchmark interest rate system in the financial market. The central problem is that deposit and loan interest rates cannot be effectively guided by financial market interest rates and open market operation rates. First of all, the target interest rate of the central bank should be established and the target interest rate of the central bank should be determined at the same time. Secondly, through accelerating the establishment of the benchmark interest rate system in the financial market, a variety of market interest rate systems and interest rate formation mechanisms have been formed. This institution is based on the benchmark interest rate of the central bank and takes the market interest rate as the intermediary to determine the pre-loan interest rate of the financial structure according to the market supply and demand.

Second, the reform of interest rate liberalization should be steadily promoted. In order to

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comprehensively and carefully consider the impact of interest policies on the financial market at various stages, it is the first step to promote the marketization of financing rate. The main method to promote the marketization of loan interest rate is to relax the lower limit of loan interest rate and simplify the grade of loan interest rate (Li Y., 2012). The second step is a gradual liberalization of deposit interest rates. In order to avoid the rise of interest rate, the decline of real interest rate and the increase of deposit margin, the deposit interest rate must be marketized.

Third, the financial supervision system should be fully and effectively established. A series of policy conditions provide the basis for the smooth implementation of interest rate rules. The effective supervision of interest rate financial system is to better realize the regulation of interest rate rules. To realize the in-depth promotion of interest rate liberalization, it is necessary to strengthen the proportion of interest rate pricing and relax the control of interest rate. But this does not represent a relaxation of interest rate management. Maintain market stability, need to establish and perfect harmonious economy. But the conventional approach to deregulating interest rates is not without risks. The problem of moral hazard and adverse selection in the financial market will be easily caused when the signal transmission and discrimination ability of the behavior subject is limited.

Fourth, we should foster a sound interest rate market and speed up the deposit insurance system. The marketization of interest rate is not complete liberalization, and it needs relevant system. First, we will optimize the structure of the bond market and improve the capital market. The problem of debt risk in the whole capital market needs special attention. It is necessary to upgrade the maturity structure in the bond market, abolish the restriction system of corporate bond allocation and interest rate gradually, and strive to realize the marketization of interest rate of bonds issued by enterprises. Secondly, the deposit insurance system is based on the guarantee of the financial system to prevent the deposit risk caused by the interest rate liberalization (Wang G., 2019). The relevant departments have stepped up the study of the deposit insurance system, formulated and

implemented it at an appropriate time, accepted the handling institutions of problem banks in the form of laws and regulations, provided financial relief, provided a clear basis and procedure for the undertaking of acquisitions and the repayment of debts, and provided practical guarantee for depositors and the stability of the financial system.

Fifth, the financial system construction and reform of the proposal. First, keep an eye on the interest rate changes in the private lending market. The interest rate of the private lending market is generally guided by the change of the interest rate in the formal financial market, which needs reasonable guidance so as to improve the interest rate management in the whole interest rate market system (He, Y., et al., 2018). From the perspective of policy, it is necessary to strengthen the monitoring of private lending interest rate and the system construction of investigation. In view of the usurious characteristics of China's private lending and the prominent problems of regional market fragmentation, it is necessary for the People's Bank of China to establish a sub-branch information monitoring and feedback system and regularize it through reasonable policy guidance and reform. Second, we should actively advocate the innovation of financial products, especially the market risk of financial derivatives within the scope of innovation of financial products. Third, the debt default problem of enterprises and governments should be firmly controlled. Only a low debt ratio can provide conditions for further decentralization of interest rate liberalization in the financial market. The in-depth reform of China's interest rate liberalization still needs to adhere to the gradual and orderly way, within the scope of the system reform that the economy can bear, actively carry out the market-oriented system construction reform, and gradually carry out the gradual and orderly targeted reform on the disadvantages of the old system. Finally, the central bank, in collaboration with local government departments and other macro-prudential regulatory authorities, should establish a comprehensive and systematic financial stability monitoring and evaluation system to better prevent risk contagion among and within financial markets and the transmission of financial risks across industries.

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