



Why do exchange rates change?

KS3 KS4 Ages 11-18 ⌚ 3 min read

An exchange rate is simply the price of one currency measured in another. Right now, £1 might buy you €1.17. Tomorrow it might buy €1.15. This price changes constantly — not every few months, but every second of every day, on global currency markets.

What drives the changes?

Currency prices are set by supply and demand, like any market. If more people want to buy pounds (to invest in the UK, buy UK goods, or visit), the price of pounds rises. If people are selling pounds (losing confidence in the UK economy, moving money elsewhere), the price falls.

Currencies are like shares in a country. When people are confident in a country's economic future — low inflation, stable government, growing economy — they want to hold its currency and its assets. High demand pushes up the price. When confidence falls — political chaos, high inflation, weak growth — people sell. Lower demand, lower price. You can think of a currency's exchange rate as a live, constantly updated vote of confidence in that country's economy.

What are the main factors?

Interest rates. Higher interest rates attract foreign investors looking for better returns, increasing demand for the currency. The Bank of England raising rates tends to strengthen the pound.

Inflation. High inflation erodes the purchasing power of a currency. If prices in the UK rise faster than in Europe, your pounds buy less — making them less valuable.

Economic performance. A growing economy with low unemployment and strong trade attracts investment, pushing up the currency.

Political stability. Uncertainty — elections, policy changes, crises — tends to weaken a currency as investors seek safer places to park money. The pound fell sharply after the Brexit referendum result in 2016 precisely because of uncertainty about future trade relationships.

Who actually trades currencies?

The foreign exchange market (forex) is the largest financial market in the world — about \$7 trillion trades every single day. Most of this isn't tourists changing money at the airport. It's banks, hedge funds, multinational companies hedging against currency risk, and central banks managing their reserves. The airport kiosk is the very small, expensive, consumer-facing tip of an enormous iceberg.