PEMEX

PROSPECTUS

OFFERS TO EXCHANGE

U.S. $350,000,000 8 3/8% Global Guaranteed Notes due 2005
and
U.S. $350,000,000 9¼% Global Guaranteed Bonds due 2018,
which have been registered under the Securities Act of 1933, as amended,
for
any and all of its outstanding unregistered 8 3/8% Global Guaranteed Notes due 2005
and
9¼% Global Guaranteed Bonds due 2018, respectively,
of

Petróleos Mexicanos

jointly and severally guaranteed by

Pemex-Exploración y Producción
Pemex-Refinación
and
Pemex-Gas y Petroquímica Básica

THE EXCHANGE OFFERS WILL EXPIRE AT 5:00 P.M., NEW YORK CITY TIME ON SEPTEMBER 23, 1998, UNLESS EXTENDED

Petróleos Mexicanos ("Petróleos Mexicanos" or the "Issuer"), a decentralized public entity of the Federal Government (the "Government") of the United Mexican States ("Mexico"), hereby offers (the "Exchange Offers"), upon the terms and subject to the conditions set forth in this Prospectus and in the accompanying Letters of Transmittal relating to the Exchange Offers (the "Letters of Transmittal"), to exchange (i) U.S. $1,000 principal amount of its registered 8 3/8% Global Gua ranteed Notes due 2005 (the "New Notes") for each U.S. $1,000 principal amount of its outstanding 8 3/8% Global Guaranteed Notes due 2005 (the "Old Notes" and, together with the New Notes, the "Notes") and (ii) U.S. $1,000 principal amount of its registered 9¼% Global Guaranteed Bonds due 2018 (the "New Bonds") for each U.S. $1,000 principal amount of its outstanding 9¼% Global Guaranteed Bonds due 2018 (the "Old Bonds" and, together with the New Bonds, the "Bonds"). The form and terms of the New Notes and the New Bonds will be identical in all material respects to the form and terms of the Old Notes and the Old Bonds, respectively, except that (i) the New Notes and the New Bonds will have been registered under the Securities Act of 1933, as amended (the "Securities Act"), (ii) holders of the New Notes and the New Bonds will not be entitled to certain rights of holders of the Old Notes and the Old Bonds under the Registration Rights Agreement referred to below, (iii) the New Notes and the New Bonds will be issued pursuant to, and entitled to the benefits of the Indenture (as defined herein) and not the Fiscal Agency Agreement dated as of June 16, 1993, and amended and restated as of February 26, 1998, between the Issuer and Bankers Trust Company, as Fiscal Agent (the "Fiscal Agency Agreement"), governing the Old Notes and the Old Bonds, and (iv) the New Notes and the New Bonds will not be issued under the Issuer's program for the issuance from time to time of Medium-Term Notes, Series B, Due from One to Thirty Years from the Date of Issue (the "Program"). The Notes and the Bonds are sometimes referred to collectively herein as the "Securities".

As of the date hereof, U.S. $350,000,000 aggregate principal amount of Old Notes and U.S. $350,000,000 aggregate principal amount of Old Bonds are outstanding. The Exchange Offers are being made pursuant to the terms of the Registration Rights Agreement dated April 1, 1998 (the "Registration Rights Agreement") entered into among the Issuer and J.P. Morgan and the other purchasers referred to therein (such purchasers, the "Purchasers"), pursuant to the terms of the Terms Agreement, dated March 25, 1998, between the Issuer and the Purchasers (the "Terms Agreement"). See "The Exchange Offers—Purpose and Effect of the Exchange Offers".

See "Risk Factors" beginning on page 16 for a discussion of certain factors that investors should consider in connection with the Exchange Offers and an investment in the Securities offered hereby.

(Cover page continued)

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is August 24, 1998.

The Issuer will accept for exchange any and all validly tendered Old Notes and Old Bonds on or prior to 5:00 p.m., New York City time, on September 23, 1998 (the "Expiration Date") unless the Exchange Offers are extended, in which case the term "Expiration Date" shall mean the latest date and time to which the Exchange Offer is extended. Tenders of Old Notes and Old Bonds may be withdrawn at any time prior to 5:00 p.m., New York City time, on the Expiration Date, unless previously accepted by the Issuer. Neither of the Exchange Offers is conditioned upon any minimum principal amount of Old Notes and Old Bonds being tendered for exchange. However, the Exchange Offers are subject to certain conditions, which may be waived by the Issuer, and to the terms and provisions of the Registration Rights Agreement. Old Notes and Old Bonds may be tendered only in denominations of U.S. $1,000 principal amount and integral multiples thereof. The Issuer has agreed to pay the expenses of the Exchange Offers. See "The Exchange Offers".

Any Old Notes and Old Bonds not tendered and accepted in the Exchange Offers will remain outstanding and will be entitled to all the rights and preferences, and will be subject to the limitations applicable thereto, under the Fiscal Agency Agreement. Following consummation of the Exchange Offers, the holders of Old Notes and Old Bonds will continue to be subject to the existing restrictions upon transfer thereof, and the Issuer will have no further obligation to such holders (subject to certain limited exceptions) to provide for the registration under the Securities Act of the Old Notes and Old Bonds held by them. Following completion of the Exchange Offers, none of the New Notes and the New Bonds will be entitled to the contingent increase in interest rate provided pursuant to the Fiscal Agency Agreement, the Old Notes, the Old Bonds and the Registration Rights Agreement. See "The Exchange Offers".

Interest on the New Notes and the New Bonds will be payable semiannually on March 30 and September 30 each year, commencing March 30, 1999, and accruing from September 30, 1998, the last day to which interest on Old Notes and Old Bonds tendered in the Exchange Offers will be paid. The New Notes will mature on March 30, 2005 and the New Bonds will mature on March 30, 2018. Interest payments will be made after withholding for, or on account of, Mexican Withholding Taxes (as defined herein), and, subject to certain exceptions, the Issuer will pay Additional Amounts (as defined herein) in respect of such taxes. All payments on the New Notes and the New Bonds will be made in U.S. dollars. In the event of certain changes involving Mexican Withholding Taxes, the New Notes and the New Bonds may be redeemed, in whole but not in part, at 100% of the principal amount thereof, plus accrued interest to the date of redemption. See "Description of New Notes and New Bonds—Tax Redemption".

The New Notes and the New Bonds will constitute direct, unsecured and unsubordinated Public External Indebtedness (as defined herein) of the Issuer and will rank *pari passu* with each other. The payment obligations of the Issuer under the New Notes and the New Bonds will, except as may be provided by applicable law and subject to "Description of New Notes and New Bonds—Negative Pledge", at all times rank equally with all other present and future unsecured and unsubordinated Public External Indebtedness for money borrowed of the Issuer. The payment of principal, interest and all other amounts due on the New Notes and the New Bonds will be unconditionally guaranteed, jointly and severally, by Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica (each, a "Guarantor" and, together, the "Guarantors"), each of which is a subsidiary of Petróleos Mexicanos and a decentralized public entity of the Government. See "Description of New Notes and New Bonds—Guaranties". The New Notes and the New Bonds are not obligations of, or guaranteed by, Mexico.

Based on interpretations by the staff of the Securities and Exchange Commission (the "Commission") set forth in no-action letters issued to third parties, the Issuer and the Guarantors believe that the New Notes and the New Bonds issued pursuant to the Exchange Offers in exchange for Old Notes and Old Bonds may be offered for resale, resold and otherwise transferred by any holder thereof (other than broker-dealers, as set forth below, and any such holder that is an "affiliate" of the Issuer or a Guarantor within the meaning of Rule 405 under the Securities Act) without compliance with the registration and prospectus delivery provisions of the Securities Act; *provided* that such New Notes and New Bonds are acquired in the ordinary course of such holder's business and that such holder is not participating, does not intend to participate and has no arrangement or understanding with any person to participate, in the distribution of such New Notes and New Bonds. Holders of Old Notes and Old Bonds wishing to accept the Exchange Offers must represent to the Issuer and the Guarantors in the Letters of Transmittal that such conditions have been met. Any holder who tenders in the Exchange Offers with the intention to participate, or for the purpose of participating, in a distribution of the New Notes or the New Bonds may not rely upon such interpretations by the staff of the Commission and, in the absence of any exemption therefrom, must comply with the registration and prospectus delivery requirements of the Securities Act in connection with any secondary resale transaction, and any such secondary resale transaction must be covered by an effective registration statement containing the selling security holder information required by Item 507 of Regulation S-K under the Securities Act.

Each broker-dealer (other than an affiliate of the Issuer or a Guarantor) that receives New Notes or New Bonds for its own account pursuant to the Exchange Offers must acknowledge that it will deliver a prospectus in connection with any resale of such New Notes or New Bonds. The Letters of Transmittal state that by so acknowledging and by delivering a prospectus a broker-dealer will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act. This Prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of New Notes or New Bonds received in exchange for Old Notes or Old Bonds, respectively, where such Old Notes or Old Bonds were acquired by such broker-dealer as a result of market-making activities or other trading activities. The Issuer has agreed that, for a period of 180 days after the Expiration Date, it will make this Prospectus available to any broker-dealer for use in connection with any such resale. See "Plan of Distribution". Any broker-dealer that is an affiliate of the Issuer or a Guarantor may not rely on the no-action letters referred to above and must comply with the registration and prospectus delivery requirements of the Securities Act in connection with any secondary resale transaction.

The New Notes and the New Bonds constitute new issues of securities with no established trading market. Application has been made to list the New Notes and the New Bonds on the Luxembourg Stock Exchange. There can be no assurance that an active trading market for the New Notes or the New Bonds will develop. To the extent that Old Notes or Old Bonds are tendered and accepted in the Exchange Offers, a holder's ability to sell untendered Old Notes or Old Bonds could be adversely affected. It is not expected that an active trading market for Old Notes or Old Bonds will develop while they are subject to restrictions on transfer.

New Notes and New Bonds will be represented by one or more permanent global New Notes and global New Bonds in fully registered form without interest coupons (each, a "Global Security") deposited on or about October 7, 1998 (unless the Expiration Date is extended) with the Trustee (as defined herein) as custodian for, and registered in the name of, a nominee of The Depository Trust Company ("DTC") in New York, New York for credit to the accounts of DTC and its participants, including Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System ("Euroclear") and Cedel Bank, *société anonyme* ("Cedel Bank"). Beneficial interests in a Global Security will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its direct and indirect participants, including Euroclear and Cedel Bank. Except in the limited circumstances described herein, certificated New Notes and certificated New Bonds will not be issued in exchange for beneficial interests in a Global Security. See "Description of New Notes and New Bonds—Form and Denomination".

This Prospectus, together with the Letters of Transmittal, is being sent or made available to all registered holders of Old Notes and Old Bonds as of August 21, 1998.

Neither of the Exchange Offers is conditioned upon any minimum principal amount of Old Notes and Old Bonds being tendered for exchange.

The Issuer will not receive any proceeds from the Exchange Offers. No dealer-manager is being used in connection with the Exchange Offers. See "Use of Proceeds" and "Plan of Distribution".

THE EXCHANGE OFFERS ARE NOT BEING MADE TO, NOR WILL THE ISSUER ACCEPT SURRENDERS OF OLD NOTES AND OLD BONDS FOR EXCHANGE FROM, HOLDERS THEREOF IN ANY JURISDICTION IN WHICH THE EXCHANGE OFFERS OR THE ACCEPTANCE THEREOF WOULD NOT BE IN COMPLIANCE WITH THE SECURITIES OR BLUE SKY LAWS OF SUCH JURISDICTION.

The Issuer was established by a decree of the Mexican Congress on June 7, 1938 as a result of the nationalization of the foreign-owned oil companies then operating in Mexico. Petróleos Mexicanos and its four subsidiary entities, Pemex-Exploración y Producción (Pemex-Exploration and Production), Pemex-Refinación (Pemex-Refining), Pemex-Gas y Petroquímica Básica (Pemex-Gas and Basic Petrochemicals) and Pemex-Petroquímica (Pemex-Petrochemicals) (each a "Subsidiary Entity", and collectively, the "Subsidiary Entities" and together with the Issuer, "PEMEX"), comprise Mexico's state oil and gas company. Each is a decentralized public entity of the Government and is a legal entity empowered to own property and carry on business in its own name.

The Issuer and the Guarantors, having made all reasonable inquiries, confirm that this Prospectus contains all information in relation to the Issuer, the Guarantors, PEMEX, Mexico, the New Notes and the New Bonds which is material in the context of Exchange Offers, there are no untrue statements of a material fact contained in it in relation to the Issuer, the Guarantors, PEMEX, Mexico, the New Notes or the New Bonds, there is no omission to state a material fact which is necessary in order to make the statements made in it in relation to the Issuer, the Guarantors, PEMEX, Mexico, the New Notes or the New Bonds, in light of the circumstances under which they were made, not misleading in any material respect, the opinions and intentions expressed in this Prospectus with regard to the Issuer, the Guarantors, PEMEX and Mexico are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions, and all reasonable inquiries have been made by the Issuer and the Guarantors to ascertain such facts and to verify the accuracy of all such information and statements. The Issuer and the Guarantors accept responsibility accordingly.

The Issuer has filed an application to register the New Notes and the New Bonds before the *Sección Especial del Registro Nacional de Valores e Intermediarios* (the Special Section of the National Registry of Securities and Intermediaries) maintained by the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission) of Mexico (the "Registry"). Registration of the New Notes and the New Bonds with the Registry does not imply any certification as to the investment quality of the New Notes or the New Bonds, the solvency of the Issuer or the Guarantors or the accuracy or completeness of the information contained in this Prospectus. The New Notes or the New Bonds may not be publicly offered or sold in Mexico.

ENFORCEMENT OF CIVIL LIABILITIES

The Issuer and the Guarantors are decentralized public entities of the Government. All of the directors and officers of the Issuer and each Guarantor and certain experts named herein reside in Mexico and all or a substantial portion of the assets of these persons, the Issuer and the Guarantors are located in Mexico. As a result, it may not be possible for investors to effect service of process within the United States upon such persons, the Issuer or the Guarantors, or enforce against them, the Issuer or the Guarantors, in U.S. courts, judgments predicated upon the civil liability provisions of the federal securities laws of the United States. The Issuer and the Guarantors have been advised by Francisco Javier Zenteno Barrios, the General Counsel and the Head of the Legal Department of Petróleos Mexicanos, that there is doubt as to the enforceability, in original actions in Mexican courts, of liabilities predicated solely on the U.S. federal securities laws and as to the enforceability in Mexican courts of judgments of U.S. courts obtained in actions predicated upon the civil liability provisions of the U.S. federal securities laws.

Moreover, the Issuer and the Guarantors are each decentralized public entities of the Government, a foreign sovereign. Consequently, it may be difficult for investors to obtain or realize upon judgments of courts in the United States against the Issuer or one or more of the Guarantors. In addition, the Issuer and the Guarantors are entitled to certain immunities under Mexican law which may restrict the ability of investors to realize upon judgments in the courts of Mexico. See "Risk Factors—Sovereign Immunity; Judgment Currency". The Issuer and each of the Guarantors will each irrevocably submit to the jurisdiction of the federal courts in the Borough of Manhattan, The City of New York, and, to the extent permitted by law, will irrevocably waive any immunity from the jurisdiction of such courts, in connection with any action based upon the New Notes or the New Bonds brought by any holder of New Notes or New Bonds. The Issuer and the Guarantors reserve the right to plead immunity under the U.S. Foreign Sovereign Immunities Act of 1976 (the "Immunities Act") with respect to actions brought against them under the U.S. federal securities laws or any state securities laws. In the absence of a waiver of immunity by the Issuer or any Guarantor with respect to such actions, it would not be possible to obtain a judgment in an action brought in a U.S. court against the Issuer or such Guarantor, as the case may be, unless such court were to determine that the Issuer or such Guarantor, as the case may be, is not entitled under the Immunities Act to sovereign immunity with respect to such action. However, even if a U.S. judgment could be obtained in any such action under the Immunities Act, it may not be possible to obtain in Mexico a judgment based on such a U.S. judgment. Moreover, execution upon property located in the United States of the Issuer or such Guarantor, as the case may be, to enforce a judgment obtained under the Immunities Act, may not be possible except under the limited circumstances specified in the Immunities Act.

CURRENCY OF PRESENTATION

References herein to "U.S. dollars", "U.S. $", "dollars" or "$" are to the lawful currency of the United States. References herein to "pesos" or "Ps." are to the lawful currency of Mexico which, effective January 1, 1993, replaced Mexico's former currency (also called the "peso") at the rate of one peso to one thousand old pesos. During the transition period from January 1, 1993 through December 31, 1995, the new currency was officially referred to as the *nuevo peso* (the new peso) and since January 1, 1996, has been officially referred to as the peso. All amounts set forth herein in Mexican currency are stated in pesos, even if such amounts relate to a period before January 1, 1996. The term "billion" as used in this Prospectus means one thousand million.

This Prospectus contains translations of certain peso amounts into U.S. dollars at specified rates solely for the convenience of the reader. These translations should not be construed as representations that the peso amounts actually represent such U.S. dollar amounts or could be converted into U.S. dollars at the rate indicated. Unless otherwise indicated, such U.S. dollar amounts have been translated from pesos at an exchange rate of Ps. 8.0833 to U.S. $1.00, the exchange rate for the settlement of obligations in foreign currencies in Mexico announced by Banco de México on December 31, 1997. On July 31, 1998, the noon buying rate for cable transfers in New York reported by the Federal Reserve Bank of New York was Ps. 8.9200 to U.S. $1.00.

PEMEX maintains its financial statements and records in nominal pesos.

The Financial Statements (as defined herein) of PEMEX are prepared in accordance with Mexican generally accepted accounting principles ("Mexican GAAP") except as described below with respect to inflation accounting. See Notes 2(b) and 14 to the Financial Statements of PEMEX included elsewhere herein for a description of the inflation accounting rules applicable to PEMEX. Moreover, Mexican GAAP differs in certain significant respects from United States generally accepted accounting principles ("U.S. GAAP"). The differences that are material to PEMEX's Financial Statements are described in Note 16 to the Financial Statements.

AVAILABLE INFORMATION

The Issuer and the Guarantors have filed with the Commission a Registration Statement on Form F-4 (together with all amendments, exhibits, schedules and supplements thereto, the "Exchange Offer Registration Statement") under the Securities Act with respect to the New Notes and the New Bonds offered hereby, of which this Prospectus constitutes a part. This Prospectus, which constitutes a part of the Exchange Offer Registration Statement, does not contain all of the information set forth in the Exchange Offer Registration Statement, certain parts of which have been omitted in accordance with the rules and regulations of the Commission. For further information with respect to PEMEX and the New Notes and the New Bonds offered hereby, reference is made to the Registration Statement and the exhibits filed therewith. Statements contained in this Prospectus as to the contents of certain documents are not necessarily complete, and, in each instance, reference is made to the copy of such document filed as an exhibit to the Exchange Offer Registration Statement, each such statement being qualified in all respects by such reference.

The Issuer is currently subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and in accordance therewith files reports and other information with the Commission. The Exchange Offer Registration Statement and such reports and other information can be inspected at the public reference facilities maintained by the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549; Seven World Trade Center, New York, New York 10048; and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661; and at the offices of the Paying Agent in Luxembourg. Copies of such materials can also be obtained at prescribed rates from the Public Reference Section of the Commission, at 450 Fifth Street, N.W., Washington, D.C. 20549.

The Issuer will furnish to the holders of the New Notes and New Bonds, through the corporate trust office of the Trustee referred to herein, its annual report in English, which will include a review of operations, and annual audited consolidated financial statements for the Issuer prepared in conformity with Mexican GAAP, together with a reconciliation of income and equity to U.S. GAAP.

GLOSSARY OF CERTAIN TECHNICAL TERMS

Unless the context indicates otherwise, the following terms as used in this Prospectus have the meanings shown below:

API. American Petroleum Institute.

Basic petrochemicals. Ethane, propane, butanes, pentanes, hexanes, heptanes, naphthas, carbon black feedstocks and methane, but in this last case, only if obtained from hydrocarbons used as basic raw materials by the petrochemical industry and obtained from deposits located in Mexico.

bcf. Billion of cubic feet.

boe. Barrels of oil equivalent.

bpd. Barrels per day.

Catalytic cracking. A refinery process using a chemical catalyst to break complex hydrocarbon molecules into smaller molecules that are commonly used to create refined end products.

cfpd. Cubic feet per day.

cfpy. Cubic feet per year.

Condensates. Liquid hydrocarbons (*i.e.*, ethane, propane, butane and certain pentanes) obtained from natural gas and recovered in surface separating facilities, as well as liquid hydrocarbons condensed in natural gas pipelines.

Crude oil. Excludes condensates and natural gas liquids production. The crude oil recovered can be light or heavy as follows:

Heavy crude oil. Crude oil with API density less than or equal to 27°.

Light crude oil. Crude oil with API density higher than 27° and less than 38°.

PEMEX exports three varieties of crude oil with the following typical characteristics:

Maya. Heavy crude oil, 22° API density and 3.3% sulfur by weight.

Isthmus. Light crude oil, 33.6° API density and 1.3% sulfur by weight.

Olmeca. Very light crude oil, 39.3° API density and 0.8% sulfur by weight.

Dry gas. Gas with a methane content of more than 90%.

Hydrotreating. A refinery process whereby sulfur is removed from the crude oil feedstock and/or intermediate refinery products in order to improve product quality.

LPG. Liquefied petroleum gas.

NGL. Natural gas liquids, including ethane, propane, butanes, pentanes and heavier paraffin hydrocarbons.

Oil or petroleum derivatives. Petroleum products including refining products, petrochemical products and natural gas.

Refining capacity. The aggregate throughput capacity at a refinery (as opposed to individual refinery units) expressed in thousands of barrels of crude oil input per day of refinery operation.

Reforming. A refinery process whereby smaller or unstable hydrocarbon molecules are changed into larger, more useful refining or blending products.

Secondary petrochemicals. All petrochemical products other than basic petrochemicals.

tpy. Tons per year.

SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information appearing elsewhere in this Prospectus.

The Exchange Offers

The Exchange Offers .... Pursuant to the Exchange Offers, (i) U.S. $1,000 principal amount of New Notes will be issued in exchange for each U.S. $1,000 principal amount of Old Notes and (ii) U.S. $1,000 principal amount of New Bonds will be issued in exchange for each U.S. $1,000 principal amount of Old Bonds, in each case, that are validly tendered and not withdrawn. As of the date of this Prospectus, U.S. $350,000,000 aggregate principal amount of Old Notes and U.S. $350,000,000 aggregate principal amount of Old Bonds were outstanding. See "The Exchange Offers".

Holders of Old Notes or Old Bonds whose Old Notes or Old Bonds are not tendered and accepted in the Exchange Offers will continue to hold such Old Notes or Old Bonds and will be entitled to all the rights and preferences, and will be subject to the limitations applicable thereto, including the restrictions upon transfer thereof, under the Indenture governing the Old Notes and the Old Bonds. Following consummation of the Exchange Offers, the holders of Old Notes and Old Bonds will continue to be subject to the existing restrictions upon transfer thereof, and, subject to certain limited exceptions, the Issuer will have no further obligation to such holders to provide for the registration under the Securities Act of the Old Notes and the Old Bonds held by them. Following the completion of the Exchange Offers, none of the New Notes or the New Bonds will be entitled to the contingent increase in interest rate provided pursuant to the Indenture, the Old Notes, the Old Bonds and the Registration Rights Agreement.

Resale... Based on an interpretation by the staff of the Commission set forth in no-action letters issued to third parties, the Issuer and the Guarantors believe that the New Notes and the New Bonds issued pursuant to the Exchange Offers in exchange for Old Notes and Old Bonds may be offered for resale, resold and otherwise transferred by any holder thereof (other than broker-dealers, as set forth below, and any such holder that is an "affiliate" of the Issuer or a Guarantor within the meaning of Rule 405 under the Securities Act) without compliance with the registration and prospectus delivery provisions of the Securities Act; *provided* that such New Notes and New Bonds are acquired in the ordinary course of such holder's business and that such holder is not participating, does not intend to participate and has no arrangement or understanding with any person to participate, in a distribution of the New Notes or the New Bonds.

Any holder who tenders in the Exchange Offers with the intention to participate, or for the purpose of participating, in a distribution of the New Notes or the New Bonds may not rely upon such interpretations by the staff of the Commission and, in the absence of an exemption therefrom, must comply with the registration and prospectus delivery requirements of the Securities Act in connection with any secondary resale transaction, and any such secondary resale transaction must be covered by an effective registration statement containing the selling securityholder information required by Item 507 of Regulation S-K under the Securities Act. Failure to comply with such requirements in such instance may result in such holder incurring liabilities under the Securities Act for which the holder is not indemnified by the Issuer or any Guarantor.

Each broker-dealer (other than an affiliate of the Issuer or a Guarantor) that receives New Notes or New Bonds for its own account pursuant to the Exchange Offers must acknowledge that it will deliver a prospectus in connection with any resale of such New Notes or New Bonds. The Letters of Transmittal state that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act. The Issuer has agreed that, for a period of 180 days after the Expiration Date, it will make this Prospectus available to any broker-dealer for use in connection with any such resale. See "Plan of Distribution".

The Exchange Offers are not being made to, nor will the Issuer accept surrenders of Old Notes and Old Bonds for exchange from, holders thereof in any jurisdiction in which the Exchange Offers or the acceptance thereof would not be in compliance with the securities or blue sky laws of such jurisdiction.

Expiration Date .... The Exchange Offers will expire at 5:00 p.m., New York City time, on September 23, 1998, unless extended, in which case the term "Expiration Date" shall mean the latest date and time to which the Exchange Offers are extended.

Conditions of the Exchange Offers.... The Exchange Offers are subject to certain conditions, which may be waived by the Issuer. See "The Exchange Offers—Terms of the Exchange Offers—Conditions of the Exchange Offers". Neither of the Exchange Offers is conditioned upon any minimum principal amount of Old Notes or Old Bonds being tendered for exchange.

Procedures for Tendering Old Notes and Old Bonds .... Each holder of Old Notes or Old Bonds wishing to accept an Exchange Offer must complete, execute, date and deliver electronically the applicable Letter of Transmittal, and deliver its Old Notes or Old Bonds, as the case may be, pursuant to DTC's Automated Tender Offer Program ("ATOP"), by which each tendering participant will agree to be bound by such Letter of Transmittal. Copies of the Letters of Transmittal are available at the offices of the Exchange Agent and the Luxembourg Listing Agent specified below.

A holder of Old Notes or Old Bonds that is not a direct participant in DTC must tender its Old Notes or Old Bonds, as the case may be, by submitting, in accordance with the procedures of the participant (including Euroclear or Cedel Bank) through which it holds its Old Notes or Old Bonds, as the case may be, a duly completed and executed Letter of Transmittal with respect to the Old Notes or Old Bonds being tendered, and must deliver computerized instructions to such participant (including Euroclear or Cedel Bank) for the transfer of such Old Notes or Old Bonds to the Exchange Agent's account at DTC's Book-Entry Transfer Facility, in each case sufficiently in advance of the Expiration Date to allow sufficient time for such participant to arrange for the electronic submission of the applicable Letter of Transmittal and tender of the related Old Notes or Old Bonds through DTC's ATOP system on or prior to the Expiration Date. **Delivery of documents to Euroclear or Cedel Bank does not constitute delivery to the Exchange Agent through DTC's ATOP system.**

By tendering its Old Notes or Old Bonds and agreeing to be bound by a Letter of Transmittal, a holder will represent to the Issuer that, among other things, (i) the New Notes or the New Bonds acquired pursuant to the applicable Exchange Offer are being obtained in the ordinary course of business of the person receiving such New Notes or New Bonds, as the case may be, whether or not such person is the holder, (ii) neither the holder nor any such other person has an arrangement or understanding with any person to participate in a distribution of such New Notes or New Bonds, (iii) the holder is not a broker-dealer, or is a broker-dealer but will not receive New Notes or New Bonds for its own account in exchange for Old Notes or Old Bonds, (iv) neither the holder nor any such other person is engaged in or intends to participate in a distribution of such New Notes or New Bonds, and (v) neither the holder nor any such other person is an "affiliate" of the Issuer or any Guarantor within the meaning of Rule 405 under the Securities Act. See "The Exchange Offers—Terms of the Exchange Offers—Procedures for Tendering Old Notes and Old Bonds".

Special Procedures for Beneficial Owners	Any beneficial owner whose Old Notes or Old Bonds are registered in the name of a broker-dealer, commercial bank, trust company or other nominee and who wishes to tender such Old Notes or Old Bonds in the Exchange Offers should contact such registered holder promptly and instruct such registered holder to tender on such beneficial owner's behalf. See "The Exchange Offers—Terms of the Exchange Offers—Procedures for Tendering Old Notes and Old Bonds".
Acceptance of Old Notes and Old Bonds and Delivery of New Notes and New Bonds	Subject to certain conditions (as described more fully in "The Exchange Offers—Terms of the Exchange Offers—Conditions of the Exchange Offers"), the Issuer will accept for exchange any and all Old Notes and Old Bonds properly tendered in the Exchange Offers and not withdrawn prior to 5:00 p.m., New York City time, on the Expiration Date. The New Notes and the New Bonds issued pursuant to the Exchange Offers will be delivered as promptly as practicable following the Expiration Date.
Withdrawal Rights	Tenders of Old Notes and Old Bonds may be withdrawn at any time prior to 5:00 p.m., New York City time, on the Expiration Date, unless previously accepted by the Issuer. See "The Exchange Offers—Terms of the Exchange Offers—Withdrawal of Tenders of Old Notes or Old Bonds".
Taxation	For a discussion of certain U.S. and Mexican federal tax considerations relating to an exchange of New Notes or New Bonds for Old Notes or Old Bonds and the purchase, ownership and disposition of New Notes and New Bonds, see "Taxation".
Exchange Agent	Bankers Trust Company is the Exchange Agent. The address, telephone number and facsimile number of the Exchange Agent are set forth in "The Exchange Offers—Terms of the Exchange Offers—The Exchange Agent".

Summary of the Terms of the New Notes and the New Bonds

The following summary of certain terms of the New Notes and the New Bonds is not complete and is qualified in its entirety by all of the terms contained in the New Notes and the New Bonds and in the Indenture. The form and terms of the New Notes and the New Bonds will be identical in all material respects to the form and terms of the Old Notes and the Old Bonds except that (i) the New Notes and the New Bonds will have been registered under the Securities Act, (ii) holders of the New Notes and the New Bonds will not be entitled to certain rights of holders of the Old Notes and the Old Bonds under the Registration Rights Agreement, (iii) the New Notes and the New Bonds will be issued pursuant to and entitled to the benefits of the Indenture and not the Fiscal Agency Agreement, and (iv) the New Notes and the New Bonds will not be issued under the Program. For a more detailed description of the terms of the New Notes and the New Bonds, see "Description of New Notes and New Bonds".

Issuer	Petróleos Mexicanos.
Guarantors	Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica.
The New Notes	U.S. $350,000,000 principal amount of $8^3/_8$% Global Guaranteed Notes due 2005.
The New Bonds	U.S. $350,000,000 principal amount of $9^1/_4$% Global Guaranteed Bonds due 2018.
The Guaranties	The payment of principal of and interest on the New Notes and the New Bonds will be unconditionally guaranteed, jointly and severally, by the Guarantors pursuant to a Guaranty Agreement, dated July 29, 1996, among the Issuer and the Guarantors, and Certificates of Designation, dated March 25, 1998. See "Description of New Notes and New Bonds—Guaranties".
Maturity Date	March 30, 2005, for the New Notes. March 30, 2018, for the New Bonds.
Interest	The New Notes will bear interest from September 30, 1998, the last day to which interest on Old Notes tendered in the Exchange Offers will be paid, at the rate of $8^3/_8$% per annum, payable semiannually in arrears. The New Bonds will bear interest from September 30, 1998, the last day to which interest on Old Bonds tendered in the Exchange Offers will be paid, at the rate of $9^1/_4$% per annum, payable semiannually in arrears. All payments on the New Notes and the New Bonds will be made in U.S. dollars through the facilities of DTC in same-day funds. See "Description of New Notes and New Bonds—General" and "—Payment of Principal and Interest".
Interest Payment Dates	March 30 and September 30 of each year, commencing March 30, 1999.

Withholding Tax	Principal of and interest on the New Notes and the New Bonds are payable by the Issuer or the Guarantors, as the case may be, without withholding or deduction for Mexican Withholding Taxes to the extent set forth herein. See "Description of New Notes and New Bonds—Additional Amounts".
Redemption	The New Notes and the New Bonds are not redeemable at the option of the Issuer, except as described in "—Tax Redemption" below.
Tax Redemption	In the event that, as a result of certain changes in Mexican law, the Issuer becomes obligated to pay Additional Amounts at a rate in excess of 15% per annum imposed on interest payments on the New Notes or the New Bonds, then, at the Issuer's option, the New Notes or the New Bonds, as the case may be, may be redeemed at any time in whole, but not in part, at a price equal to 100% of the outstanding principal amount thereof, plus accrued interest and any Additional Amounts due thereon to the date of such redemption. See "Description of New Notes and New Bonds—Tax Redemption".
Status of the New Notes and the New Bonds	The New Notes and the New Bonds will constitute direct, unsecured and unsubordinated Public External Indebtedness (as defined under "Description of New Notes and New Bonds—Negative Pledge") of the Issuer and will rank *pari passu* with each other and with all other present and future unsecured and unsubordinated Public External Indebtedness for money borrowed of the Issuer. See "Description of New Notes and New Bonds—Ranking of New Notes and New Bonds". The Issuer currently has outstanding certain financial leases which will, with respect to the assets securing such financial leases, rank prior to the New Notes and the New Bonds. See Note 9 to the Financial Statements of PEMEX included elsewhere herein.
Status of the Guaranties	The Guaranties will constitute direct, unsecured and unsubordinated Public External Indebtedness of each Guarantor and will rank *pari passu* with each other and with all other present and future unsecured and unsubordinated Public External Indebtedness for money borrowed of each Guarantor. See Note 9 to the Financial Statements of PEMEX included elsewhere herein for a description of the financial leases of the Issuer that will, with respect to the assets securing such financial leases, rank senior to the Guaranties.

Negative Pledge	The Indenture will contain a negative pledge clause restricting the creation of Security Interests (as defined under "Description of New Notes and New Bonds—Negative Pledge") over the crude oil and receivables in respect of crude oil of the Issuer and the Guarantors (in excess of a threshold) to secure Public External Indebtedness of any person. *The negative pledge clause does not restrict the creation of Security Interests over other assets of the Issuer and the Guarantors, the creation of Security Interests to secure obligations payable in pesos or the creation of Security Interests to secure obligations (such as commercial bank borrowings) that are not similar to the New Notes and the New Bonds (i.e., issuances of debt securities).*
Events of Default	For a description of certain events that will permit acceleration of the principal amount of the New Notes and the New Bonds (together with any interest and Additional Amounts accrued and unpaid thereon), see "Description of New Notes and New Bonds—Events of Default; Waiver and Notice".
Indenture	The New Notes and the New Bonds will be issued pursuant to an indenture dated as of August 7, 1998 (the "Indenture"), to be entered into between the Issuer and Bankers Trust Company, as trustee (the "Trustee").
Form and Denomination	The New Notes and the New Bonds will be represented by one or more permanent Global Securities in fully registered form without interest coupons, deposited with the Trustee as custodian for, and registered in the name of, a nominee of DTC in New York, New York for credit to the accounts of DTC's participants, including Euroclear and Cedel Bank. Except in the limited circumstances described under "Description of New Notes and New Bonds—Certificated Notes and Certificated Bonds", owners of beneficial interests in a Global Security will not be entitled to receive physical delivery of New Notes or New Bonds in certificated (*i.e.*, non-global) form. The New Notes and the New Bonds will be issued in minimum denominations of U.S. $1,000 and integral multiples in excess thereof.
Use of Proceeds	The Issuer will not receive any proceeds from the issuance of the New Notes and the New Bonds. See "Use of Proceeds".
Trustee	Bankers Trust Company.

Governing Law	The New Notes, the New Bonds and the Indenture will be governed by, and construed in accordance with, the laws of the State of New York, except that authorization and execution of such documentation by the Issuer will be governed by the laws of Mexico.
Listing	Application has been made to list the New Notes and the New Bonds on the Luxembourg Stock Exchange.
Risk Factors	For a discussion of certain considerations relevant to an investment in the New Notes and the New Bonds, see "Risk Factors".

RISK FACTORS

Prospective investors in the New Notes or New Bonds should consider carefully all the information in this Prospectus and, in particular, the information set forth below.

The Mexican Economy

During the period from 1982 through 1994, Mexico pursued far-reaching and comprehensive adjustment policies designed to reform its economy and achieve a return to sustained economic growth. While successful in reducing inflation from 159.2% in 1987 to 7.1% in 1994 and achieving real Gross Domestic Product ("GDP") growth averaging 3.0% over the 1990-1994 period, the Mexican economy had certain weaknesses by 1994 that made it unable to withstand the severe internal and external political and economic shocks that occurred in 1994, resulting in the destabilization of the Mexican economy at the end of 1994, a sharp and rapid devaluation of the peso, a significant loss of international reserves, a crisis of confidence on the part of foreign portfolio investors and an economic and financial crisis facing the Government. The Government established a broad economic reform program in response to these events. See "Annex A—United Mexican States—The Economy—The Government's Response".

The Government believes that these reforms, together with the changes in the Mexican economy since 1982, have restored order to the foreign exchange markets and enabled the Mexican economy to recover from the economic crisis of 1995. In the short-term, however, inflation and interest rates higher than those experienced in the 1990-1994 period are expected. In addition, in the medium-term, significant new investment in infrastructure, industrial and agricultural modernization, training and environmental protection will be required for continued growth and development. The Mexican economy is likely to continue to be subject to the effects of adverse domestic and external factors such as declines in foreign direct and portfolio investment, high interest rates and low oil prices, which may lead to volatility in the foreign exchange and financial markets and which may affect the ability of the Issuer or the Guarantors to service their foreign debt (including their obligations in respect of the New Notes and the New Bonds).

Relationship with the Government

Regulation and Supervision by the Government. The operations of PEMEX are subject to close regulation and supervision by the Government. See "Regulatory Framework and Relationship with the Government".

Federal Taxes and Duties. In addition to being subject to the payment of all taxes and contributions set forth by federal and local tax laws (except as indicated below), the Issuer and the Guarantors are presently subject to the following special taxes and duties: a hydrocarbon extraction duty, an extraordinary hydrocarbon extraction duty, an additional hydrocarbon extraction duty, a petroleum gains tax and the *Impuesto Especial Sobre Producción y Servicios* (Special Tax on Products and Services, or "IEPS Tax"). In 1998, the sum of these duties and taxes are expected to total approximately 60.8% of the sales revenue of the Issuer and the Guarantors to third parties. (Sales revenues are defined to include the IEPS Tax generated by the sale of gasolines and diesel fuel, but not to include value-added tax ("VAT").) These taxes and duties are to be credited against the *Derecho Sobre Hidrocarburos* (the "Hydrocarbon Duty"), which is calculated by applying a rate of 60.8% to the sales revenue of PEMEX to third parties. In addition to the payment of the Hydrocarbon Duty, PEMEX must pay to the Government an excess revenue gains duty, which, effective January 1, 1998, equals 39.2% of its revenues in respect of crude oil sales at prices in excess of U.S. $15.50 per barrel.

The rate of PEMEX's taxes and duties has varied from year to year (and can be expected to vary in the future) and is arrived at by PEMEX and the Government after taking into consideration PEMEX's projected sales revenues, operating program, capital expenditures program and financing needs. PEMEX is not subject to the *Ley del Impuesto Sobre la Renta* (Income Tax Law) or the *Ley del Impuesto al Activo* (Assets Tax Law). See "Management's Discussion and Analysis of Financial Condition and Results of Operations—General—Income" and "Regulatory Framework and Relationship with the Government—Taxes and Duties". With the objective of maximizing the economic value of PEMEX's production, and therefore increasing the amount of dividends and taxes payable to the Government, PEMEX has proposed and is currently negotiating with the Government to obtain: (a) a new tax regime for PEMEX consistent with that applicable to private companies in Mexico; (b) the removal of PEMEX from the Government's annual budget; and (c) a new "performance agreement" that would be entered into between the Government and PEMEX.

External Debt Restructuring. Since 1982, Mexico and its commercial bank creditors have concluded four debt restructurings and new money exercises, and Mexico has entered into agreements with official bilateral creditors to reschedule public-sector external debt. No restructuring of bonds or debt owed to multilateral agencies was requested. The 1989-92 Financing Package for Mexico reduced the principal amount of, and debt service burden associated with, Mexico's external commercial bank debt. As part of that package, U.S. $7.36 billion of the Issuer's external commercial bank debt was exchanged for "Discount Bonds" and "Par Bonds" issued by the Government. At the same time, the Issuer's indebtedness to the Government was increased by the same amount, and this new indebtedness was subsequently capitalized as equity or *certificados de aportación* (certificates of contribution "A", or "CAPs"). As a condition of this capitalization, the Issuer agreed to pay a minimum guaranteed dividend to the Government equivalent to the debt service on the capitalized debt. The total dividend to the Government in respect of the CAPs is approved annually by the Board of Directors of the Issuer after the close of each fiscal year, although an amount equal to the minimum guaranteed dividends is paid to the Government monthly in advance payments during the year. During 1993, 1994, 1995, 1996 and 1997, the Issuer paid the Government advance payments of Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively, in respect of minimum guaranteed dividends.

The total dividends paid by the Issuer to the Government in respect of the CAPs regarding the 1993, 1994, 1995, 1996 and 1997 fiscal years amounted to Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively.

In December 1997, the Issuer and the Government agreed to a reduction in the equity of the Issuer, and in connection therewith, the Board of Directors of the Issuer authorized a reduction in the CAPs by an amount of Ps. 12,118.05 million, and the Issuer paid the Government U.S. $1,500 million in December 1997 as consideration for such reduction in the CAPs. The Issuer and the Government also agreed to a reduction in the minimum guaranteed dividend payable in 1998, 2001 and certain future years. See Note 13 to the Financial Statements.

Ownership and Revision of Reserves. All oil and other hydrocarbon reserves within Mexico are owned by the Mexican nation and not by PEMEX. Under the Political Constitution of Mexico (the "Constitution"), reserves may be exploited only by Mexico. Under Mexican law, PEMEX and the Subsidiary Entities were established for the purpose of exploiting, and are granted the exclusive right to exploit, Mexico's hydrocarbon reserves.

PEMEX is in the process of reviewing and auditing its estimates of Mexico's proved reserves. With the new information gathered on the behavior of the reservoirs, and the more rigorous criteria and standards of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers, as of December 31, 1996, the proved reserves for the Northeast and

Southwest marine regions are estimated to total 17,110 million boe. Using the criteria and information previously employed, PEMEX had estimated its proved reserves for those two regions at 27,923 million boe as of the same date. Based on the new standards, PEMEX estimates that the proved reserves for the Southern region totaled 7,669 million boe as of December 31, 1997; using the criteria and information previously employed, PEMEX had estimated its proved reserves for this region at 11,374 million boe as of the same date. Pemex-Exploration and Production is preparing a revised estimate of Mexico's proved reserves in the Northern region; this revised reserve estimate is expected to be published in 1999. Based on the information available to date, PEMEX expects that this process will result in a downward revision of PEMEX's total reserve estimates. See "Business—Reserves".

Financial Information. The consolidated financial statements of PEMEX are audited and published annually, and interim financial statements are generally not made available to the public or to security holders of PEMEX. The financial statements of PEMEX are prepared in conformity with Mexican GAAP, and, as to the recognition of inflation, in accordance with the guidelines established in Financial Reporting Standard NIF-06-BIS/A ("NIF-06-BIS/A"). These principles and guidelines differ in certain significant respects from U.S. GAAP. See "Selected Financial Data".

No Guaranty by Government. The Notes are obligations of the Issuer and the Guarantors and are not obligations of, or guaranteed by, Mexico.

Fluctuations in International Oil Prices. International oil prices have fluctuated widely over the last 14 years and are determined by global supply and demand and other factors over which PEMEX has no control. For example, the weighted average price per barrel of crude oil exported by PEMEX reached U.S. $26.82 in 1984 before falling to U.S. $11.86 in 1986. The weighted average price per barrel of crude oil exported by PEMEX was U.S. $13.20 in 1993, U.S. $13.88 in 1994, U.S. $15.70 in 1995, U.S. $18.94 in 1996 and U.S. $16.46 in 1997. The weighted average price per barrel of crude oil exported by PEMEX during first half 1998 was U.S. $10.63, a 61.7% decline from the average price for 1997. The spot price for the weighted price per barrel of crude oil exported by PEMEX at July 31, 1998 was U.S. $10.30.

Higher crude oil prices generally have a positive effect on PEMEX's results, as its upstream crude oil and gas business benefits from the resulting increase in prices realized from production. Lower crude oil prices generally have a corresponding negative effect. Future significant changes in international crude oil prices will directly affect the results of PEMEX. PEMEX does not enter into transactions to hedge against fluctuations in crude oil prices.

Imports. The current demand for unleaded gasoline in Mexico exceeds the domestic production of this product by PEMEX, causing PEMEX to be a net importer of unleaded gasoline. PEMEX purchases its unleaded gasoline imports at international prices and resells such imports at prices fixed by the Government in pesos, which may differ from international prices. PEMEX was a net importer of natural gas in 1994, 1995, 1996 and 1997.

Capital Expenditures. The recent decline in crude oil prices and concurrent Government budget cuts has required PEMEX to reduce its 1998 operating budget by 11.08%, which includes a 20.69% decrease in PEMEX's capital expenditures budget (excluding PIDIREGAS, as defined below) for 1998, from Ps. 38,945 million to Ps. 30,888 million, an amount that constitutes a decrease of 2.07% as compared to PEMEX's 1997 capital expenditures budget. The principal goals of PEMEX's investment program are to increase and improve the quality of reserves, enhance the recovery ratio and improve the reliability of its infrastructure to produce and deliver crude oil and natural gas, including projects initiated under the Government infrastructure financing program entitled *Proyectos de Impacto Diferido en el Registro del Gasto* (Projects with Deferred Impact on the Accounting Registry, or "PIDIREGAS").

The operations of PEMEX are subject to a wide range of general and industry-specific Mexican federal and state laws and regulations relating to the protection of the environment. See "Regulatory Framework and Relationship with the Government—Environmental Regulation". PEMEX expects to be required to make significant additional expenditures over the medium term to reduce the impact of its operations on the environment. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" and "—Capital Expenditures".

Exchange Rates. From late 1982 until November 10, 1991, Mexico maintained a dual foreign exchange rate system, with a Controlled Rate and a Free Market Rate. The Controlled Rate applied to certain imports and exports of goods, advances and payments of registered foreign debt, funds used in connection with the in-bond industry and payments of royalties and technical assistance under registered agreements. The Free Market Rate was applicable to all other transactions. Mexico repealed its exchange control rules effective November 11, 1991, and now exchange rates are determined by market forces. During the four-month period from September 1, 1982 to December 20, 1982, the Government imposed strict exchange control policies which limited the right to exchange pesos for dollars. While the Government does not currently restrict the ability of Mexican or foreign persons or entities to convert pesos into dollars or other currencies, no assurance can be given that the Government will not impose a restrictive exchange control policy in the future. The imposition of such a policy in the future may impair the Issuer's or the Guarantors' ability to meet its or their obligations requiring payments in foreign currency, including the New Notes and the New Bonds.

From October 1992 to December 21, 1994, Banco de México, through intervention in the foreign exchange market, maintained the peso/dollar exchange rate within a band (which widened daily) prescribed by the Government. The ceiling of the band, which was the maximum selling rate, depreciated at a daily rate of 0.0004 pesos (equal to approximately 4.9% per year), while the floor of the band, *i.e.,* the minimum buying rate, remained fixed. On December 20, 1994, the Government increased the ceiling of the trading band by Ps. 0.53, equivalent to an effective devaluation of 15.3%.

On December 21, 1994, the Government announced its decision to suspend intervention by Banco de México and to allow the peso to float freely against the U.S. dollar. Factors contributing to the decision included the growing size of Mexico's current account deficit, the declining level of Banco de México's foreign exchange reserves, rising interest rates for other currencies, especially the U.S. dollar, and reduced confidence in the Mexican economy on the part of international investors due to political uncertainty, especially concerning events in the State of Chiapas. By December 31, 1994, the exchange rate was Ps. 5.00 per U.S. dollar, as compared to Ps. 3.47 per U.S. dollar on December 19, 1994. See "Annex A—United Mexican States—The Economy—Events During 1994 and 1995". Throughout 1997, the peso fluctuated between Ps. 7.7 and Ps. 8.4 per U.S. dollar. During the first six months of 1998, the peso fluctuated between Ps. 8.4643 and Ps. 8.9852 per U.S. dollar. See "Exchange Rates". There can be no assurance that the Government will maintain its current policies with regard to the peso or that the peso will not further depreciate or appreciate significantly in the future.

Sovereign Immunity; Judgment Currency

The Issuer and the Guarantors are each decentralized public entities of the Government, a foreign sovereign. Consequently, it may be difficult for investors to obtain or realize upon judgments of courts in the United States against the Issuer or one or more of the Guarantors. In addition, the Issuer and the Guarantors are entitled to certain immunities under Mexican law which may restrict the ability of investors to realize upon judgments in the courts of Mexico, as explained below. The Issuer and each of the Guarantors will each irrevocably submit to the jurisdiction of the federal courts in the Borough of Manhattan, The City of New York, and, to the extent permitted by law, will irrevocably waive any immunity from the jurisdiction of such courts, in connection with any action based upon the New Notes or the New Bonds brought by any holder of New Notes or New Bonds. The Issuer and the Guarantors reserve the right to plead immunity under the Immunities Act with respect to actions brought against them under the U.S. federal securities laws or any state securities laws. In the absence of a waiver of immunity by the Issuer or any Guarantor with respect to such actions, it would not be possible to obtain a judgment in an action brought in a U.S. court against the Issuer or such Guarantor, as the case may be, unless such court were to determine that the Issuer or such Guarantor, as the case may be, is not entitled under the Immunities Act to sovereign immunity with respect to such action. However, even if a United States judgment could be obtained in any such action under the Immunities Act, it may not be possible to obtain in Mexico a judgment based on such a United States judgment. Moreover, execution upon property of the Issuer or such Guarantor, as the case may be, located in the United States to enforce a judgment obtained under the Immunities Act may not be possible except under the limited circumstances specified in the Immunities Act. Notwithstanding any waiver of immunity by the Issuer and the Guarantors, under Mexico's Federal Code of Civil Procedure, a Mexican court may not enforce a judgment against Petróleos Mexicanos or any Subsidiary Entity by ordering the attachment of its assets. See "Description of New Notes and New Bonds—Governing Law, Jurisdiction and Waiver of Immunity".

Under Article 8 of Mexico's *Ley Monetaria* (the "Monetary Law"), in the event that proceedings were brought in Mexico seeking to enforce in Mexico the obligations of the Issuer under the New Notes or the New Bonds or the Guarantors under the Guaranties, neither the Issuer nor the Guarantors would be required to discharge such obligations in Mexico in a currency other than Mexican currency. According to the Monetary Law, an obligation in a currency other than Mexican currency which is payable in Mexico may be satisfied in Mexican currency at the rate of exchange in effect on the date payment occurs. Such rate is currently published by Banco de México every banking day in the *Diario Oficial de la Federación* (the Official Gazette of the Federation or *"Diario Oficial"*) of Mexico.

Limited Market for the New Notes and the New Bonds

The New Notes and the New Bonds constitute new issues of securities with no established trading market. Although application has been made to list the New Notes and the New Bonds on the Luxembourg Stock Exchange, there can be no assurance that an active public market for the New Notes and the New Bonds develop or, if such market develops, that it will continue. Future trading prices of the New Notes and the New Bonds will depend on many factors, including, among other things, prevailing interest rates and the liquidity of the trading market for the New Notes and the New Bonds. See "Plan of Distribution".

Failure to Tender Old Notes and Old Bonds

Holders of Old Notes or Old Bonds not tendered pursuant to the Exchange Offers will continue to be subject to the existing restrictions on transfer thereof, which will adversely affect their liquidity. The Issuer will have no further obligation (subject to certain limited exceptions) to such holders to provide for the registration under the Securities Act of the Old Notes and the Old Bonds held by them. To the extent that Old Notes or Old Bonds are tendered and accepted in the Exchange Offers, a holder's ability to sell untendered Old Notes or Old Bonds could be adversely affected.

THE EXCHANGE OFFERS

Background and Purpose of the Exchange Offers

The Old Notes and Old Bonds were issued and sold by the Issuer to the Purchasers on April 1, 1998 pursuant to the Terms Agreement. The Purchasers subsequently resold the Old Notes and the Old Bonds to persons in offshore transactions in reliance on Regulation S under the Securities Act and to qualified institutional buyers in reliance on Rule 144A. The Issuer and the Purchasers entered into the Registration Rights Agreement, pursuant to which the Issuer agreed, with respect to the Old Notes and the Old Bonds and unless the Exchange Offers would not be permitted under applicable law, to use its best efforts to (a) file the Exchange Offer Registration Statement on or prior to 150 days after the date of issue of the Old Notes and the Old Bonds, (b) have the Exchange Offer Registration Statement declared effective by the Commission on or before 240 days after the date of issue of the Old Notes and the Old Bonds and (c) commence promptly the Exchange Offers after such declaration of effectiveness and issue, on or prior to 270 days after the date of issue of the Old Notes and the Old Bonds, New Notes and the New Bonds in exchange for all Old Notes and Old Bonds tendered in the Exchange Offers. The Exchange Offers are intended to satisfy the Issuer's exchange offer obligations under the Registration Rights Agreement.

Terms of the Exchange Offers

General. The Issuer hereby offers, upon the terms and subject to the conditions set forth herein and in the accompanying Letters of Transmittal, (i) to exchange U.S. $1,000 in principal amount of New Notes for each U.S. $1,000 in principal amount of Old Notes and (ii) to exchange U.S. $1,000 in principal amount of New Bonds for each U.S. $1,000 in principal amount of Old Bonds. The Issuer will accept for exchange any and all Old Notes and Old Bonds that are validly tendered on or after August 24, 1998 and on or prior to 5:00 p.m., New York City time, on the Expiration Date, which is September 23, 1998, unless extended. See "—Expiration Date; Extensions; Amendments" below. The Exchange Offers are not conditioned upon any minimum principal amount of Old Notes or Old Bonds being tendered for exchange. See "—Conditions of the Exchange Offers".

Prior to the commencement of the Exchange Offers, a notice will be published in Luxembourg announcing the date of the commencement of the Exchange Offers and the initial Expiration Date. Upon completion of the Exchange Offers, the results of the Exchange Offers will be published in Luxembourg, and the Luxembourg Stock Exchange will notified of such results.

Any holder of Old Notes or Old Bonds that is an "affiliate" of the Issuer or any Guarantor within the meaning of Rule 405 under the Securities Act may not participate in the Exchange Offers. The Issuer believes that, as of the date of this Prospectus, no such holder is an "affiliate", as defined in Rule 405.

Old Notes and Old Bonds may be tendered only in multiples of U.S. $1,000. Subject to the foregoing, Holders may tender less than the aggregate principal amount of the Old Notes or the Old Bonds held by them, *provided* that they appropriately indicate this fact on the applicable Letter of Transmittal accompanying the tendered Old Notes or Old Bonds.

Solely for reasons of administration (and for no other purpose), the Issuer has fixed the close of business on August 21, 1998 as the record date (the "Exchange Record Date") for purposes of determining the persons to whom this Prospectus and the Letters of Transmittal will be initially sent or made available. Only a holder of Old Notes or Old Bonds or such holder's legal representative or attorney-in-fact may participate in the Exchange Offers. There will be no fixed record date for determining holders of the Old Notes or the Old Bonds entitled to participate in the Exchange Offers.

The Issuer shall be deemed to have accepted validly tendered Old Notes and Old Bonds when, as and if the Issuer has given written notice of such acceptance to the Exchange Agent. The Exchange Agent will act as agent for the Issuer.

If any tendered Old Notes or Old Bonds are not accepted for exchange because of an invalid tender, the occurrence of certain other events set forth herein or otherwise, any such unaccepted Old Notes or Old Bonds will be returned, without expense, to the tendering holder thereof as promptly as practicable after the Expiration Date.

The New Notes and the New Bonds issued pursuant to the Exchange Offers will be delivered as promptly as practicable following the Expiration Date.

Expiration Date; Extensions; Amendments. The Expiration Date shall be September 23, 1998, at 5:00 p.m., New York City time, unless extended, in which case the Expiration Date shall be the latest date and time to which the Exchange Offers are extended.

In order to extend the Exchange Offers, the Issuer will notify the Exchange Agent of any extension by written notice and will make a public announcement thereof, each prior to 9:00 a.m., New York City time, on the next business day after the previously scheduled Expiration Date.

The Issuer reserves the rights, in its sole discretion, (i) to delay accepting any Old Notes or Old Bonds tendered, (ii) to extend the Exchange Offers and (iii) to amend the terms of the Exchange Offers in any manner. If the Exchange Offers are amended in a manner determined by the Issuer to constitute a material change, the Issuer will promptly disclose such amendments by means of a prospectus supplement that will be distributed to the registered holders of the Old Notes and the Old Bonds. If the Exchange Offers are extended, a notice will be published in Luxembourg, and the Luxembourg Stock Exchange will be notified, of the new Expiration Date.

Additional Interest. If (i) the Exchange Offer Registration Statement (or a Shelf Registration Statement (as defined below) in lieu thereof) is not filed within 150 days after the date of issue of the Old Notes and the Old Bonds, (ii) the Exchange Offer Registration Statement (or a Shelf Registration Statement in lieu thereof) is not declared effective by the Commission within 240 days after the date of issue of the Old Notes and the Old Bonds, (iii) the Exchange Offer is not consummated within 90 days after the date specified for the effectiveness of the Exchange Offer Registration Statement, (iv) a "shelf" registration statement otherwise required to be filed pursuant to the Registration Rights Agreement (a "Shelf Registration Statement") is not filed on or before the date specified for such filing, (v) a Shelf Registration Statement otherwise required to be filed pursuant to the Registration Rights Agreement is not declared effective on or before the date specified for effectiveness thereof or (vi) a Shelf Registration Statement is declared effective but thereafter, subject to certain limited exceptions, ceases to be effective or usable in connection with resales of the Old Notes and the Old Bonds during the periods specified in the Registration Rights Agreement (each such event referred to in clauses (i) through (vi) above, a "Registration Default"), then, with respect to any Old Notes and the Old Bonds, in the case of a Registration Default referred to in clause (i), (ii) or (iii) above, the interest rate on all such Old Notes or Old Bonds or, in the case of a Registration Default referred to in clause (iv), (v) or (vi) above, the interest rate on the Old Notes or the Old Bonds to which such Registration Default relates, will increase by 0.25% per annum with respect to each 90-day period until all such Registration Defaults have been cured, up to a maximum amount of 1.00% per annum. In such event, the holders of the Old Notes or Old Bonds, as the case may be, will be notified thereof as set forth under "Description of New Notes and New Bonds—Notices" and the Luxembourg Stock Exchange will be notified thereof. Following the cure of any Registration Default, the accrual of such additional interest related to such Registration Default will cease, and the interest rate applicable to the affected Old Notes and the Old Bonds will revert to the original rate.

Procedures for Tendering Old Notes and Old Bonds. The tender of a holder's Old Notes and Old Bonds as set forth below and the acceptance thereof by the Issuer will constitute a binding agreement between the tendering holder and the Issuer upon the terms and subject to the conditions set forth in this Prospectus and in the accompanying Letters of Transmittal. Except as set forth below, a holder who wishes to tender Old Notes or Old Bonds for exchange pursuant to the Exchange Offers must transmit such Old Notes or Old Bonds, as the case may be, by book-entry transfer to the account maintained by the Exchange Agent for purposes of the Exchange Offers at the Book-Entry Transfer Facility (the "Book-Entry Transfer Facility") system maintained by DTC prior to 5:00 p.m., New York City time, on the Expiration Date, together with a computer generated message (an "Agent's Message"), transmitted by means of DTC's ATOP system and received by the Exchange Agent, in which such holder acknowledges and agrees to be bound by the terms of the applicable Letter of Transmittal. Accordingly, Old Notes and Old Bonds may only be tendered by a financial institution that is a participant in the Book-Entry Transfer Facility system.

A holder of Old Notes or Old Bonds that is not a direct participant in DTC must tender its Old Notes or Old Bonds, as the case may be, by submitting, in accordance with the procedures of the participant (including Euroclear or Cedel Bank) through which it holds its Old Notes or Old Bonds, as the case may be, a duly completed and executed Letter of Transmittal with respect to the Old Notes or Old Bonds being tendered, and must deliver computerized instructions to such participant (including Euroclear or Cedel Bank) for the transfer of such Old Notes or Old Bonds to the Exchange Agent's account at DTC's Book-Entry Transfer Facility, in each case sufficiently in advance of the Expiration Date to allow sufficient time for such participant to arrange for the electronic submission of the applicable Letter of Transmittal and tender of the related Old Notes or Old Bonds through DTC's ATOP system on or prior to the Expiration Date. Copies of the Letters of Transmittal are available at the offices of the Exchange Agent and the Luxembourg Listing Agent specified below. **Delivery of documents to Euroclear or Cedel Bank does not constitute delivery to the Exchange Agent through DTC's ATOP system.**

IN NO EVENT SHOULD OLD NOTES OR OLD BONDS OR LETTERS OF TRANSMITTAL BE DELIVERED DIRECTLY TO THE ISSUER OR IN ANY MANNER OTHER THAN THE ELECTRONIC SUBMISSION PROVIDED FOR HEREIN.

Notwithstanding the foregoing, in the unlikely event that any Old Notes or Old Bonds are represented by securities in definitive, certificated form ("Certificated Securities"), such Certificated Securities can be tendered delivering, by hand or overnight courier to the Exchange Agent at its address specified in the Letters of Transmittal or to the Paying Agent and Transfer Agent in Luxembourg at its address specified below, such Certificated Securities, duly endorsed in form satisfactory to the Issuer by the holder thereof or his attorney duly authorized in writing, and a duly executed Letter of Transmittal relating thereto. Copies of the Letters of Transmittal are available at the specified offices of the Exchange Agent and the Luxembourg Listing Agent. No such tender will be effective unless received by the Exchange Agent (or by the Paying Agent and Transfer Agent in Luxembourg) on or before 5:00 p.m., New York City time, on the Expiration Date.

Whenever any Old Notes or Old Bonds are validly tendered for exchange and accepted by the Issuer, the Issuer shall execute, and the Trustee shall authenticate and deliver to the surrendering holder thereof, New Notes or New Bonds, as the case may be, in the same aggregate principal amount as the Old Notes or Old Bonds so surrendered as promptly as practicable following the Expiration Date.

All questions as to the validity, form, eligibility (including time of receipt), acceptance and withdrawal of the Old Notes and the Old Bonds tendered for exchange will be determined by the Issuer in its sole discretion, which determination shall be final and binding. The Issuer reserves the absolute right to reject any and all Old Notes or Old Bonds not properly tendered and to reject any Old Notes or Old Bonds the Issuer's acceptance of which might, in the judgment of the Issuer or its counsel, be unlawful. The Issuer also reserves the absolute right to waive any defects or irregularities or conditions of the Exchange Offers as to particular Old Notes or Old Bonds either before or after the Expiration Date (including the right to waive the ineligibility of any holder who seeks to tender Old Notes or Old Bonds in the Exchange Offers). The interpretation of the terms and conditions of the Exchange Offers (including the Letters of Transmittal and the instructions thereto) by the Issuer shall be final and binding on all parties. Unless waived, any defects or irregularities in connection with tenders of Old Notes or Old Bonds for exchange must be cured within such period of time as the Issuer shall determine. The Issuer will use reasonable efforts to give notification of defects or irregularities with respect to tenders of Old Notes or Old Bonds for exchange but shall not incur any liability for failure to give such notification. Tenders of the Old Notes or the Old Bonds will not be deemed to have been made until such irregularities have been cured or waived.

If any Letter of Transmittal or any other documents required by the Letters of Transmittal is signed by a trustee, executor, administrator, guardian, attorney-in-fact, officer of a corporation or other person acting in a fiduciary or representative capacity, such person should so indicate when signing, and, unless waived by the Issuer, proper evidence satisfactory to the Issuer, in its sole discretion, of such person's authority to so act must be submitted.

Any beneficial owner of Old Notes or Old Bonds (a "Beneficial Owner") whose Old Notes or Old Bonds are registered in the name of a broker, dealer, commercial bank, trust company or other nominee and who wishes to tender Old Notes or Old Bonds in the Exchange Offers should contact such registered holder promptly and instruct such registered holder to tender on such Beneficial Owner's behalf.

By tendering Old Notes or Old Bonds through transmission of an Agent's Message, each holder will represent to the Issuer that, among other things, (i) the New Notes or the New Bonds to be acquired in connection with the Exchange Offers by the holder and each Beneficial Owner of the Old Notes or the Old Bonds are being acquired by the holder and each such Beneficial Owner in the ordinary course of business of such holder and each such Beneficial Owner, (ii) neither such holder nor any such Beneficial Owner is engaged in, intends to engage in or has any arrangement or understanding with any person to participate in, a distribution of the New Notes or the New Bonds to be issued in the Exchange Offers; (iii) neither such holder nor any such Beneficial Owner is an affiliate of the Issuer or any Guarantor (within the meaning of the Securities Act); and (iv) if the holder is a broker-dealer holding Old Notes or Old Bonds acquired for its own account as result of market-making activities or other trading activities, it acknowledges that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any resale of New Notes or New Bonds received in respect of such tendered Old Notes or Old Bonds pursuant to the Exchange Offers. In connection with each book-entry transfer, each participant will confirm that it makes the representations and warranties contained in the Letters of Transmittal.

Acceptance of Old Notes and Old Bonds for Exchange; Delivery of New Notes and New Bonds. Upon satisfaction or waiver of all the conditions to the Exchange Offers, the Issuer will accept any and all Old Notes and Old Bonds that are properly tendered in the Exchange Offers prior to 5:00 p.m., New York City time, on the Expiration Date. The New Notes and the New Bonds issued pursuant to the Exchange Offers will be delivered as promptly as practicable following the Expiration Date. For purposes of the Exchange Offers, the Issuer shall be deemed to have accepted validly tendered Old Notes and Old Bonds, when, as and if the Issuer has given written notice thereof to the Exchange Agent.

In all cases, issuances of New Notes for Old Notes and issuance of New Bonds for Old Bonds that are accepted for exchange pursuant to the Exchange Offers will be made only after confirmation of a timely book-entry transfer of such Old Notes or Old Bonds into the Exchange Agent's account at DTC and timely receipt of an Agent's Message transmitted by means of DTC's ATOP system and received by the Exchange Agent, in which the tendering holder acknowledges and agrees to be bound by the applicable Letter of Transmittal; *provided* that the Issuer reserves the absolute right to waive any defects or irregularities in the tender or conditions of the Exchange Offers. If any tendered Old Notes or Old Bonds are not accepted for any reason, such unaccepted Old Notes or Old Bonds will be credited without expense to the account of the tendering holder thereof at DTC as promptly as practicable after the expiration or termination of the Exchange Offers.

Withdrawal of Tenders of Old Notes or Old Bonds. Tenders of Old Notes or Old Bonds may be withdrawn by delivery of a written notice to the Exchange Agent through the electronic submission of an Agent's Message through, and in accordance with the withdrawal procedures applicable to, DTC's ATOP system, at any time prior to 5:00 p.m., New York City time, on the Expiration Date, unless previously accepted by the Issuer. Any such notice of withdrawal must (i) specify the name of the person that deposited the Old Notes or Old Bonds to be withdrawn (the "Depositor"), (ii) identify the Old Notes or Old Bonds to be withdrawn (including the principal amount of such Old Notes or Old Bonds, as applicable), and (iii) be signed electronically by the holder in the same manner as the original signatures on the Letter of Transmittal by which such Old Notes or Old Bonds were tendered. All questions as to the validity, form and eligibility (including time of receipt) of such notices will be determined by the Issuer, in its sole discretion. The Old Notes or the Old Bonds so withdrawn will be deemed not to have been validly tendered for exchange for purposes of the Exchange Offers. Any Old Notes or Old Bonds that have been tendered for exchange but that are withdrawn will be credited without expense to the account of the holder thereof at DTC as soon as practicable after withdrawal. Properly withdrawn Old Notes or Old Bonds may be retendered by following the procedures described under "—Procedures for Tendering Old Notes and Old Bonds" at any time on or prior to the Expiration Date.

Conditions of the Exchange Offers. Notwithstanding any other terms of the Exchange Offers, or any extension of the Exchange Offers, the Issuer shall not be required to accept for exchange, or exchange New Notes for any Old Notes or exchange New Bonds for any Old Bonds, and may terminate the Exchange Offers as provided herein before the acceptance of such Old Notes or Old Bonds, if:

(a) any statute, rule or regulation shall have been enacted, or any action shall have been taken by any court or governmental authority, which, in the reasonable judgment of the Issuer, would prohibit, restrict or otherwise render illegal the consummation of the Exchange Offers; or

(b) any stop order shall be threatened or in effect with respect to the Exchange Offer Registration Statement of which this Prospectus constitutes a part or the qualification of the Indenture under the Trust Indenture Act of 1939, as amended; *provided* that the Issuer will use its best efforts to prevent the issuance of any such order and, if any such order is issued, to obtain the withdrawal of such order as promptly as practicable; or

(c) there shall occur a change in the current interpretations by the staff of the Commission which, in the Issuer's reasonable judgment, might materially impair the Issuer's ability to proceed with the Exchange Offers.

If the Issuer makes a good faith determination that any of the above conditions are not satisfied, the Issuer may (i) refuse to accept any Old Notes or Old Bonds and return all tendered Old Notes or Old Bonds to the tendering holders, (ii) extend the Exchange Offers and retain all Old Notes or Old Bonds tendered prior to the Expiration Date, subject, however to the right of holders to withdraw such Old Notes or Old Bonds (see "—Withdrawal of Tenders of Old Notes or Old Bonds") or (iii) waive such unsatisfied conditions with respect to the Exchange Offers and accept all validly tendered Old Notes and Old Bonds that have not been withdrawn. If such waiver constitutes a material change to the Exchange Offers, the Issuer will promptly disclose such waiver by means of a supplement to this Prospectus that will be distributed to the registered holders, and the Issuer will extend the Exchange Offers for a period of time, depending upon the significance of the waiver and the manner of disclosure to the registered holders, if the Exchange Offers would otherwise expire during such period.

Consequences of Failure to Exchange. Holders who do not tender their Old Notes or Old Bonds by the Expiration Date will be unable to exchange Old Notes or Old Bonds for New Notes or New Bonds pursuant to the Exchange Offers. Old Notes or Old Bonds held by holders who do not tender their Old Notes or Old Bonds pursuant to the Exchange Offers may not be offered or sold in the United States except in accordance with an applicable exemption from the registration requirements of the Securities Act.

The Exchange Agent. Bankers Trust Company is the Exchange Agent. All tendered Old Notes and Old Bonds, executed Letters of Transmittal and other related documents should be directed to the Exchange Agent, by book-entry transfer as set forth under "—Procedures for Tendering Old Notes and Old Bonds". Questions and requests for assistance and requests for additional copies of this Prospectus, the Letters of Transmittal and other related documents should be addressed to the Exchange Agent as follows:

Bankers Trust Company
Corporate Trust and Agency Group
4 Albany Street, 7th Floor
New York, New York 10006
Phone: (212) 250-7012
Fax: (212) 250-0933

Fees and Expenses. All expenses incident to the Issuer's performance of the Exchange Offers will be borne by the Issuer, including without limitation: (i) all registration and filing fees and expenses; (ii) all fees and expenses associated with compliance with federal securities and state Blue Sky or securities laws; (iii) all expenses of printing (including printing of any certificates evidencing the New Notes and the New Bonds and printing of this Prospectus); (iv) all fees and disbursements of counsel for the Issuer; and (v) all fees and disbursements of independent certified public accountants of the Issuer.

The Issuer has not retained any dealer-manager in connection with the Exchange Offers and will not make any payments to brokers, dealers or others soliciting acceptance of the Exchange Offers. The Issuer, however, will pay the Exchange Agent reasonable and customary fees for its services and will reimburse it for its reasonable out-of-pocket expenses in connection therewith.

Transfer Taxes. Holders who tender their Old Notes and Old Bonds for exchange will not be obligated to pay any transfer taxes in connection therewith, except that Holders who instruct the Issuer to register the New Notes and the New Bonds in the name of, or request that the Old Notes and the Old Bonds not tendered or not accepted in the Exchange Offers be returned to, a person other than the tendering Holder will be responsible for the payment of any applicable transfer tax thereon.

Resales of the New Notes and the New Bonds. Based on an interpretation by the staff of the Commission set forth in no-action letters issued to third parties, the Issuer believes that the New Notes or the New Bonds issued pursuant to the Exchange Offers to a holder in exchange for Old Notes or Old Bonds may be offered for resale, resold and otherwise transferred by such holder (other than (i) a broker-dealer who purchased Old Notes or Old Bonds directly from the Issuer for resale pursuant to Rule 144A under the Securities Act or any other available exemption under the Securities Act, or (ii) a person that is an "affiliate," within the meaning of Rule 405 under the Securities Act, of the Issuer or a Guarantor) without compliance with the registration and prospectus delivery provisions of the Securities Act; *provided* that the holder is acquiring the New Notes or the New Bonds in the ordinary course of business and is not participating, and has no arrangement or understanding with any person to participate, in a distribution of the New Notes or the New Bonds. However, if any holder acquires New Notes or New Bonds in the Exchange Offers for the purpose of distributing or participating in a distribution of the New Notes or the New Bonds, such holder cannot rely on the position of the staff of the Commission enunciated in the no-action letters regarding *Morgan Stanley & Co., Incorporated* (available June 5, 1991) and *Exxon Capital Holdings Corporation* (available May 13, 1988), or interpreted in the Commission interpretive letter to *Shearman & Sterling* (available July 2, 1993), or similar no-action or interpretive letters, and must comply with the registration and prospectus delivery requirements of the Securities Act, including an effective registration statement containing the selling security holder information required by Item 507 of Regulation S-K, in connection with any secondary resale transaction, unless an exemption from registration is otherwise available. Each broker-dealer that receives New Notes or New Bonds for its own account in exchange for Old Notes or Old Bonds, where such Old Notes or Old Bonds were acquired by such broker-dealer as a result of market-making or other trading activities, acknowledges thereby that it will deliver a copy of this Prospectus in connection with any resale of such New Notes or New Bonds. See "Plan of Distribution". In addition, to comply with the securities or Blue Sky laws of certain jurisdictions, if applicable, the New Notes and the New Bonds may not be offered or sold unless they have been registered or qualified for sale in such jurisdictions or an exemption from registration or qualification is available and complied with.

PEMEX

Petróleos Mexicanos was established by a decree of the Mexican Congress passed on June 7, 1938 as a result of the nationalization of the foreign-owned oil companies then operating in Mexico. Petróleos Mexicanos and the Subsidiary Entities together comprise Mexico's state oil and gas company. Each is a decentralized public entity of the Government and is a legal entity empowered to own property and carry on business in its own name. PEMEX's executive offices are located at Avenida Marina Nacional No. 329, Colonia Anáhuac, México, D.F. 11311. PEMEX's telephone number is (52-5) 722-2500.

PEMEX is the largest company in Mexico and one of the largest in the world in terms of both total assets and total revenues. According to data published in *Petroleum Intelligence Weekly* on December 22, 1997, PEMEX was the ninth largest oil company in the world in terms of total assets (Ps. 312.1 billion) as of December 31, 1996, topped by, for example, Royal Dutch-Shell Group, Exxon and Petróleos de Venezuela, S.A. ("PDVSA"). In terms of its total revenues (Ps. 235.8 billion) and total income (Ps. 16.5 billion), PEMEX ranked as the twelfth and eleventh largest company, respectively, in the oil industry. As measured by the *Petroleum Intelligence Weekly Composite Index* (which comprises reserves, output, refining capacity, and product sales by volume), PEMEX ranked as the fifth most important oil company in the world after Saudi Aramco, PDVSA, the Royal Dutch-Shell Group and the National Iranian Oil Company as of December 31, 1996.[1]

Mexico is the fifth largest producer of crude oil and condensates in the world and one of the largest in the Americas, accounting for approximately 5% of the world's crude oil and condensates production in 1996. It is one of the major suppliers of crude oil to the United States accounting for 13% of that country's imports of crude oil in 1996. Mexico is not a member of the Organization of Petroleum Exporting Countries ("OPEC"), but entered into an agreement with the governments of Saudi Arabia and Venezuela in 1998 to reduce its exports of crude oil.

In 1997, PEMEX earned income (before duties and the IEPS Tax, as defined below) of Ps. 167.4 billion on total revenues (net of the IEPS Tax) of Ps. 231.8 billion, as compared with income (before duties and the IEPS Tax) during 1996 of Ps. 161.5 billion on total revenues (net of the IEPS Tax) of Ps. 216.1 billion, an increase of 3.7% in such income. Income after duties and the IEPS Tax declined from Ps. 16.5 billion in 1996 to Ps. 7.9 billion in 1997. Total sales revenues for 1997 (net of the IEPS Tax) reached Ps. 226.3 billion. Of this amount, Ps. 127.6 billion resulted from sales in the domestic market and Ps. 98.7 billion resulted from exports to 52 clients in 20 countries. Excluding the operations of PMI Comercio Internacional, S.A. de C.V. ("PMI Comercio"), in 1997 crude oil exports accounted for 92.2% of export sales, petroleum products (including natural gas) for 6.2% and petrochemical products for 1.6%. The weighted average price of crude oil exported by PEMEX was U.S. $16.46 per barrel in 1997, 13.1% less than the price per barrel in 1996 of U.S. $18.94. Total equity of PEMEX as of December 31, 1997 was Ps. 158.2 billion and total capitalization (long-term debt plus equity) amounted to Ps. 214.5 billion.

In 1997, production averaged 3.02 million bpd of crude oil, 4.47 billion cfpd of natural gas, and 387,760 bpd of condensates. The production level of crude oil in 1996 was 5.7% higher than in 1996. Natural gas production in 1997 increased by 6.4% with respect to 1996 production, while condensates production decreased by 7.4% with respect to 1996. PEMEX produces three types of crude oil: Isthmus, a light crude oil; Maya, a heavy crude oil; and Olmeca, a very light crude oil. PEMEX produces a wide range of different oil and natural gas products, including LPG, gasolines, jet fuel, diesel, fuel oil, asphalts, lubricants, and other refined products. Production of refined products (excluding NGL and dry gas) totaled 1.226 million bpd in 1997, as compared to

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1 *Petroleum Intelligence Weekly*, December 22, 1997.

1.278 million bpd in 1996. PEMEX is one of the major producers of crude oil worldwide that experiences a significant domestic demand for their refined products.

PEMEX also manufactures a variety of petrochemicals, including methane derivatives, ethane derivatives, aromatics and derivatives thereof, and propylene and derivatives thereof. Annual petrochemical production totaled 18.4 million tons in 1996 and 16.1 million tons in 1997.

USE OF PROCEEDS

The Issuer will not receive any proceeds from the issuance of the New Notes and the New Bonds offered hereby. In consideration for issuing the New Notes and the New Bonds as contemplated in this Prospectus, the Issuer will receive in exchange a like principal amount of Old Notes and Old Bonds, respectively, which will be canceled. Accordingly, the Exchange Offers will not result in any increase in the indebtedness of the Issuer or the Guarantors.

The estimated net proceeds from the issuance of the Old Notes and Old Bonds (approximately U.S. $347,400,000 for the Old Notes and U.S. $346,500,000 for the Old Bonds) will be used to refinance PEMEX's debt and to finance its investment program.

EXCHANGE RATES

From late 1982 until November 10, 1991, Mexico maintained a dual foreign exchange rate system, with a Controlled Rate and a Free Market Rate. The Controlled Rate applied to certain imports and exports of goods, advances and payments of registered foreign debt, funds used in connection with the in-bond industry and payments of royalties and technical assistance under registered agreements. The Free Market Rate was applicable to all other transactions. Mexico repealed its exchange control rules effective November 11, 1991, and now exchange rates are determined by market forces. During the four-month period from September 1, 1982 to December 20, 1982, the Government imposed strict exchange control policies which limited the right to exchange pesos for dollars. While the Government does not currently restrict the ability of Mexican or foreign persons or entities to convert pesos into dollars or other currencies, no assurance can be given that the Government will not impose a restrictive exchange control policy in the future. The imposition of such a policy in the future may impair the Issuer's or the Guarantors' ability to meet its or their obligations requiring payments in foreign currency, including the New Notes and the New Bonds.

From October 1992 to December 21, 1994, Banco de México, through intervention in the foreign exchange market, maintained the peso/dollar exchange rate within a band (which widened daily) prescribed by the Government. The ceiling of the band, which was the maximum selling rate, depreciated at a daily rate of 0.0004 pesos (equal to approximately 4.9% per year), while the floor of the band, *i.e.,* the minimum buying rate, remained fixed. On December 20, 1994, the Government increased the ceiling of the trading band by Ps. 0.53, equivalent to an effective devaluation of 15.3%.

On December 21, 1994, the Government announced its decision to suspend intervention by Banco de México and to allow the peso to float freely against the U.S. dollar. Factors contributing to the decision included the growing size of Mexico's current account deficit, the declining level of Banco de México's foreign exchange reserves, rising interest rates for other currencies, especially the U.S. dollar, and reduced confidence in the Mexican economy on the part of international investors due to political uncertainty, especially concerning events in the State of Chiapas. By December 31, 1994, the exchange rate was Ps. 5.00 per U.S. dollar, as compared to Ps. 3.47 per U.S. dollar on December 19, 1994. See "Annex A—United Mexican States—The Economy—Events During 1994 and 1995". Throughout 1997, the peso fluctuated between Ps. 7.7 and Ps. 8.4 per U.S. dollar. There can be no assurance that the Government will maintain its current policies with regard to the peso or that the peso will not further depreciate or appreciate significantly in the future.

The following table sets forth, for the periods indicated, the period-end, average, high and low free market rate, or as the case may be, Noon Buying Rate, for the purchase of U.S. dollars, expressed in nominal pesos per U.S. dollar.

	Free Market Rate[1]			
Year ended December 31	Period End	Average[2]	High	Low
1993	3.108	3.110	3.240	3.102
1994	5.000	3.479	5.750	3.105
1995	7.740	6.442	8.050	5.270
1996	7.851	7.600	8.048	7.312
1997	8.070	7.918	8.410	7.717

(1) Source: Banco de México until November 5, 1993, with the free-market rate representing the average of the buy and sell rates on the relevant date(s). Commencing November 5, 1993, the Free Market Rate is the Noon Buying Rate for Cable Transfers in New York reported by the Federal Reserve Bank of New York.

(2) Average of month-end rates.

The Noon Buying Rate for cable transfers in New York reported by the Federal Reserve Bank of New York on August 18, 1998 was Ps. 9.2400 = U.S.$1.00.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth PEMEX's consolidated ratio of earnings to fixed charges for each year in the five-year period ended December 31, 1997 in accordance with Mexican GAAP and U.S. GAAP.

Earnings for this purpose consist of income after hydrocarbon duties and the IEPS tax, plus fixed charges, minus (i) interest capitalized during the period and (ii) minority interests in losses of majority-owned subsidiaries.

Fixed charges for this purpose consist of the sum of interest expense plus interest capitalized during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to PEMEX's indebtedness. Mexican GAAP differs in certain significant respects from U.S. GAAP. The material differences as they relate to PEMEX's Financial Statements are described in Note 16 to the Financial Statements included elsewhere herein.

	Year Ended December 31,			
	1994	1995	1996	1997
Ratio of Earnings to Fixed Charges, according to:				
Mexican GAAP	1.37	1.95	2.97	1.65
U.S. GAAP	—[1]	—[1]	2.20	2.13

[1] Under U.S. GAAP earnings for the years ended December 31, 1994 and 1995 were insufficient to cover fixed charges. The amount by which fixed charges exceeded earnings was Ps. 17,826,441,000 and Ps. 3,155,688,000 for the years ended December 31, 1994 and 1995, respectively.

CAPITALIZATION

The following table sets forth the capitalization of PEMEX, in accordance with Mexican GAAP, at December 31, 1997 and June 30, 1998.

	At December 31, 1997[1]	At June 30, 1998[2][3]	
	(in millions of nominal pesos or U.S. dollars)		
Long-Term External Debt	Ps. 48,075	Ps. 56,533	$ 6,292
Long-Term Domestic Debt	8,264	9,344	1,040
Total Long-Term Debt	56,339	65,877	7,332
Certificates of Contribution	10,222	10,222	1,138
Specific Oil-Field Exploration and Depletion Reserve	8,227	8,423	937
Revaluation Surplus	112,960	113,613	12,644
Retained Earnings (Prior Years)	18,795	20,924	2,329
Income	7,946	(2,082)	(232)
Total Equity	158,150	151,100	16,816
Total Capitalization[3]	Ps.214,489	Ps.216,977	$ 24,148

Note: Totals may differ due to rounding.

(1) Audited. Includes Petróleos Mexicanos, the Subsidiary Entities and the Subsidiary Companies.

(2) Unaudited. Includes Petróleos Mexicanos and the Subsidiary Entities, but not the Subsidiary Companies. Conversions into U.S. dollars of amounts in pesos have been made at the established exchange rate for accounting purposes of Ps. 8.9852 = $1.00 as at June 30, 1998.

(3) Except for the issuance of the Issuer's U.S. $1,000,000,000 Daily Adjusted Yield Securities ("DAYS[SM]") due 2005 issued in July 1998, there have been no material changes in the capitalization of PEMEX since June 30, 1998.

SELECTED FINANCIAL DATA

The selected financial data set forth below as at and for the five years ended December 31, 1997, have been derived from the consolidated Financial Statements of PEMEX and Subsidiary Companies as at and for the five years ended December 31, 1997, which have been audited by Coopers & Lybrand, Despacho Roberto Casas Alatriste, independent accountants. The selected financial data set forth below should be read in conjunction with, and are qualified in their entirety by reference to, the audited consolidated balance sheets of PEMEX and the Subsidiary Companies as at December 31, 1997 and 1996, and the related consolidated statements of income, changes in equity and changes in financial position for the years ended December 31, 1997, 1996 and 1995 (the "Financial Statements"). The Financial Statements are set forth elsewhere in this Prospectus.

The Financial Statements are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with the guidelines established in Financial Reporting Standard NIF—06 BIS/A. See Notes 2(b) and 14 to the Financial Statements for a discussion of the inflation accounting rules applicable to PEMEX.

Mexican GAAP differs in certain significant respects from United States generally accepted accounting principles ("U.S. GAAP"). The most important of the material items generating a difference between operating results under U.S. and Mexican GAAP are the accounting methodologies for the treatment of impairment of fixed assets, petroleum exploration and drilling costs, measurement of pension obligations, accounting for capitalized interest and accounting for foreign exchange losses. Under SFAS No. 121, PEMEX is required to evaluate its long-lived assets for impairment for U.S. GAAP purposes whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Such impaired assets must be permanently written down to fair value or the present value of expected future cash flows of related assets. There is no such requirement under Mexican GAAP. Under Mexican GAAP, oil exploration and development costs are charged to a capital reserve rather than expensed or directly capitalized as required by U.S. GAAP. Such capital reserve is funded by charging a certain percentage to cost of sales for each barrel of crude extracted. PEMEX sets this percentage on an annual basis. Seniority premiums and retirement plans generate a difference between U.S. and Mexican GAAP due to the different actuarial cost assumptions applied under Bulletin D-3 and SFAS No. 87. In addition, PEMEX's adoption dates for Bulletin D-3 and SFAS No. 87 were different, resulting in differences in period expenses due to the differing amortization of transition amounts. The treatment of capitalized interest between PEMEX's Mexican GAAP Financial Statements and U.S. GAAP differs in that for Mexican GAAP purposes, PEMEX treats all interest expense as being associated with construction or well development and accordingly capitalizes all interest. For purposes of the U.S. GAAP reconciliation, PEMEX capitalizes interest by applying its average borrowing rate to its average amount of construction in progress. PEMEX applies NIF-06 BIS/A to its Financial Statements to reflect the effects of inflation. NIF-06 BIS/A provides for the restatement of fixed assets, inventories and costs of sales by indexing and/or appraisals. Since NIF-06 BIS/A does not represent a comprehensive basis of inflation accounting, beginning with its 1992 fiscal year, PEMEX has reversed the effects of NIF-06 BIS/A on its Financial Statements from the U.S. GAAP reconciliation of equity. Under NIF-06 BIS/A, a devaluation of the peso does not have a negative impact on the income of PEMEX because exchange losses are capitalized into fixed assets. Furthermore, a devaluation of the peso relative to the dollar results in an increase in income to the extent that expenses remain relatively stable because they are incurred in pesos, while revenues, which are mostly denominated in dollars or linked to international, dollar-denominated prices, increase in peso terms. In contrast, under U.S. GAAP, a devaluation of the peso has a negative impact on the income of PEMEX because the exchange losses are not capitalized but are charged immediately to income. This one-time charge to income will be gradually offset by dollar-linked revenues. In any particular accounting period, the negative impact of a devaluation is, therefore, greater when the devaluation occurs at or near the end of the period, as occurred with the peso at the end of 1994. For a further discussion of these and other adjustments, see Note 16 to the Financial Statements.

	Year ended December 31,					
	1993(1)(2)	1994(1)(2)	1995(1)(2)	1996(1)	1997(1)(2)	1997(1)
	(in thousands of pesos and thousands of U.S. dollars)					
	Ps. 84,201,636	Ps. 100,299,725	Ps. 161,547,025	Ps. 235,819,924	Ps. 269,507,287	$33,341,245
	66,752,136	78,502,779	143,843,855	216,053,033	231,778,958	28,673,804
	82,790,455	95,159,781	157,309,598	231,992,934	264,030,357	32,663,684
	3,024,670	3,326,259	9,808,638	16,494,601	7,946,187	983,037
;AAP(1)						
	1,916,237	(21,084,652)	(8,275,621)	10,231,096	10,000,747	1,237,211
	1,910,949	5,781,485	11,787,227	17,999,663	17,428,855	2,156,156
	153,102,379	201,518,067	244,438,124	312,049,087	344,479,650	42,616,215
	18,030,113	35,141,909	47,538,903	42,534,637	56,338,936	6,969,794
	27,143,313	58,579,375	78,470,363	91,595,615	125,085,325	15,474,537
	107,808,558	118,231,566	126,601,993	155,779,537	158,150,506	19,565,092
;AAP(1)						
	98,231,995	74,856,730	64,680,247 (5)	69,256,789	62,003,329	7,670,547
	6,765,214	6,618,095	9,385,382	10,398,324	10,668,623	1,319,835
	9,110,730	8,027,485	14,366,084	18,094,915	28,108,525	3,477,358
ed by						
	$ 13.20	$ 13.88	$ 15.70	$18.94	$ 16.46	$ 16.46

prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with the guidelines
d (NIF-06 BIS/A). For information concerning (i) material differences between Mexican GAAP and U.S. GAAP, as applied to
f certain material differences in income and equity and a reconciliation of such differences and (iii) the manner in which
rporations, accounts for the effect of inflation, see Notes 2(b), 14 and 16 to the Financial Statements.
31,1994, the financial condition and results of KOT Insurance Co. Ltd. are included, beginning with the year ended December
ults of Integrated Trade Systems, Inc. are included and beginning with the year ended December 31, 1997, the financial
ine Ltd. are included. See "Management's Discussion and Analysis of Financial Condition and Results of

de the IEPS Tax as part of the sales price of the products sold.
capitalized interest, and excludes certain expenditures charged to the oil field exploration and depletion reserve. See
f Financial Condition and Results of Operations—Liquidity and Capital Resources".
gains from investment securities due to the cumulative effect of a change in accounting principles for the adoption of SFAS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Financial Statements. The Financial Statements have been prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with the guidelines established in Financial Reporting Standard NIF-06 BIS/A. See Notes 2(b) and 14 to the Financial Statements for a discussion of the inflation accounting rules applicable to PEMEX. Mexican GAAP differs in certain respects from U.S. GAAP. Note 16 to the Financial Statements provides a description of the material differences between Mexican GAAP and U.S. GAAP, as they relate to PEMEX, and a reconciliation to U.S. GAAP of income and total equity.

General

PEMEX's operating results are affected by a variety of factors, including general economic conditions, particularly in Mexico, and movements in international oil prices, which are denominated in U.S. dollars. The discussion below is based on the amounts contained under "Selected Financial Data" and should be read in conjunction with the introductory paragraphs set forth therein.

Prices. Higher crude oil prices generally have a positive effect on PEMEX's results, as its upstream crude oil and gas business benefits from the resulting increase in prices realized from production. Lower crude oil prices generally have a corresponding negative effect. The impact of changes in crude oil prices on PEMEX's downstream refining and marketing activities and in its petrochemicals business depends in part on the speed with which petroleum and petrochemical product prices in the international markets adjust to reflect changes in crude oil prices and, in part, on the extent to which prices in the Mexican markets, where most of PEMEX's production of natural gas, refined products and petrochemicals is sold, reflect international prices.

The following table sets forth international prices for the weighted average price per barrel of crude oil exported by PEMEX and, for comparative purposes, the average price of West Texas Intermediate ("WTI") crude oil for the years indicated.

Year Ended December 31	WTI Average Price	PEMEX Weighted Average Export Price
	(in U.S. dollars per barrel)	
1993	$18.45	$13.20
1994	17.20	13.88
1995	18.43	15.70
1996	22.14	18.94
1997	20.61	16.46
First Half 1998	15.95	10.63

Source: Platt's and PEMEX's March 1998 Indicadores Petroleros.

Future significant changes in international crude oil prices will directly affect the results of PEMEX. PEMEX does not enter into transactions to hedge against fluctuations in crude oil prices. See "Business—Exports and Imports". The price formulas used by PEMEX to determine the domestic prices of its products are set by committees composed of representatives of PEMEX and the Government. Generally, the wholesale prices received by PEMEX, net of the IEPS Tax for sales of gasoline, automotive diesel and natural gas for automotive use, are linked to their international reference prices. The IEPS Tax is an indirect tax on these product sales that is collected by PEMEX on behalf of the Government. See "Regulatory Framework and Relationship with the Government".

The IEPS Tax on gasoline and automotive diesel is the difference between the producer price – linked to international markets – and the retail price less VAT and distribution costs, the retail price being a price managed by the Government. As a consequence, a fall in the international price of such products will result in a fall in the producer price and, therefore, in an increase in the IEPS Tax collected from consumers and paid to the Government. Alternatively, an increase in international prices will have the opposite effect to the extent that domestic prices do not adjust to reflect the changes in international prices. In effect, through the IEPS Tax, the Government ensures that PEMEX retains only a portion of its sales revenues equal to adjusted international reference prices of its products, while the Government collects the difference between the international reference prices and the prices at which such products are sold in Mexico. As discussed under "Regulatory Framework and Relationship with the Government—Taxes and Duties", an increase in the IEPS Tax may result in a decline in hydrocarbon extraction duties payable by PEMEX, while a decline in the IEPS Tax may cause an increase in hydrocarbon extraction duties.

The IEPS Tax on natural gas sales is determined as a function of the retail price of unleaded regular gasoline and the reference price of natural gas. Both prices are quoted in heating equivalent and the price of gasoline is discounted to reflect transport costs, service costs and commercial margins.

PEMEX's revenues and expenses from domestic sales reflect the collection and payment of the IEPS Tax, thereby offsetting revenue and cost of sales, respectively.

Inflation. Mexico experienced high inflation during most of the 1980s. The rate of inflation (as measured by the change in the National Consumer Price Index) was reduced from a high of 159.2% in 1987 to 11.9% in 1992, 8.0% in 1993 and 7.1% in 1994. However, in light of the economic events that followed the devaluation of the peso against the U.S. dollar in late 1994 and 1995, Mexico registered an inflation rate of 52% in 1995, which then declined to 27.7% in 1996 and 15.72% in 1997. See "Annex A—United Mexican States—The Economy—Prices and Wages". For 1998, the Government expects the annual rate of inflation to be approximately 12%. In accordance with NIF-06 BIS/A, which differs from Mexican GAAP, PEMEX restates certain items in its Financial Statements to reflect the effects of inflation. Such restatement is not the comprehensive restatement of Financial Statements required by Bulletin B-10. Due to the economic stability and low rates of inflation during 1993, PEMEX did not restate its fixed assets during that year. For a description of the differences in accounting for inflation under the accounting principles applicable to PEMEX and under Mexican GAAP, see Notes 2(b) and 14 to the Financial Statements.

Mexican inflation has affected PEMEX's consolidated financial statements results as follows: (i) since the prices of certain products and services purchased and sold by PEMEX tend to increase in line with general inflation, sales and expense items in PEMEX's income statement contain substantial effects from nominal price increases, and as a result inter-period comparisons may not reflect the real trends; (ii) the value of fixed assets, materials and spare parts on PEMEX's balance sheet are generally revalued annually to reflect the effect of inflation; and (iii) PEMEX's income each year is affected negatively by an increase in depreciation of fixed assets and inventories that are revalued to reflect the effects of inflation on those assets.

In 1994, PEMEX restated the value of its fixed assets in the amount of Ps. 16,507 million to reflect the effect of inflation. In 1995, PEMEX determined that it was not necessary to revalue its assets to reflect the effects of inflation. In 1996, PEMEX revalued its assets based on an appraisal conducted by the *Instituto Mexicano del Petróleo* (Mexican Petroleum Institute or "IMP") which was based on the specific index method and adjusted by obsolescence and utilization factors. The pipelines and assets related to distribution, transportation and storage of natural gas were revalued by an independent appraiser through the specific cost method and useful lives were reviewed. In 1997, PEMEX revalued its assets based on an appraisal conducted by the IMP and an independent appraiser. The appraisals were performed utilizing the specific index method, considering the assets usage, a factor for obsolescence, specific costs, remaining useful lives of the assets and the relative classification of the fixed assets.

Income. PEMEX's income declined as a percentage of its total revenues (net of the IEPS Tax), from 4.5% in 1993 to 4.2% in 1994, which was due in part to the impact of inflation on PEMEX's cost of sales (including wages, cost of materials and supplies, depreciation of fixed assets, and reserves for retirement payments and pensions), higher distribution and administrative expenses, and also to higher depreciation expenses resulting from increases in PEMEX's fixed assets caused by increased capital expenditures. See "—Inflation" above. Over the same period, however, the international prices of crude oil and petroleum products remained relatively stable and, until mid-December 1994, the peso/dollar exchange rate also remained fairly stable. As a result of these factors, expenses during the period from 1992 through 1994 increased faster than revenues. However, in 1995, there was a significant change from the prior trend, when PEMEX's income as a percentage of total revenues (net of the IEPS Tax) increased to 6.8%, mainly because the devaluation of the peso caused the peso value of PEMEX's exports to increase, while PEMEX's costs of sales did not increase proportionately. See "Annex A—United Mexican States—The Economy—Events During 1994 and 1995". Income as a percentage of total revenues (net of the IEPS Tax) increased again in 1996 to 7.6% due to an increase in net sales and a reduction of costs and operating expenses as a percentage of net sales, but then declined to 3.4% in 1997. The 1997 result was attributable primarily to an increase in costs and operating expenses.

PEMEX's income is also affected by the level of the direct tax and duty payments to the Government, which, together with indirect taxes collected by PEMEX for the Government, represent a substantial portion—27.1% in 1993, 27.5% in 1994, 35.3% in 1995, 37.6% in 1996 and 36.1% in 1997—of the Government's total tax receipts. The taxes and duties that PEMEX pays to the Government or collects on behalf of the Government consist of direct taxes (*i.e.*, the hydrocarbon extraction duties and a hydrocarbon tax on income) and indirect taxes (*i.e.*, the IEPS Tax and the VAT). Direct taxes affect PEMEX's income because they are recorded as expenses; however, indirect taxes have no impact on PEMEX's income because they represent a pass-through tax which PEMEX collects from its sales to customers and pays to the Government. From 1992 to 1997, the composition of PEMEX's payments changed, with indirect taxes (which did not have any impact on PEMEX's income) representing a greater percentage of PEMEX's total taxes and duties and direct taxes (which had an impact on PEMEX's income) representing a smaller portion of such taxes and duties.

Because PEMEX had no taxable income in 1993, 1994, 1995, 1996 and 1997 to which the Hydrocarbon Income Tax was applicable and expects to have no such taxable income in 1998, the difference between PEMEX's revenues and its costs and expenses is called "income". See "Regulatory Framework and Relationship with the Government—Taxes and Duties".

Consolidation. PEMEX's Financial Statements include, on a consolidated basis, the accounts of Petróleos Mexicanos, the Subsidiary Entities and the Subsidiary Companies (as defined below). The PEMEX subsidiaries that were consolidated with PEMEX's 1993, 1994, 1995, 1996 and 1997 results were PMI Comercio, P.M.I. Trading Ltd., P.M.I. Holdings, N.V., P.M.I. Holdings, B.V. and P.M.I. Norteamérica, S.A. de C.V. (together, the "PMI Group"); since 1994, KOT Insurance Co. Ltd.; since 1995, Integrated Trade Systems, Inc.; and, since 1997, P.M.I. Marine Ltd. (together with the PMI Group, KOT Insurance Co. Ltd. and Integrated Trade Systems, Inc. the "Subsidiary Companies"). Each of these companies (other than KOT Insurance Co. Ltd., which did not commence operations until February 1993) was previously accounted for under the cost method. The consolidation of the Subsidiary Companies, after intercompany eliminations, increased total assets of PEMEX by Ps. 1,865 million in 1996 and Ps. 1,108 million in 1997, decreased equity by Ps. 1,061 million in 1996 and Ps. 601 million in 1997, and decreased income by Ps. 22 million in 1996 and increased income by Ps. 136 million in 1997.

PEMEX Restructuring. From 1992 to 1995, PEMEX undertook the most comprehensive restructuring process since its creation in 1938, with a view towards increasing productivity and competitiveness. As part of the restructuring program, the Organic Law separated the operating functions of PEMEX into the four Subsidiary Entities. The new legal and administrative structure grants more control and responsibility to the management of each operating area through integrated lines of business. As of December 31, 1997, PEMEX had 121,220 employees (excluding PMI Group employees), down from 210,157 in 1987. See "Business—Employee Matters". This reduction in PEMEX's labor force reflects the various measures undertaken by PEMEX in recent years to reduce its costs and improve its efficiency.

Results of Operations - 1997 compared to 1996

In 1997, PEMEX earned income of Ps. 7.9 billion on total revenues (net of the IEPS Tax) of Ps. 231.8 billion, as compared with 1996 income of Ps. 16.5 billion on total revenues (net of the IEPS Tax) of Ps. 216.1 billion. The decrease in income from 1996 to 1997 was attributable primarily to an increase in costs and operating expenses as a percentage of net sales. Total revenues (net of the IEPS Tax) increased by 7.3%, due primarily to an increase in net sales. PEMEX's total sales revenues (net of the IEPS Tax) reached Ps. 226.3 billion in 1997, an increase of 6.6% over 1996 total sales revenues (net of the IEPS Tax) of Ps. 212.2 billion, due to an increase in sales prices in the domestic market and higher volume of the export sales. Of the total sales revenues (net of the IEPS Tax) in 1997, Ps. 98.7 billion (or 43.6%) resulted from exports and Ps. 127.6 billion (or 56.4%) resulted from domestic sales.

Export sales decreased by 2.4% in peso terms (with dollar-denominated export revenues converted to pesos at the exchange rate for the date on which the export sale was made), from Ps. 101.1 billion in 1996 to Ps. 98.7 billion in 1997, and decreased as a percentage of total sales revenues (net of the IEPS Tax) from 47.7% in 1996 to 43.6% in 1997. Excluding the activities of the PMI Group, export sales increased by 0.4% from Ps. 88.2 billion in 1996 to Ps. 88.6 billion in 1997. In dollar terms, export sales (excluding the activities of the PMI Group) decreased by 4.2% from U.S. $11.7 billion in 1996 to U.S. $11.2 billion in 1997. Crude oil exports accounted for 92.2% of export sales in 1996 and 92.2% in 1997, petroleum products (including natural gas) accounted for 5.3% of export sales in 1996 and 6.2% in 1997, and petrochemical products accounted for the remainder of export sales in those years. Crude oil export sales increased by 0.4% from Ps. 81.3 billion in 1996 to Ps. 81.7 billion in 1997, and decreased in dollar terms by 3.7% from U.S. $10.7 billion in 1996 to U.S. $10.3 billion in 1997, as a result of a decrease in international crude oil prices.

The weighted average price per barrel of crude oil exported by PEMEX was U.S. $16.46 in 1997, a 13.1% decrease from the average of U.S. $18.94 observed in 1996. Export sales of petroleum products (including NGL) increased by 16.5% from Ps. 4.7 billion in 1996 to Ps. 5.5 billion in 1997, and increased in dollar terms by 10.9% from U.S. $622 million in 1996 to U.S. $690 million in 1997, due to higher prices in international markets. Export sales of petrochemical products (including certain by-products of the petrochemical process) decreased by 33.3% from Ps. 2.1 billion in 1996 to Ps. 1.4 billion in 1997, and decreased in dollar terms by 35.0% from U.S. $282.8 million in 1996 to U.S. $183.8 million in 1997, due to the lower demand and the decline in the prices of several products.

Net of collection of the IEPS Tax, domestic sales increased by 14.9% from Ps. 111.1 billion in 1996 to Ps. 127.6 billion in 1997. Domestic sales of petroleum products (other than natural gas) increased by 16.1% from Ps. 88.0 billion in 1996 to Ps. 102.2 billion in 1997, led by an increase in the prices of domestic sales of unleaded gasoline and fuel oil. Domestic petrochemical sales (including sales of certain by-products of the petrochemical production process) decreased from Ps. 13.1 billion in 1996 to Ps. 12.9 billion in 1997, due to a decrease in international prices for petrochemicals and a decrease in domestic demand. Sales of natural gas increased from Ps. 9.9

billion in 1996 to Ps. 12.6 billion in 1997 due to higher domestic demand and higher prices in 1997 as compared to 1996. Other income increased from Ps. 3.3 billion in 1996 to Ps. 5.1 billion in 1997, primarily because PEMEX obtained gains from the sales of its participation in an associated company and the increase in premiums earned through its affiliate company, KOT Insurance Co.

In addition, in 1997 PEMEX recorded an exchange gain of Ps. 365 million, primarily due to the depreciation of the peso between the date on which PEMEX recorded export sales on its books in pesos (*i.e.,* the date of shipment) and the date on which PEMEX collected the proceeds from such sales.

Excluding the IEPS Tax, total costs and operating expenses increased by 12.2% from Ps. 199.6 billion in 1996 to Ps. 223.8 billion in 1997. The costs of sales increased by Ps. 22.1 billion, primarily due to an increase in the reserve for retirement payments, pensions and indemnities, the reserve for oil field exploration and depletion, wages and salaries, repairs and maintenance. Hydrocarbon extraction duties decreased from Ps. 125.2 billion to Ps. 121.8 billion, largely because of the decrease in the international price of crude oil. In addition, transportation and distribution expenses increased by Ps. 2,536.2 million over their 1996 level, primarily due to an increase in wages and salaries and repairs and maintenance expenses. Net interest income (expenses) represented an expense of Ps. 878 million in 1997 as compared to income of Ps. 773 million in 1996; this reversal (from interest income to interest expense) was due to higher debt interest expense, despite significant growth in financial revenues.

Results of Operations – 1996 compared to 1995

In 1996, PEMEX earned income of Ps. 16.5 billion on total revenues (net of the IEPS Tax) of Ps. 216.1 billion, as compared with 1995 income of Ps. 9.8 billion on total revenues (net of the IEPS Tax) of Ps. 143.8 billion. The increase in income from 1995 to 1996 was attributable primarily to an increase in net sales and a reduction of costs and operating expenses as a percentage of net sales. Total revenues (net of the IEPS Tax) increased by 50.2%, due primarily to an increase in net sales. PEMEX's total sales revenues (net of the IEPS Tax) reached Ps. 212.2 billion in 1996, an increase of 52% over 1995 total sales revenues (net of the IEPS Tax) of Ps. 139.6 billion, due to increases in prices, sales in the domestic market and the international price of crude oil. Of the total sales revenues (net of the IEPS Tax) in 1996, Ps. 101.1 billion (or 47.7%) resulted from exports and Ps. 111.1 billion (or 52.3%) resulted from domestic sales.

Export sales increased by 55.2% in peso terms (with dollar-denominated export revenues converted to pesos at the exchange rate for the date on which the export sale was made), from Ps. 65.2 billion in 1995 to Ps. 101.1 billion in 1996, and increased as a percentage of total sales revenues (net of the IEPS Tax) from 46.7% in 1995 to 47.7% in 1996. Excluding the activities of the PMI Group, export sales increased by 64.4% from Ps. 53.7 billion in 1995 to Ps. 88.2 billion in 1996. In dollar terms, export sales (excluding the activities of the PMI Group) increased by 39.3% from U.S. $8.4 billion in 1995 to U.S. $11.7 billion in 1996. Crude oil exports accounted for 89.3% of export sales in 1995 and 92.2% in 1996, petroleum products (including natural gas) accounted for 6.2% of export sales in 1995 and 5.3% in 1996, and petrochemical products accounted for the remainder of export sales in those years. Crude oil export sales increased by 69.7% from Ps. 47.9 billion in 1995 to Ps. 81.3 billion in 1996, and increased in dollar terms by 43.1%, from U.S. $7.5 billion in 1995 to U.S. $10.7 billion in 1996, as a result of an increase in international crude oil prices.

The weighted average price per barrel of crude oil exported by PEMEX was U.S. $18.94 in 1996, a 20.6% increase from the average of U.S. $15.70 observed in 1995. Export sales of petroleum derivatives (including NGL) increased by 42.1% from Ps. 3.3 billion in 1995 to Ps. 4.7 billion in 1996, and increased in dollar terms by 18.3% from U.S. $526 million in 1995 to U.S. $622 million in 1996, due to increased prices in international markets. Export sales of petrochemical products (including certain by-products of the petrochemical process) decreased by 11.4% from Ps. 2.4 billion in 1995 to Ps. 2.1 billion in 1996, and decreased in dollar terms by 24.9% from U.S. $376.8 million in 1995 to U.S. $282.8 million in 1996 due to the decrease in production volume caused by the explosions at the Cactus Natural Gas Processing Complex and in the decline in the sales prices of several products.

Net of collection of the IEPS Tax, domestic sales increased by 49.3% from Ps. 74.4 billion in 1995 to Ps. 111.1 billion in 1996. Domestic sales of petroleum derivatives (other than natural gas) increased by 49.6% from Ps. 58.9 billion in 1995 to Ps. 88 billion in 1996, led by an increase in the prices of domestic sales of unleaded gasoline and fuel oil. Domestic petrochemical sales (including sales of certain by-products of the petrochemical production process) increased from Ps. 10.5 billion in 1995 to Ps. 13.1 billion in 1996, due to an increase in international prices for petrochemicals and an increase in domestic demand. Sales of natural gas increased from Ps. 5.1 billion in 1995 to Ps. 9.9 billion in 1996. Other income increased from Ps. 2.6 billion in 1995 to Ps. 3.3 billion in 1996.

In addition, in 1996 PEMEX recorded an exchange gain of Ps. 475 million, primarily due to the depreciation of the peso between the date on which PEMEX recorded export sales on its books in pesos (*i.e.,* the date of shipment) and the date on which PEMEX collected the proceeds from such sales.

Excluding the IEPS Tax, total costs and operating expenses increased by 48.9% from Ps. 134 billion in 1995 to Ps. 199.6 billion in 1996, primarily due to a Ps. 11.0 billion increase in cost of sales and a Ps. 50.3 billion increase in hydrocarbon extraction duties. The increase in cost of sales resulted primarily from the increase in the volume of domestic sales. Cost of sales as a percentage of total net sales (net of the IEPS Tax) decreased from 32.8% in 1995 to 26.7% in 1996. Hydrocarbon extraction duties increased from Ps. 74.9 billion to Ps. 125.2 billion, largely because of the increase in the international price of crude oil. In addition, transportation and distribution expenses increased by Ps. 383 million over their 1995 level, interest (net) decreased from Ps. 1,052 million in 1995 to Ps. 773 million in 1996, and other expenses (including write-offs of accounts receivable and rental expense) increased by Ps. 372 million from the level of Ps. 1,472 million in 1995. The change in interest was due to higher interest expenses from debt servicing, despite significant growth in financial revenues.

Risk Management and Financial Instruments

PEMEX operates internationally, which significantly exposes it to market risks brought on by interest rates, commodity prices and foreign exchange rates. Managing these exposures is a priority of PEMEX's senior management and PEMEX's Risk Management Committee, composed of representatives of PEMEX, Banco de México, the Ministry of Finance and PMI Comercio.

Since August 1997, PEMEX's Risk Management Committee, along with a group of external consultants, has been working to determine a conceptual framework for risk management. This will include: (i) the definition and classification of market risks reflected in the balance sheet and the income statement; (ii) a quantitative analysis of exposure against a determined "overall benchmark"; and (iii) risk management policies for decision making and for implementing dynamic hedging activities.

Foreign Currency Exchange Rate Risk. A significant portion of PEMEX's revenues is derived from exports of crude oil and petroleum products, which are denominated and payable in U.S. dollars. Domestic revenues of PEMEX (net of IEPS Taxes) from its sales of petroleum products and petrochemicals are related to the international prices of these products, which are denominated in U.S. dollars. With the exception of hydrocarbon duties, which are linked to sales, most of PEMEX's costs of sales and other expenses are payable in pesos and are not linked to the U.S. dollar. As a result, any depreciation of the peso relative to the U.S. dollar will increase PEMEX's revenues in peso terms and will also increase PEMEX's net income, while an appreciation of the peso relative to the U.S. dollar will have the opposite effect. Because a significant portion of PEMEX's revenues is denominated in U.S. dollars, PEMEX's borrowings are generally denominated in dollars. To the extent that, since 1991, PEMEX has borrowed in currencies other than U.S. dollars, PEMEX generally enters into currency swaps to hedge against movements in exchange rates. In 1995, PEMEX's hedging activities were concentrated mainly in interest rate and currency swaps. In 1996 and 1997, PEMEX did not enter into any new contracts for interest rate or peso/dollar forwards, but entered into currency forwards to fix the Japanese yen exchange rate for all 1997 Japanese yen debt service including principal and interest payments as well as currency swaps to swap the new debt obligations denominated in foreign currency other than U.S. dollars for U.S. dollars. There were no open positions on these forwards at December 31, 1997.

Foreign exchange losses derived from debt are capitalized on PEMEX's balance sheet, provided that they do not exceed the increase in the value of PEMEX's fixed assets resulting from their restatement. PEMEX capitalized Ps. 20,952 million, Ps. 1,043 million and Ps. 1,360 million of foreign exchange losses in respect of its debt due to the devaluation of the peso during 1995, 1996 and 1997, respectively. Any foreign exchange gains and losses derived from PEMEX's operations, which relate mainly to receivables in respect of export sales and payables to foreign suppliers, are recorded in results of operations rather than being capitalized. PEMEX recorded Ps. 1,601 million of foreign exchange gains related to its operations in 1995, Ps. 475 million of foreign exchange gains in 1996 and Ps. 365 million of foreign exchange gains in 1997.

Interest Rate Risk. In addition to entering into currency swaps with respect to its bond issues denominated in currencies other than U.S. dollars, PEMEX has sought to reduce its exposure to increases in interest rates, since the interest rate on most of its debt and the minimum guaranteed dividend rate on its CAPs (see "—Liquidity and Capital Resources" below) fluctuate in parallel with changes in international interest rates. PEMEX uses interest rate swaps and option contracts to manage its debt portfolio toward a fix-floating mix approved by PEMEX's Risk Management Committee. In 1997, PEMEX's hedging activities consisted principally of interest rate swaps (where PEMEX in effect converted floating-rate exposure into fixed-rate payments) and, to a lesser extent, interest rate caps (which set a fixed ceiling on floating-rate payments).

During 1994, PEMEX's hedging committee determined that it would remove some of the protection provided by its interest rate swaps by selling interest rate caps. In exchange for receiving a premium, PEMEX is obligated to pay to the holder the amount, if any, calculated with reference to a notional principal amount, by which the floating interest rate exceeds the rate specified in the cap agreement on the exercise date of the cap. In addition, PEMEX has sold interest rate floors under which, in exchange for a premium, PEMEX is obligated to pay the holder the amount, if any, calculated with reference to a notional principal amount, by which the rate specified in the cap exceeds the floating interest rate on the exercise date of the floor.

Under its interest rate swap agreements, PEMEX is obligated to make payments based on fixed interest rate and is entitled to receive payments based on the floating three-month LIBOR interest rate. As of December 31, 1997, PEMEX was a party to interest rate swap agreements in an aggregate notional amount of U.S. $6.45 billion with a weighted average of approximately 1 year and 7 months and with an average fixed interest rate of approximately 6.9%. As of December 31, 1997, the aggregate notional amount of written caps totaled U.S. $900 million, with fixed rate caps that ranged from 7.5% to 10%, and with expiration dates from 1998 to 2001. As of December 31, 1997, the aggregate notional amount of caps purchased totaled U.S. $400 million. As of December 31, 1997, the aggregate notional amount of written floors totaled U.S. $550 million with fixed rate floors that ranged from 5.7% to 6.0%, and with expiration dates in 1998. As of December 31, 1997, the aggregate notional amount of floors purchased totaled U.S. $700 million, with fixed rate floors that ranged from 5.3% to 6.0% and with expiration dates in 1998.

The market value as of December 31, 1997 and May 31, 1998 of PEMEX's aggregate interest rate derivatives position was negative U.S. $110.5 million and negative U.S. $109.8 million, respectively.

For accounting purposes, the results from the financial hedges of interest rate swap contracts are recorded on an accrual basis and when the definitive amounts receivable or payable are known. The results from other financial derivative instruments, as well as the premiums that are received or paid, are recognized in accordance with their collection or payment date. For presentation purposes, these results are registered as interest expense. From time to time PEMEX reviews its contingencies.

The following table provides information about PEMEX's debt portfolio and financial derivative instruments that ar obligations, the table presents principal cash flows and related weighted average interest rates for fixed and variable rate debt. table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Weighted average the yield curve at the reporting date. Fair values are obtained from market quotes received from market sources, such as Reuter available, fair value is calculated internally discounting from the corresponding zero coupon yield curve in the original curren PEMEX's experience. For all instruments the table shows the contract terms in order to determine future cash flows categorized U.S. dollar debt that has been swapped is considered as U.S. dollar debt, so cross-currency swaps are included for informati Mexican peso equivalents, which is PEMEX's reporting currency. However, the instrument's actual cash flows are denomina indicated in parentheses.

QUANTITATIVE DISCLOSURE OF MARKET RISK (Interest Rate Sensitivity) as at Decemb

	Expected Maturity Date					
	1998	1999	2000	2001	2002	Thereafter
Liabilities			(in thousands of pesos)			
Outstanding Debt						
Fixed Rate (U.S. dollars)	10,129,051	4,533,755	2,022,964	1,195,408	2,676,418	19,742,30
Average Interest Rate	7.86	7.68	8.00	7.40	8.14	8.6
Fixed Rate (Japanese Yens)	797,819	797,819	797,815	797,619	365,000	3,938,90
Average Interest Rate	3.55	3.93	3.79	3.61	3.42	3.2
Fixed Rate (British Pounds)	4,611	-	-	-	-	668,41
Average Interest Rate	14.23	14.50	14.50	14.50	14.50	14.5
Fixed Rate (French Francs)	651	651	651	651	651	7,90
Average Interest Rate	2.00	2.00	2.00	2.00	2.00	2.0
Fixed Rate (Deutschemarks)	22,594	5,964	5,964	5,964	5,964	
Average Interest Rate	6.35	5.38	5.38	5.38	5.38	
Fixed Rate (Swiss Francs)	799	-	-	-	-	
Average Interest Rate	4.625	-	-	-	-	
Fixed Rate (Austrian Schillings)	-	-	-	320,000	-	
Average Interest Rate	10.75	10.75	10.75	10.75	10.75	10.7
Total Fixed Debt[1]						
Variable Rate (U.S. dollars)[2]	21,356,399	3,089,105	6,214,299	1,234,558	4,304,669	5,660,20
Variable Rate (Swiss Francs)	660	701	918	1,042	1,091	3,71
Variable Rate (Deutschemarks)	3,850	4,085	5,353	6,076	5,360	21,64
Variable Rate (Belgian Francs)	251	352	341	505	709	2,17
Total Variable Debt[1]						
Total Debt						

(footnotes appear on following page)

QUANTITATIVE DISCLOSURE OF MARKET RISK (Interest Rate Risk) as at December 31, 1997

Derivative financial instruments held or issued for purposes other than trading:

	Expected Maturity Date						
	1998	**1999**	**2000**	**2001**	**2002**	**Thereafter**	**Total Notio Amount**
Interest Rate Derivatives			(in thousands of pesos)				
Hedging Instruments(2)							
Interest Rate Swaps (U.S. dollars)							
Variable to Fixed	20,612,415	9,699,960	18,995,755	2,020,825	-	808,330	52,137,2
Average pay rate	6.74	7.06	6.88	7.31	7.33	7.33	6.89
Average receive rate	5.97	6.07	6.14	6.22	6.30	6.32	6.06
Variable to variable	-	-	5,052,063	-	-	-	5,052,0
Average pay rate	6.00	6.43	7.08	-	-	-	6.
Average receive rate	5.97	6.07	6.14	-	-	-	6.
Interest Rate Options (U.S. dollars)(2)							
Caps Purchased	2,424,990	808,330	-	-	-	-	3,233,3
Average receive rate	5.91	6.08	-	-	-	-	5.
Average pay rate (strike price)	7.63	8.00	-	-	-	-	7.
Cross-Currency Swaps	5,845,285	622,271	-	-	-	6,035,200	12,502,7
French Francs to U.S. dollars	1,078,253	-	-	-	-	-	1,078,2
Swiss Francs to U.S. dollars	787,079	-	-	-	-	-	787,0
Canadian Dollars to U.S. dollars	-	622,271	-	-	-	-	622,2
Austrian Shillings to U.S. dollars	769,327	-	-	-	-	-	769,3
Italian Lire to U.S. dollars	1,556,976	-	-	-	-	5,118,978	6,675,9
Japanese Yens to U.S. dollars	1,653,650	-	-	-	-	-	1,653,6
British Pounds to U.S. dollars	-	-	-	-	-	916,222	916,2
Non-Hedging Instruments							
Interest Rate Options (U.S. dollars)							
Floors Written	4,445,815	-	-	-	-	-	4,445,8
Average receive rate	5.97	-	-	-	-	-	5.
Average pay rate (strike price)	5.49	-	-	-	-	-	5.
Floors Purchased	5,658,310	-	-	-	-	-	5,658,3
Average receive rate (strike price)	5.97	-	-	-	-	-	5.
Average pay rate	5.60	-	-	-	-	-	5.
Caps Written	4,041,650	808,330	1,616,660	808,330	-	-	7,274,9
Average receive rate (strike price)	5.97	6.07	6.14	6.22	-	-	6.
Average pay rate	8.76	8.83	8.83	9.84	-	-	8.

(1) See Note 3 to the Financial Statements for foreign exchange rates except for Ps. 1.3489 per French franc and Ps. 5.5414 per Swiss franc.

(2) The outstanding amount in hedging interest rate derivatives is U.S. $7,475 million (Ps. 60,423 million), from which U.S. $625 million (Ps. 50,052 million) is usec U.S. dollar LIBOR debt to Australian dollar, Canadian dollar, and Deutschmark LIBOR debt denominated in U.S. dollars and U.S. $4,869 million (Ps. 39,360 n related to the minimum guaranteed dividends in connection with the CAPs denominated in U.S. dollars. The rest of the hedging interest rate derivatives, U.S. used to hedge the U.S. dollar variable debt rate.

(3) See Note 10 to the Financial Statements for additional financial instruments information.

Credit Risk. As a creditor, PEMEX faces the risk that counterparties might fail to meet payment obligations to PEMEX. To minimize this risk, PEMEX monitors the creditworthiness and exposure to derivative instruments of counterparties, while dealing exclusively with major financial institutions and maintaining a diversified portfolio.

Liquidity and Capital Resources

General. In March 1990, as a result of the implementation of the 1989-92 Financing Package for Mexico, U.S. $7.58 billion worth of Petróleos Mexicanos' external debt with international commercial banks was exchanged for Brady Bonds issued by the Government. At the same time, Petróleos Mexicanos' indebtedness to the Government was increased by the same amount, which new indebtedness was denominated in currencies other than pesos. In December 1990, the Government and Petróleos Mexicanos agreed to capitalize such amount into Petróleos Mexicanos' equity as CAPs. As a condition of this capitalization, Petróleos Mexicanos agreed to pay a minimum guaranteed dividend to the Government equal to the debt service on the capitalized debt. The total dividend on the CAPs is approved annually by the Board of Directors of Petróleos Mexicanos after the close of each fiscal year, although an amount equal to the minimum guaranteed dividend is paid to the Government monthly in advance payments during the year. During 1993, 1994, 1995, 1996 and 1997, Petróleos Mexicanos made advance payments to the Government of Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively, of minimum guaranteed dividends. The total dividends paid by Petróleos Mexicanos to the Government in respect of the CAPs for the 1993, 1994, 1995, 1996 and 1997 fiscal years amounted to Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively.

In December 1997, the Board of Directors of Petróleos Mexicanos and the Government agreed to an equity reduction of the CAPs in exchange for a cash payment to the Government of Ps. 12.118 billion (U.S. $1.5 billion). The Ministry of Finance, acting on behalf of the Government, has agreed to a reduction in the minimum guaranteed dividend payable in 1998, 2001 and certain future years. See Note 13 to the Financial Statements.

From 1990 through 1997, PEMEX's total indebtedness increased from U.S. $8.1 billion to U.S. $11.3 billion, while PEMEX financed a capital expenditure program that averaged U.S. $2.6 billion per year during the same period.

During 1997, net funds provided by operations were Ps. 25.2 billion, down Ps. 4.5 billion from 1996. Funds provided by income plus items not requiring cash outlays totaled Ps. 38.9 billion in 1997. An additional Ps. 11.1 billion of net funds was provided by new financing (excluding Ps. 1.6 billion of foreign exchange losses). During 1997, PEMEX applied net funds of Ps. 27.7 billion for net investments at cost in fixed assets consisting of Ps. 28.1 billion of new investments and capitalized interest, less Ps. 1.3 billion in dispositions of fixed assets and Ps. 1.4 billion of capitalized foreign exchange losses.

During 1996 net funds provided by operations were Ps. 29.7 billion, up Ps. 12.5 billion from

At December 31, 1997, PEMEX had cash and marketable securities totaling Ps. 17.4 billion, as compared with Ps. 18.0 billion at December 31, 1996. PEMEX's cash requirements for working capital, capital expenditures and investments over the past three years have been funded by a combination of funds provided by operations and financing.

During 1997, several short-term lines of credit were contracted to finance trade operations for imports and exports of crude oil and petroleum products for a total amount of U.S. $2,505 million, granted by, among other banks, Swiss Bank Corporation, Banco Español de Crédito, Banco Santander, Credit Agricole, Chase Manhattan Bank, BANCOMEXT, Bladex, Swiss Bank and Banesto. Four bond issues were placed in the euromarkets, one for ItL. 350 billion (equivalent to U.S. $209.7 million) with a seven-year maturity at a rate of three-month ItL. LIBOR plus 165 basis points, one for U.S. $300 million with a five-year maturity at a rate of 8.5% per annum, one for U.S. $250 million with a ten-year maturity at a rate of 9% per annum and one for ItL. 750 billion (equivalent to U.S. $423.6 million) with a ten-year maturity and a step-down coupon structure. In addition, PEMEX issued U.S. $600 million of 8.85% ten-year notes and U.S. $400 million of 9.50% 30-year bonds. Also, PEMEX's commercial paper program with Bank of America was increased to U.S. $620 million.

During 1996, several short-term lines of credit were contracted to finance trade operations of imports and exports of crude oil and petroleum and petrochemical products, for a total amount of U.S. $1.1 billion, granted among other banks by Société Générale, the Chase Manhattan Bank, Credit Suisse First Boston, Standard Chartered Bank and Banco Bilbao Vizcaya. Also, U.S. $308.7 million was obtained from lines of credit with different maturities, the longest being for five years, with Deutsche Bank, Banque Européenne pour L'Amérique Latine, Société Générale, Kreditanstalt Für Wiederaufbau, the Export Development Corporation and Westdeutsche Landesbank Girozentrale. Three bond issues were placed, one for ItL. 300 billion (equivalent to U.S. $192.6 million) with a two-year maturity at a rate of 12.25%, one for U.S. $300 million with a two-year maturity at a rate of 8% and one for U.S. $300 million with a three-year maturity at a rate of 7.75%. Also, PEMEX's commercial paper program with Bank of America was increased to U.S. $500 million from U.S. $365 million. In addition, PEMEX's bankers' acceptances facilities arranged in 1994 by J.P. Morgan and The Industrial Bank of Japan were renewed and increased to U.S. $800 million and U.S. $460 million, from U.S. $700 million and U.S. $427 million, respectively.

In 1997, net payments on external borrowings amounted to U.S. $5.1 billion, of which U.S. $1.9 billion were paid to amortize foreign trade lines, U.S. $344 million to amortize buyers' credit, U.S. $833 million to amortize bonds, U.S. $1.0 billion to amortize the existing bankers' acceptance facilities and U.S. $600 million to reduce outstanding commercial paper. The remainder was used to amortize leases, restructured debt and direct loans. Of PEMEX's total debt and advance sales of future receivables, which amounted to U.S. $11.3 billion as of December 31, 1997, long-term debt was approximately U.S. $7.0 billion. At the end of 1997, PEMEX's ratio of equity to total assets fell to 45.9%, since the increase in liabilities in 1997 was higher than the increase in equity. Total assets, liabilities and equity of PEMEX increased by 10.4%, 19.2% and 1.5%, respectively, from 1996 to 1997.

In 1996, net payments on external borrowings amounted to U.S. $2.7 billion, of which U.S. $215 million were paid to amortize foreign trade lines, U.S. $231 million to amortize buyers' credits, U.S. $347.8 million to amortize bonds, U.S. $25 million to amortize the existing bankers' acceptance facilities and U.S. $475 million to reduce outstanding commercial paper. The remainder was used to amortize leases, restructured debt and direct loans. Of PEMEX's total debt and sales of future receivables, which amounted to U.S. $10 billion as at December 31, 1996, long-term debt was approximately U.S. $5.4 billion. PEMEX's ratio of equity to total assets fell to 49.9% at the end of 1996, since the increase in liabilities in 1996 was higher than the increase in equity. Total assets, liabilities and equity of PEMEX increased by 27.7%, 32.6% and 23.0%, respectively, from 1995 to 1996.

The following table sets forth a breakdown of PEMEX's total indebtedness and sales of receivables as at December 31 for each of the five years from 1993 to 1997.

	As at December 31,				
	1993	1994(7)	1995	1996	1997(8)
	(in millions of U.S. dollars)(1)				
Domestic Debt(2)					
Pesos	—	—	—	—	—
Other Currencies	$ 1,633	$ 1,777	$ 2,100	$ 1,235	$ 1,475
Total Domestic Debt	1,633	1,777	2,100	1,235	1,475
External Debt(2)(3)					
MYRA(4)	589	543	532	498	473
Other Direct Bank Loans	707	533	388	224	40
Securities	2,582	3,405	3,256	3,577	5,479
Bonds	2,259	2,930	2,906	3,352	4,694
Commercial Paper	323	475	350	225	785
Revolving Loans	0	0	80	0	0
Trade Financing(5)	1,749	1,452	1,638	2,835	2,250
Acceptance Lines	1,200	1,127	985	1,260	1,107
Advances from Commercial Banks	549	325	653	1,575	1,143
Purchasing Loans(6)	520	332	296	370	410
Financial Leases	260	263	425	464	491
Project Finance(7)	559	657	519	507	410
Total External Debt	6,966	7,184	7,134	8,476	9,553
Sale of Future Accounts Receivable	361	352	330	294	241
Total Debt and Sale of Future Accounts Receivables	$ 8,960	$ 9,314	$ 9,564	$ 10,004	$ 11,269

Note: Totals may differ due to rounding.

(1) Indebtedness payable in currencies other than in U.S. dollars was converted into pesos for accounting purposes at the exchange rates set by Banco de México and then to U.S. dollars at the following exchange rates: Ps. 3.1099 = $1.00 at December 31, 1993, Ps. 5.3250 = $1.00 at December 31, 1994, Ps. 7.6425 = $1.00 at December 31, 1995, Ps. 7.8509 = $1.00 at December 31, 1996 and Ps. 8.0833 = $1.00 at December 31, 1997. See Note 7 to the Financial Statements. Figures for 1995, 1996 and 1997 do not include indebtedness of the Subsidiary Companies.

(2) Excludes capitalized interest and other accrued interest. See Note 7 to the Financial Statements for amount of capitalized interest.

(3) Indebtedness payable other than in pesos and owed to persons or institutions outside Mexico.

(4) Multi-Year Restructure Agreement.

(5) To finance external trade of crude oil and derivatives.

(6) To finance imports of equipment and spare parts.

(7) Includes PMI Group project finance debt of U.S. $32 million.

(8) As at December 31, 1997 included U.S. $1 billion of PIDIREGAS.

Capital Expenditures. PEMEX's total capital expenditures in 1997 amounted to approximately Ps. 28.9 billion, of which Ps. 219.9 million corresponded to financial investment and approximately Ps. 28.7 billion to capital expenditures. Capital expenditures represented a 22.0% increase from the Ps. 23.6 billion invested in 1996 and a 97% increase from the Ps. 14.6 billion invested in 1995.

The following table provides a breakdown of the allocation of PEMEX's capital expenditure program for the five years ended December 31, 1997. These capital expenditure figures may differ from amounts contained in the Financial Statements under investments at cost, because some expenditures are charged to the oil field exploration and depletion reserve and the figures in the table below do not include the capitalization of interest.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(in millions of pesos)				
Construction in Progress	Ps. 3,160	Ps. 3,751	Ps. 5,732	Ps. 6,488	Ps. 5,997
Equipment for Oil Drilling	416	288	828	1,652	1,627
Drilling of Oil Wells by Contract	1,639	1,952	2,574	4,395	4,425
Real Estate	798	626	856	2,063	2,397
Maintenance	1,058	1,540	2,295	5,131	8,830
Labor for Exploration and Drilling	488	436	562	964	1,247
Other Investments	267	854	1,182	2,177	3,193
Exploration	738	461	556	707	958
Total	Ps. 8,564	Ps. 9,908	Ps. 14,587	Ps. 23,578	Ps. 28,674

Note: Totals may differ due to rounding.

For 1998, the adjusted capital expenditures budget of PEMEX (excluding PIDIREGAS) calls for a total investment of Ps. 30,888 million. Of that amount, Ps. 17,724 million, equivalent to 58.4% of total capital expenditures, will be directed to exploration and production programs.

The principal objectives of PEMEX's upstream investment program are to increase and improve the quality of its reserves, enhance the recovery ratio and improve the reliability of its production and transportation infrastructure for its crude oil and natural gas operations. In its downstream activities, PEMEX's main objectives are to improve the quality of its product slate, while achieving efficiencies similar to those of its international competitors and emphasizing industrial safety and environmental compliance.

In its downstream projects, PEMEX will adapt some of its existing refineries such as Cadereyta, to enable them to produce unleaded gasoline and to reduce sulfur levels in fuel oil and diesel. In order to increase its refining capacity, PEMEX recently completed two facilities for thermal cracking of heavy residues from crude oil, two fluid catalytic units and a reformer.

On December 21, 1995 the *Ley General de Deuda Pública* and the *Ley de Presupuesto, Contabilidad y Gasto Público Federal* (the General Law of Public Debt and the Law of Federal Budget, Accounting and Public Expenditure) were amended to allow for a new Government infrastructure financing program entitled PIDIREGAS. PIDIREGAS are those infrastructure projects deemed essential for Mexico's economic development which are eligible for treatment as special off-budget items. PIDIREGAS must be approved by the Government. These projects must be economically profitable and thus able to meet debt obligations through self-generating income, and must also be capable of securing private long-term financing at favorable rates. See Note 2(a) to the Financial Statements.

The total adjusted capital expenditures budget of PEMEX for 1998, including Ps. 31,665 million for PIDIREGAS, amounts to Ps. 62,553 million, of which Ps. 45,676 million (73.02%) will be directed to exploration and production programs.

Results of Operations by Business Segment

The presentation of segment information reflects the activities of PEMEX according to the following criteria: exploration and production includes crude oil and gas exploration and production activities, which are conducted through Pemex-Exploration and Production; refining includes crude oil refining to produce petroleum products and derivatives and the storage, distribution and marketing thereof, activities which are conducted by Pemex-Refining; gas and petrochemicals includes the processing of natural gas, natural gas liquids and derivatives and the production of petrochemical products and the storage, distribution and marketing thereof, activities which are conducted through Pemex-Gas and Basic Petrochemicals and Pemex-Petrochemicals.

The table below sets forth PEMEX's trade and intersegment net sales revenues by business segment for the 1994, 1995, 1996 and 1997 fiscal years, as well as the percentage change in sales revenues for the periods indicated.

	Year ended December 31,				Fiscal Year 1996 vs.	Fiscal Year 1997 vs.
	1994	1995	1996	1997	1995	1996
	(in millions of pesos)					
Exploration and Production						
Trade sales	Ps. 22,078	Ps. 47,931	Ps. 81,337	Ps. 81,653	69.7%	0.4%
Intersegment sales	31,190	53,966	87,249	91,378	61.7%	4.7%
Total net sales	Ps. 53,268	Ps. 101,897	Ps. 168,586	Ps. 173,031	65.4%	2.6%
Refining						
Trade sales	Ps. 52,169	Ps. 72,099	Ps. 101,169	Ps. 128,168	40.3%	26.7%
Intersegment sales	2,321	5,987	7,952	8,670	32.8%	9.0%
Total net sales	Ps. 54,490	Ps. 78,086	Ps. 109,121	Ps. 136,838	39.7%	25.4%
Gas and Petrochemicals						
Trade sales	Ps. 15,087	Ps. 25,752	Ps. 36,708	Ps. 44,554	42.5%	21.4%
Intersegment sales	7,833	11,174	18,945	17,922	69.5%	(5.4)%
Total net sales	Ps. 22,920	Ps. 36,926	Ps. 55,653	Ps. 62,476	50.7%	12.3%
Corporate and Other and Intercompany Eliminations						
Trade sales	Ps. 5,826	Ps. 11,528	Ps. 12,779	Ps. 9,655	10.9%	(24.4)%
Intersegment sales	(41,344)	(71,127)	(114,146)	(117,970)	(60.5)%	(3.4)%
Total net sales	Ps. (35,518)	Ps. (59,599)	Ps.(101,367)	Ps.(108,315	(70.1)%	(6.9)%
Total Sales	Ps. 95,160	Ps. 157,310	Ps. 231,993	Ps. 264,030	47.5%	13.8%

The table below sets forth PEMEX's income by business segment for each year in the three-year period ended December 31, 1997, as well as the percentage change in income for the period indicated.

	Year ended December 31,			Fiscal Year 1996 vs.	Fiscal Year 1997 vs.
	1995	1996	1997	1995	1996
	(in millions of pesos)				
Exploration and Production	Ps. 7,888	Ps. 15,178	Ps. 12,988	92.4%	(14.4)%
Refining	(2,372)	(1,086)	(6,812)	54.2%	(527.3)%
Gas and Petrochemicals	4,436	2,977	1,910	(32.9)%	(35.8)%
Corporate and other	(143)	(574)	(140)	(301.4)%	(75.6)%
Total Income	Ps. 9,809	Ps. 16,495	Ps. 7,946	68.2%	(51.8)%

1997 Compared to 1996. Trade sales relating to exploration and production activities, which in their entirety represent export sales, showed an increase of 0.4% relative to 1996 sales, and a decrease in U.S. dollar terms of 3.4%, as a result of a decrease in the international price of crude oil, which was only partially offset by an increase in the volume exported, from 1,544,000 bpd in 1996 to 1,721,000 bpd in 1997. The weighted average price of exported crude oil was U.S. $16.46 in 1997 as compared to U.S. $18.94 in 1996. Intersegment sales increased by 4.7% principally as a result of an increase in natural gas sales. Income related to exploration and production activities decreased from Ps. 15,178 million in 1996 to Ps. 12,988 million in 1997, mainly as a result of an increase in operating costs.

Trade sales related to refining activities increased by 26.7% from Ps. 101,169 million in 1996 to Ps. 128,168 million in 1997. Export sales decreased from Ps. 2,071 million in 1996 to Ps. 1,541 million in 1997, as a result of decreased volume of export sales due to lower prices for refined products in international markets; whereas domestic sales increased by Ps. 27,530 million principally due to an increase in the prices of such products. The IEPS Tax increased by Ps. 18,197 million. Intersegment sales increased by Ps. 718 million, largely due to an increase in the sale of naphthas and liquid gas. Losses related to refining activities increased from Ps. 1,086 million in 1996 to Ps. 6,812 million in 1997, mainly due to increases in the costs of labor liabilities, operating expenses and the value of imports.

Trade sales related to the natural gas and petrochemical business segment increased by 21.4%, from Ps. 36,708 million in 1996 to Ps. 44,554 million in 1997. The increase in trade sales was driven by increases in the volume and prices of domestic sales. In 1997, the volume of petrochemical exports decreased by 5.4%, from 1,123,400 tpy in 1996 to 1,062,300 tpy in 1997. The volume of domestic sales of petrochemicals decreased 13.8% in 1997, from 6,657,500 tpy in 1996 to 5,739,500 tpy in 1997. The volume of domestic sales of natural gas increased by 5.1% in 1997, with natural gas sales revenues increasing by 25.6% from Ps. 9,999 million in 1996 to Ps. 12,560 million in 1997. Income related to natural gas and petrochemicals fell by 35.8%, from Ps. 2,977 million in 1996 to Ps. 1,910 million in 1997, mainly due to decreases in the value of domestic sales and exports of petrochemical products as well as increases in operating expenses.

1996 Compared to 1995. Trade sales relating to exploration and production activities, which in their entirety represent export sales, showed an increase of 69.7% relative to 1995 sales, and an increase in U.S. dollar terms of 43.1%, as a result of an increase in the international price of crude oil, and an increase in volume exported, from 1,306,000 bpd in 1995 to 1,544,000 bpd in 1996. The weighted average price of exported crude oil was U.S. $18.94 in 1996 as compared to U.S. $15.70 in 1995. Intersegment sales increased by 62% principally as a result of an increase in domestic prices and the sale of higher quality crude oil, which resulted in a higher weighted average price. Income related to exploration and production activities increased from Ps. 7,888 million in 1995 to Ps. 15,178 million in 1996, mainly as a result of increased revenue, which was partially offset by an increase in taxes and hydrocarbon extraction duties. Such taxes and duties increased from Ps. 74,196 million in 1995 to Ps. 124,412 million in 1996. In 1996, Pemex-Refining registered a loss amounting to Ps. 1,086 million, as compared with a loss of Ps. 2,372 million in 1995.

Trade sales related to refining activities increased by 40.3% from Ps. 72,099 million in 1995 to Ps. 101,169 million in 1996. Export sales decreased from Ps. 2,262 million in 1995 to Ps. 2,071 million in 1996, as a result of a lesser volume of sales. Domestic sales increased by Ps. 29,261 million principally due to an increase in the value of such sales. The IEPS Tax increased by Ps. 2,064 million. Intersegment sales increased by Ps. 1,965 million, largely due to an increase in the sale of naphthas and liquid gas.

Trade sales related to the natural gas and petrochemical business segment increased by 42.5%, from Ps. 25,752 million in 1995 to Ps. 36,708 million in 1996. The increase in trade sales was driven by increases in the volume of domestic sales of petrochemicals, as well as an increase in the prices of petrochemical products in international markets. In 1996, the volume of petrochemical exports decreased by 8.4%, from 1,226,100 tpy in 1995 to 1,123,400 tpy in 1996. The volume of domestic sales of petrochemicals increased by 4.5% in 1996, from 6,371,800 tpy in 1995 to 6,657,500 tpy in 1996. The volume of domestic sales of natural gas increased by 4.4% in 1996; natural gas sales increased by 92.6% from Ps. 5,191 million in 1995 to Ps. 9,999 million in 1996.

U.S. GAAP Reconciliation

Operating results between U.S. GAAP and Mexican GAAP differ as a result of various U.S. GAAP reconciling items. The most important of the material items generating a difference between U.S. and Mexican GAAP are the accounting methodologies for the treatment of impairment of fixed assets, foreign exchange losses, petroleum exploration and drilling costs, measurement of pension obligations and accounting for capitalized interest. Under SFAS No. 121, PEMEX is required to evaluate its long-lived assets for impairment for U.S. GAAP purposes whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Such impaired assets must be permanently written down to the fair value of the present value of expected future cash flows or related assets. There is no such requirement under Mexican GAAP. Under Mexican GAAP, oil exploration and development costs are charged to a capital reserve rather than expensed or directly capitalized as required by U.S. GAAP. Such capital reserve is funded by charging a certain percentage to cost of sales for each barrel of crude extracted. PEMEX sets this percentage on an annual basis. Seniority premiums and retirement plans generate a difference between U.S. and Mexican GAAP due to the different actuarial cost assumptions applied under Bulletin D-3 and SFAS No. 87. In addition, PEMEX's adoption dates for Bulletin D-3 and SFAS No. 87 were different, resulting in differences in period expenses due to the differing amortization of transition amounts. The treatment of capitalized interest between PEMEX's Mexican GAAP Financial Statements and U.S. GAAP differs in that for Mexican GAAP purposes PEMEX treats all interest expense as being associated with construction or well development and accordingly capitalizes all interest. For purposes of the U.S. GAAP reconciliation, PEMEX capitalizes interest by applying its average borrowing rate to its average amount of construction in progress. PEMEX applies NIF-06 BIS/A to its Financial Statements to reflect the effects of inflation. NIF-06 BIS/A provides for the restatement of fixed assets, inventories and costs of sales by indexing and/or appraisals. Since NIF-06 BIS/A does not represent a comprehensive basis of inflation accounting, PEMEX has reversed the effects of NIF-06 BIS/A on its Financial Statements from the U.S. GAAP reconciliation of equity. Under NIF-06 BIS/A, a devaluation of the peso does not have a negative impact on the income of PEMEX because exchange losses are capitalized into fixed assets. Furthermore, a devaluation of the peso relative to the dollar results in an increase in income to the extent that expenses remain relatively stable because they are incurred in pesos, while revenues, which are mostly denominated in dollars or linked to international, dollar-denominated prices, increase in peso terms. In contrast, under U.S. GAAP, a devaluation of the peso has a negative impact on the income of PEMEX because the exchange losses are not capitalized but are charged immediately to income. This one-time charge to income will be gradually offset by dollar-linked revenues. In any particular accounting period, the negative impact of a devaluation is, therefore, greater when the devaluation occurs at or near the end of the period, as occurred with the peso at the end of 1994. During 1995, PEMEX implemented SFAS 106 "Employers' Accounting for Post-retirement Benefits Other than Pension" using the transitional recognition method.

For the year ended December 31, 1997, PEMEX's income under U.S. GAAP was approximately Ps. 10 billion, which represented a Ps. 2.1 billion increase from Mexican GAAP income. For the years ended December 31, 1996 and 1995, PEMEX reported gains under U.S. GAAP approximating Ps. 10.2 billion and losses of Ps. 8.3 billion, respectively. The adjustments to Mexican GAAP income in 1997 are explained by the adjustments to Mexican GAAP income in 1996 and 1995, both of which resulted largely from the effect of the impairment of fixed assets of Ps. 7.2 billion and the treatment of Ps. 21.1 billion of foreign exchange losses in 1996 and 1995, respectively. Such foreign exchange losses were capitalized in PEMEX's Mexican GAAP Financial Statements; in the reconciliation to U.S. GAAP, such losses were charged to income. For a further discussion of these and other adjustments, see Note 16 to the Financial Statements.

PEMEX's equity under U.S. GAAP was approximately Ps. 62 billion as of December 31, 1997, a decrease from Ps. 69.3 billion as of December 31, 1996. The 1997 decrease in equity under U.S. GAAP principally reflected the income obtained under U.S. GAAP of Ps. 10.0 billion, less the advance payments on minimum guaranteed dividends of Ps. 5.8 billion and the reduction of the CAPs of Ps. 12.1 billion. For a further discussion of these and other adjustments, see Note 16 to the Financial Statements.

Recently Issued Accounting Standards

In June 1997, the U.S. Financial Accounting Standards Board ("FASB") issued SFAS No.130, "Reporting Comprehensive Income". SFAS No.130 establishes standards for the reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The statement requires that changes in the amounts of items that are required to be recognized under SFAS No.130 as components of comprehensive income, including foreign currency translation adjustments and gains and losses on certain securities, be reported in a financial statement that is displayed with the same prominence as other financial statements; it does not address the issues of recognition or measurement. This statement is effective for fiscal years beginning after December 15, 1997 and requires reclassification of earlier financial statements for comparative purposes. Management believes that the impact of implementing the requirements of SFAS No.130 will not have a material effect on its consolidated financial statements.

The FASB issued SFAS No.131, "Disclosure about Segments of an Enterprise and Related Information", in June 1997. SFAS No.131 establishes a new framework for the way that public business enterprises report financial and descriptive information about reportable operating segments in financial statements. It requires entity-wide disclosures about the products and services an entity provides, the significant countries in which it holds assets and reports revenue, and its major customers. This statement is effective for periods beginning after December 15, 1997. Management believes the impact of implementing the disclosure requirements of SFAS No.131 will not have a material effect on its consolidated financial statements.

The FASB issued Statement No.132, "Employers' Disclosure about Pensions and Other Postretirement Benefits", in February 1998. SFAS No.132 revises current disclosure requirements for employers' pension and other retiree benefits but does not change the measurement or recognition of pension or other postretirement benefit plans. The statement is effective January 1, 1998. Management believes the impact of implementing the disclosure requirements of SFAS No.132 will not have a material effect on its consolidated financial statements.

The FASB issued SFAS No.133, "Accounting for Derivative Instruments and Hedging Activities", is June 1998. The statement in effective for all quarters of all fiscal years beginning after June 15, 1999. PEMEX is currently reviewing the impact of adopting SFAS No.133.

Year 2000 Issue

PEMEX has conducted a comprehensive review of its computer systems to identify those applications that could be affected by the "Year 2000" issue and has developed a workplan to correct the programs that are affected by the issue. The workplan consists of 4 phases: diagnostic, planning, conversion and testing and follow-up. PEMEX has completed the diagnostic phase and is currently in the planning phase for the remediation of the Year 2000 issue through the replacement of systems with SAP R/3 software and the modification of its remaining software. PEMEX intends to complete the necessary modifications to and/or replacements of the identified applications by the end of the third quarter of 1999. PEMEX is also communicating with outside consultants, customers, suppliers, financial institutions and others with which it does business to coordinate Year 2000 compliance. Management currently estimates that its Year 2000 compliance costs related to computer systems will not exceed Ps. 157 million. In addition, PEMEX is currently evaluating the impact, if any, that the Year 2000 issue may have with respect to production areas. Actions taken in this area to date include the appointment of two team leaders in the areas of systems and operations, who will be responsible for ensuring Year 2000 compliance. PEMEX believes that, with the contemplated actions and modifications to existing systems applications and replacement with new systems, the Year 2000 issue will not have a material effect on PEMEX's results of operations or financial position.

RECENT DEVELOPMENTS

Set forth below is certain selected unaudited interim financial and statistical data of PEMEX as at or for the first half of 1998. This selected first half information supplements the information presented elsewhere in this Prospectus.

Interim First Half Financial Data

The interim financial data set forth below have been derived from the unaudited summary consolidated financial statements of Petróleos Mexicanos and the Subsidiary Entities as at and for the six months ended June 30, 1998 and 1997. The selected financial data do not include the accounts of the Subsidiary Companies. The interim financial data set forth below are unaudited.

	Six Months ended June 30,		
	1997 (unaudited)(1)(2)	1998 (unaudited)(1)(2)(3)	
	(Millions of nominal pesos or U.S. dollars)		
Net sales:			
Domestic(2)	Ps. 79,396	Ps. 88,666	$ 9,868
Export	43,938	32,377	3,603
Total	123,333	121,043	13,471
Costs and operating expenses	39,683	49,057	5,460
Total revenues before interest and other expenses	83,650	71,986	8,012
Interest expense, net	562	1,873	208
Other expenses (income)	(2,325)	(1,037)	(115)
Net total revenues before taxes and duties	85,413	71,150	7,919
Taxes and duties:			
Direct	61,750	42,828	4,766
Indirect	15,635	30,404	3,384
Total	77,385	73,232	8,150
Income	8,028	(2,082)	(232)

(1) The financial condition and results of operations of the Subsidiary Companies are not included.

(2) Total Revenues and Net Sales include the IEPS tax as part of the sales price of the products sold. The IEPS tax amounted to Ps. 15,635 million in the first half of 1997 and Ps. 30,404 million in the first half of 1998. Because the IEPS Tax equals the difference between the producer price—linked to international markets—and the retail price less VAT and distribution costs, a fall in the international reference price of gasoline and diesel will result in a fall in the producer price and, therefore, in an increase in the IEPS Tax collected from consumers and paid to the Government. Such was the case during the last quarter of 1997 and the first half of 1998.

(3) Conversions into U.S. dollars of amounts in pesos have been made at the established exchange rate for accounting purposes of Ps. 8.9852 = U.S. $1.00 as at June 30, 1998.

Management's Discussion and Analysis—Results of Operations
First Half of 1998 Compared to First Half of 1997

The interim financial data set forth below as at and for the first half of 1998 and the first half of 1997 has been derived from unaudited balance sheets of PEMEX as at June 30, 1998 and 1997 and the related unaudited income statements and include the accounts of Petróleos Mexicanos and the Subsidiary Entities only.

In the first half of 1998, PEMEX earned income (before taxes and duties) of Ps. 71.2 billion on total sales revenues (net of the IEPS tax) of Ps. 90.6 billion, as compared with income (before taxes and duties) during the first half of 1997 of Ps. 85.4 billion on total sales revenues (net of the IEPS tax) of Ps. 107.7 billion, a decrease of 16.7% in such income. In the first half of 1998, total sales revenues (net of the IEPS tax) decreased by 15.8%, mainly as a result of the fall in the weighted average price of crude oil exported by PEMEX, which was only partially offset by higher production and sales volumes. The weighted average price of crude oil exported by PEMEX was U.S. $10.63 per barrel in the first half of 1998 as compared to U.S. $17.08 per barrel in the first half of 1997, a 37.8% decrease in such price. During the first half of 1998, PEMEX's loss (after taxes and duties) amounted to Ps. 2.1 billion, as compared with income (after taxes and duties) during the first half of 1997 of Ps. 8.0 billion, a 125.9% decrease in such income, which was due primarily to the aforementioned decrease in crude oil prices. As a result of the continued low crude oil prices during the third quarter of 1998, no assurance can be given that PEMEX's income will not continue to be negative during the second half of this year, or that PEMEX's income for the year will not be negative.

Export sales decreased by 26.3% in peso terms (with dollar-denominated export revenues converted to pesos at the exchange rate on the date on which the export sale was made), from Ps. 43.9 billion in the first half of 1997 to Ps. 32.4 billion in the first half of 1998. Export sales decreased as a percentage of total sales revenues (net of the IEPS tax), from 40.8% in the first half of 1997 to 35.7% in the first half of 1998. Crude oil exports accounted for 90.3% of export sales, petroleum products (including natural gas) accounted for 7.8% of export sales, and petrochemical products accounted for the remainder of export sales in the first half of 1998.

Net of collection of the IEPS tax, domestic sales decreased by 8.6%, from Ps. 63.8 billion in the first half of 1997 to Ps. 58.3 billion in the first half of 1998. Domestic sales of petroleum products (other than natural gas) decreased by 8.4%, from Ps. 51.2 billion in the first half of 1997 to Ps. 46.9 billion in the first half of 1998, due to a decrease in domestic prices of PEMEX's principal petroleum products. Domestic petrochemical sales (including sales of certain byproducts of the petrochemical production process) decreased from Ps. 6.8 billion in the first half of 1997 to Ps. 5.2 billion in the first half of 1998, due to a decrease in international prices for petrochemical products and a decrease in domestic demand. Sales of natural gas increased from Ps. 5.8 billion in the first half of 1997 to Ps. 6.2 billion in the first half of 1998.

Excluding the IEPS tax, operating costs increased by 23.6%, from Ps. 39.7 billion in the first half of 1997 to Ps. 49.1 billion in the first half of 1998. Operating costs as a percentage of total sales (net of the IEPS tax) increased from 36.8% in the first half of 1997 to 54.1% in the first half of 1998, due to increases in the cost of PEMEX's imports, as well as increases in the reserves for retirement payments, pensions and indemnities and oil field exploration and depletion. Other income decreased from Ps. 2.3 billion in the first half of 1997 to Ps. 1.0 billion in the first half of 1998, primarily due to lower income in 1997 and to register the exchange losses that resulted from the behavior of exchange rates during this period. Net interest expense increased by 233.3%, from Ps. 562 million in the first half of 1997 to Ps. 1.9 billion in the first half of 1998, primarily due to lower interest obtained by Pemex in domestic markets, which resulted in a relatively higher interest expense on outstanding debt.

Liquidity and Capital Resources

General. PEMEX's total equity as of June 30, 1998 was Ps. 151.1 billion, and its total capitalization (long-term debt plus equity) amounted to Ps. 217.0 billion. During the first half of 1998, Petróleos Mexicanos made advance payments to the Government (interest only) of Ps. 1,491.2 million of minimum guaranteed dividends relating to the *Certificados de Aportación* ("CAPs"), as compared to Ps. 2,825.6 million in the first half of 1997.

In March 1998, Petróleos Mexicanos issued ItL 200,000,000,000 of Fixed/Reverse Floating Rate Notes due 2008; in April 1998, Petróleos Mexicanos issued U.S. $350 million of 8³/₈% Global Guaranteed Notes due 2005 and U.S. $350 million of 9¼% Global Guaranteed Bonds due 2018; and in July 1998, Petróleos Mexicanos issued U.S. $1,000,000,000 of Daily Adjusted Yield Securities ("DAYS[SM]") due 2005.

On June 23, 1998, PEMEX and Bancomext signed an agreement regarding a U.S. $270 million line of credit to be made to PEMEX to refinance existing lines of credit.

On June 30, 1998, PEMEX and the Export-Import Bank of Japan signed a protocol regarding a loan for an amount of Japanese Yen equivalent to U.S. $1 billion to be made to PEMEX to finance further development of the Cantarell oil fields in the Campeche Sound in the Gulf of Mexico.

1998 Budget Reductions. During the first half of 1998, the Government announced three reductions in PEMEX's budget which, in the aggregate, required an 11.08% reduction in PEMEX's operating budget, including a 20.69% decrease in PEMEX's capital expenditure budget (excluding PIDIREGAS, as defined herein) for 1998, from Ps. 38,945 million to Ps. 30,888 million. Although certain of PEMEX's investment projects will be deferred as a result of these budget cuts, PEMEX does not anticipate the budgetary reductions to affect materially its operations or its strategic investment activities. For additional recent developments regarding Mexico, the Government and the Government's fiscal policies, see "Annex A—United Mexican States".

First Half Business Developments

Production. The following table sets forth PEMEX's average daily crude oil and natural gas production rates for the first half of 1997 and 1998.

	Six Months ended June 30,	
	1997	1998
	(in thousands of bpd)	
Crude oil	2,970	3,120
Condensates(1)	370	419
Total liquids production	3,340	3,539
Natural gas (millions of cfpd)	4,379	4,759

Note: Numbers may not total due to rounding.
(1) Includes NGL.
Source: PEMEX's June 1998 Indicadores Petroleros.

In the first half of 1998, production averaged 3.12 million bpd of crude oil, 4.76 billion cfpd of natural gas and 419 thousand bpd of condensates. Crude oil production in the first half of 1998 increased by 5.1%, natural gas production in the first half of 1998 increased by 8.7%, and condensates production in the first half of 1998 increased by 13.2%, in each case as compared to the first half of 1997.

The increase in crude oil production resulted from increased production of heavy crude oil in the offshore facilities located in the Campeche Sound. Total liquids production in the first half of 1998 increased by 6.0% over the level for the first half of 1997.

Refining

Production of refined products (including NGL) totaled 1.53 million bpd in the first half of 1998, up from 1.47 million bpd in the first half of 1997. During the first half of 1998, PEMEX imported approximately 335 thousand bpd of refined products (including NGL) as compared to 232 thousand bpd in the first half of 1997.

Petrochemicals

Petrochemical production totaled 5.41 million tons in the first half of 1998, as compared to 6.15 million tons in the first half of 1997.

Commercial Activities

The following table shows the value of PEMEX's gross sales by product (excluding the IEPS tax) for the six months ended June 30, 1997 and 1998.

	Six Months ended June 30,(1)	
	1997	1998(2)
	(in millions of U.S. dollars)	
Crude Oil	$ 5,166	$ 3,427
Natural Gas	763	738
Refined Products	6,781	5,772
Petrochemicals	939	676
Total	$13,649	$10,613
Indirect Taxes		
IEPS	$ 1,982	$ 3,560

Note: Numbers may not total due to rounding.

(1) Does not include crude oil, refined products, petrochemicals or natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.

(2) Conversions into U.S. dollars of amounts in pesos have been made at the established rate for accounting purposes of Ps. 8.5396 = U.S. $1.00 as at June 30, 1998.

Source: Unaudited Financial Statements of Petróleos Mexicanos.

Exports and Imports

The following table shows the average crude oil prices for oil exported by PEMEX during the first half of 1997 and 1998 and spot prices as at July 31, 1998.

	Six Months ended June 30,		Spot Prices as at July 31, 1998
	1997	1998	
	(n U.S. dollars per barrel)		
Weighted Average Price.....	$17.08	$10.63	$10.30
Isthmus..........................	18.71	12.81	11.96
Maya	15.08	8.80	8.88
Olmeca...........................	20.35	14.00	13.07

Source: PMI Comercio.

In the first half of 1998, the weighted average price per barrel of crude oil exported by PEMEX was U.S. $10.63, a 37.8% decline from the weighted average price for the same period of 1997.

The following table sets forth the average unit volume of exports and imports of crude oil, natural gas and petroleum products for the first half of 1997 and 1998.

	Six Months ended June 30,(1)(2)	
	1997	1998
	(in thousands, except as provided otherwise)	
Exports:		
Crude Oil (bpd)	1,669.7	1,793.0
Refined Products (bpd).......	80.9	115.4
Petrochemicals (tons).........	481.3	569.4
Natural Gas (cfpd)(3)..........	63.0	48.5
Imports:		
Refined products (bpd).......	231.8	335.5
Petrochemicals (tons).........	47.1	50.1
Natural Gas (cfpd)(3)..........	74.9	142.9

Note: Numbers may not total due to rounding.
(1) Excludes the activities of P.M.I. Norteamérica, S.A. de C.V.
(2) Does not include crude oil, refined products, petrochemicals or natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.
(3) In millions.
Source: PEMEX's June 1998 Indicadores Petroleros.

The following table sets forth the value of exports and imports of crude oil, natural gas and petroleum products for the first half of 1997 and 1998.

	Six Months ended June 30,[1]	
	1997	1998
	(in millions of U.S. dollars)	
Exports:		
Crude Oil	$ 5,176	$ 3,450
Refined Products[2] and Natural Gas	322	302
Petrochemicals	85	73
Total	5,583	3,825
Imports:		
Refined Products[2] and Natural Gas	$ 1,011	$ 1,136
Petrochemicals	14	15
Total	1,025	1,151
Net Exports	$ 4,558	$ 2,674

Note: Numbers may not total due to rounding.

(1) Excludes the activities of P.M.I. Norteamérica, S.A. de C.V. Does not include crude oil, refined products, petrochemicals or natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.

(2) Includes pentanes.

Source: Pemex's June 1998 Indicadores Petroleros.

BUSINESS

General

Petróleos Mexicanos is an integrated state oil and gas company which conducts its operations through the four Subsidiary Entities: Pemex-Exploration and Production, Pemex-Refining, Pemex-Gas and Basic Petrochemicals and Pemex-Petrochemicals. PEMEX is the largest company in Mexico and one of the largest in the world in terms of both total assets and total revenues.[2] According to data published in *Petroleum Intelligence Weekly* in December 1997, PEMEX was the ninth largest oil company in the world as of December 31, 1996 in terms of total assets (Ps. 312.1 billion), topped by, for example, Royal Dutch-Shell Group, Exxon and PDVSA.[2] In terms of its total revenues (Ps. 235.8 billion) and total income (Ps. 16.5 billion), PEMEX ranked as the twelfth and eleventh largest company, respectively, in the oil industry. As measured by the *Petroleum Intelligence Weekly Composite Index* (which comprises reserves, output, refining capacity and product sales by volume), PEMEX ranked as the fifth most important oil company in the world after Saudi Aramco, PDVSA, the Royal Dutch-Shell Group and the National Iranian Oil Company as of December 31,1996.[2]

The activities of Petróleos Mexicanos and the Subsidiary Entities are regulated by the *Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo* (Regulatory Law to Article 27 of the Political Constitution of Mexico Concerning Petroleum Affairs, or the "Regulatory Law"), effective November 30, 1958, as amended effective November 14, 1996, and the *Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios* (Organic Law of Petróleos Mexicanos and Subsidiary Entities, or the "Organic Law") effective July 17, 1992, as amended effective January 1, 1994. Under the Organic Law and related regulations, Petróleos Mexicanos is entrusted with the central planning and the strategic management of Mexico's petroleum industry, and PEMEX (with the exception of Pemex-Petrochemicals) is granted the exclusive authority to conduct: (i) the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil, (ii) the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production, and (iii) the production, storage, transportation, distribution and first-hand sale of the derivatives of petroleum (including petroleum products) and of natural gas used as basic industrial raw materials that are considered Basic Petrochemicals.

The Organic Law separates the operating functions of Petróleos Mexicanos into four entities, the Subsidiary Entities, each of which is controlled by (and has characteristics of a subsidiary of) Petróleos Mexicanos. The principal objectives of the Subsidiary Entities are as follows: (i) Pemex-Exploration and Production: exploration and exploitation of crude oil and natural gas, and the transportation, storage in terminals and marketing thereof; (ii) Pemex-Refining: refining of petroleum products and derivatives that may be used as basic industrial raw materials, and the storage, transportation, distribution and marketing thereof; (iii) Pemex-Gas and Basic Petrochemicals: processing of natural gas, natural gas liquids and derivatives that may be used as basic industrial raw materials and the storage, transportation, distribution and marketing thereof, to obtain basic petrochemicals, and the storage, transportation, distribution and marketing thereof; and (iv) Pemex-Petrochemicals: industrial petrochemical processes, and the storage, distribution and marketing of Secondary Petrochemicals.

The Regulatory Law was amended effective May 12, 1995 to provide that private and social sector companies (which may be owned by non-governmental, non-Mexican companies or individuals) may participate, upon governmental authorization, in the storage, distribution and transportation of natural gas and to that end may construct, own and operate pipelines,

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2 *Petroleum Intelligence Weekly*, December 22, 1997.

installations and equipment. Implementing regulations to the amendment were published on November 8, 1995. The *Comisión Reguladora de Energía* (the Energy Regulatory Commission or "CRE"), first established in October 1993 as a technical agency of the *Secretaría de Energía* (the "Ministry of Energy"), was re-organized with new powers under the *Ley de la Comisión Reguladora de Energía* (Law of the Energy Regulatory Commission), which was enacted in October 1995, and given technical, operational and budgetary autonomy within the Ministry of Energy. Its powers include the regulation of the activities of both public and private operators in the electricity and natural gas industries, the establishment of pricing and tariff methodologies and general contractual terms through issuance of directives, and the resolution of disputes between regulated parties and users of their services. Under the current regulatory framework, PEMEX is the sole domestic producer and dominant transporter of natural gas. PEMEX applies methodologies established by the CRE in setting its first-hand sales prices for domestic natural gas (imported gas being excluded from such price regulation) and calculating its transportation rates. PEMEX is required to divest its existing distribution assets and since August 1997 has been required to allow open access to its transportation system to third parties while the necessary measurement and control systems are implemented. PEMEX will continue to perform marketing functions and may develop storage systems with respect to natural gas and retains exclusive autonomy with respect to the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production. See "—Transportation and Distribution" below.

In 1996, the CRE approved the *Programa de Acceso Gradual 1996-1997* (Gradual Access Program for 1996-1997), which provides gradual access to domestic natural gas distribution to the private sector as well as open access to imports of more than 5 million cfpd in Northern Mexico. Subsequently, access was given in September 1996 to the private sector for the Naco-Hermosillo pipeline and it was granted the first permit for private sector distribution pipelines in Mexicali. To date, the bidding for Pemex-Gas and Basic Petrochemicals' pipelines located in the distribution zones in Chihuahua, Cuauhtémoc-Anáhuac, Delicias, Hermosillo, Toluca, Río Pánuco and Norte de Tamaulipas have been completed, and the bidding process for Tijuana, Querétaro and El Bajío (Celaya, Salamanca, León and Irapuato) geographic zone has been initiated by Pemex-Gas and Basic Petrochemicals. In addition, Saltillo and Nuevo Laredo grids have been privatized. The Distrito Federal (Mexico City), Valle de Cuautitlán-Texcoco, Ciudad Juárez and Piedras Negras pipelines will be privatized during 1998.

Mexico is the fifth largest producer of crude oil and condensates in the world and one of the largest in the Americas, accounting for approximately 5% of the world's crude oil and condensates production in 1996.[3] It is one of the major suppliers of crude oil to the United States, accounting for 13% of that country's imports of crude oil in 1996.[3] Mexico is not a member of the Organization of Petroleum Exporting Countries ("OPEC"), but has entered into an agreement with the governments of Saudi Arabia and Venezuela in 1998 to reduce its exports of crude oil. See "—Exports and Imports" below.

PEMEX supplies substantially all of Mexico's consumption of petroleum products, a market which is larger than those of Sweden and Saudi Arabia, similar in size to that of Canada and equivalent to four-fifths of the oil consumption of France or Italy in 1996.[3] PEMEX's refining capacity totaled 1,970 million bpd at the end of 1997, with 1,520 million bpd of such capacity directed to the primary distillation of crude oil and the remainder (450 million bpd) used for the fractionation of condensates.

In 1997, PEMEX earned income (before duties and the IEPS Tax, as defined below) of Ps. 167.4 billion on total revenues (net of the IEPS Tax) of Ps. 231.8 billion, as compared with

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3 *BP Statistical Review of World Energy 1997.*

income (before duties and the IEPS Tax) during 1996 of Ps. 161.5 billion on total revenues (net of the IEPS Tax) of Ps. 216.1 billion, an increase of 3.7% in such income. Income after duties and the IEPS Tax declined from Ps. 16.5 billion in 1996 to Ps. 7.9 billion in 1997. Total sales revenues for 1997 (net of the IEPS Tax) reached Ps. 226.3 billion. Of this amount, Ps. 127.6 billion resulted from sales in the domestic market and Ps. 98.7 billion resulted from exports to 52 clients in 20 countries. Excluding the operations of PMI Comercio, in 1997 crude oil exports accounted for 92.2% of export sales, petroleum products (including natural gas) for 6.2% and petrochemical products for 1.6%. The weighted average price of crude oil exported by PEMEX was U.S. $16.46 per barrel in 1997, 13.1% less than the price per barrel in 1996 of U.S. $18.94. In First Half 1998, the weighted average price of crude oil exported by PEMEX was U.S. $16.46 per barrel, a 61.7% decline from First Half 1997. Total equity of PEMEX as of December 31, 1997 was Ps. 158.2 billion and total capitalization (long-term debt plus equity) amounted to Ps. 214.5 billion.

PEMEX's exports accounted for approximately 17.2% of Mexico's foreign revenues in 1997 and 19.6% in 1996. If the indirect IEPS Tax collected by PEMEX is also taken into account, PEMEX's contribution to the Government's revenues was approximately 36.1% in 1997 and 37.6% in 1996.

PEMEX owns a 5% interest in Repsol, S.A., which is an integrated oil company organized under the laws of Spain, subject to the transaction described in Note 6 to the Financial Statements.

Exploration and Drilling

The main objective of PEMEX's exploration program is to identify new oil reservoirs and thereby maintain an adequate level of reserves. PEMEX's exploration program was accelerated in the late 1970's, leading to a substantial growth in proven reserves from 11.2 billion barrels in 1976 to 72.1 billion barrels in 1982. However, PEMEX's exploration program, like that of other oil producing companies, was scaled back as international crude oil prices dropped first in 1981 and then again in 1986. Nonetheless, beginning in 1990, PEMEX initiated the drilling of 914 wells and by December 31, 1997 completed 896 exploration and development wells with average success rates of 49% and 93%, respectively. From 1993 to 1997, this process led to the discovery of 16 new crude oil and 11 new natural gas fields, which brought the number of PEMEX's crude oil and natural gas fields in production to 335 at the end of 1997.

PEMEX's most productive crude oil and natural gas fields in the Gulf of Mexico are Cantarell, Ku and Chac in the Northeast Marine region and Caan, Abkatun and Pol in the Southwest Marine region. The Cantarell field produced 1.2 million bpd of crude oil and 465 million cfpd of natural gas in 1997, which represented 39.1% and 10.4% of PEMEX's total production of crude oil and natural gas, respectively.

Most of the offshore production in the Gulf of Mexico is obtained in waters less than 100 meters deep; however, the exploration program for 1997 included the exploration of regions which are located in deeper waters.

The following table summarizes PEMEX's drilling activity for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
Wells Drilled	66	72	104	118	130
Wells Completed	78	63	102	114	121
Exploratory Wells	25	16	10	10	10
Development Wells	53	47	92	104	111
Producing Wells at End of Period	4,641	4,555	4,616	4,718	4,663
Fields in Production	336	340	342	334	335

Sources: PEMEX's 1996 Statistical Yearbook, Pemex-Exploration and Production and 1997 Memoria de Labores.

In 1996, PEMEX invested Ps. 18,136 million in exploration and production. Of the total investment budget, 55% (Ps. 10,043 million) was allocated to strategic projects, 30% (Ps. 5,445 million) to field development projects, 10% (Ps. 1,882 million) to exploration activities and 5% (Ps. 906.8 million) to other projects. The strategic projects were the Campeche and Litoral de Tabasco projects in the Marine region, the Cuencas del Sureste project in the Southern region and the Burgos project in the Northern region. The most significant field development projects were the Ku, Taratunich, Och-Uetch-Kax and Cantarell in the Marine region and the Jacinto, Samaria, Jujo-Tecominoacán and Sen projects in the Southern region. The main investments in exploration activities were directed to complete 114 wells, 10 exploratory wells and 104 development wells.

In 1997, PEMEX invested Ps. 26,068 million in exploration and production activities. Twenty-one percent of such investment was designated as *Proyectos de Impacto Diferido en el Registro del Gasto* (Investment Projects with Deferred Impact on the Expense Register, or "PIDIREGAS"), but are reflected in the financial statements included herein. See Note 2(a) to the Financial Statements. Investment, other than PIDIREGAS, included Ps. 8,779 million (42.5% of the total) directed to strategic projects and Ps. 11,889 million (57.5%) in operating projects. In strategic projects, PEMEX invested Ps. 3,667 million in exploratory fields and Ps. 1,104 million in field development projects. The exploratory fields of Abkatún-Pol-Chuc, Zaap, Ek-Balam in the Marine region and Samaria-Iride, Jujo-Tecominoacán and Delta del Grijalva in the Southern region had the most significant projects. The fields of Taratunich, Cantarell, Och-Uetch-Kax in the Marine region and Catedral in the Southern region received the largest investments of the field-development projects. PIDIREGAS investments included the Cantarell project (Ps. 3,109 million) and the Burgos project (Ps. 2,291 million) as described below.

On October 10, 1997, PEMEX awarded to a consortium formed by BOC Holdings, Linde, Marubeni, West Coast Energy and ICA Flour Daniel a 15-year build-own-operate contract for a nitrogen cryogenic plant in the Marine region's Cantarell oil and natural gas field. The plant, which will cost an estimated of U.S. $1 billion, is expected to increase oil recovery rates by injecting nitrogen into the Cantarell oil reservoirs, thereby maintaining pressure during oil extraction. By maintaining favorable oil recovery rates at Cantarell, investment in this nitrogen cryogenic process is expected to yield long-term benefits for PEMEX, including the increase of exploitable reserves at Cantarell.

In 1997, Ps. 4,440 million were budgeted for investments at Cantarell project, not including Ps. 3,109 million of PIDIREGAS investments. For 1998, the budget for this project is Ps. 23,047.9 million. PEMEX expects that the Canterell project will cost PEMEX a total of approximately U.S. $5 billion by the year 2000.

In 1997, Pemex-Exploration and Production initiated a 15-year, U.S. $5.5 billion investment project to develop the Burgos basin gas fields in Northern Mexico, which represented 10.9% of PEMEX's total natural gas production in 1997. PEMEX hopes that the Burgos project will convert

Mexico from a marginal gas importer to a net gas exporter. Three major turn-key contracts worth U.S. $108 million, U.S. $96.4 million and U.S. $71 million, respectively, have been awarded for the project. Exploratory activities and field reentrance and maintenance activities in the Burgos region incorporated reserves of 128 million boe in 1997. In 1997, Ps. 2,290.6 million was invested in the Burgos project. For 1998, the budget for this project is Ps. 5,172.5 million.

For 1998, Pemex-Exploration and Production budgeted Ps. 19,802.7 million for investment in exploration and production, approximately 49% for investment in projects relating to field development, pipelines and exploration activities, including the continuation of certain projects that began in 1996 and 1997. The remaining 51% was budgeted for operating projects as well as for projects relating to maintenance facilities, industrial safety and environmental matters. The recent budgetary adjustment, however, has resulted in downward revisions to these figures. See "Risk Factors—Relationship with the Government—Capital Expenditures" and "Recent Developments—Liquidity and Capital Resources—1998 Budget Reductions".

Reserves

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, *i.e.*, prices and costs as of the date the estimate is made.

Under the Political Constitution of Mexico, all oil and other hydrocarbon reserves within Mexico are owned by Mexico and not by PEMEX. Pursuant to the Organic Law, PEMEX has the exclusive right to extract and administer those reserves. PEMEX's exploration and development activities are limited to reserves located in Mexico.

At the end of 1997, approximately 45.4% of Mexico's hydrocarbon reserves were located in the Marine region, 35.7% in the Northern region and 18.9% in the Southern or Chiapas-Tabasco region. Mexico's total hydrocarbon reserves reached their peak level at the beginning of 1984. Since then, reserves have decreased at an average annual rate of 1.3%, except in 1992, when additions to reserves exceeded the volume extracted.

Estimates of reserves are prepared by PEMEX using standard geological and engineering methods generally accepted by the petroleum industry. The choice of method or combinations of methods employed in the analysis of each reservoir is determined by experience in the area, stage of development, quality and completeness of basic data and production history.

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond the control of the producer. The reserve data set forth herein represents only estimates. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates of different engineers often vary. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revision of such estimate. Accordingly, reserve estimates may be materially different from the quantities of crude oil and natural gas that are ultimately recovered. The significance of such estimates is highly dependent upon the accuracy of the assumptions upon which they are based.

PEMEX is in the process of reviewing and auditing its estimates of Mexico's proved reserves. Beginning in 1996, Pemex-Exploration and Production revised its procedures for estimating such reserves to meet the reserve definitions and standards of the Society of Petroleum Engineers and the World Petroleum Congress. In 1997, PEMEX revised its estimates for the marine reservoirs in the Northeast and the Southwest production regions in the Campeche Sound in the Gulf of Mexico to reflect the new criteria. In 1998, PEMEX revised its estimates for the reserves in the Southern region to reflect the new criteria. PEMEX expects to publish in 1999 revised reserve estimates for the Northern region reflecting the new criteria.

PEMEX will continue to publish estimates based on its criteria established prior 1996 to provide for more meaningful inter-period comparisons. The estimated reserves set forth in the tables below are based on these previously established criteria.

With the new information gathered on the behavior of the reservoirs, and the more rigorous criteria and standards of the Society of Petroleum Engineers and the World Petroleum Congress, proved reserves for the Northeast and Southwest marine regions, as of December 31, 1997, amounted to 16,123.3 million boe. Using the previous criteria and information, PEMEX had estimated its proved reserves for these regions at 27,309 million boe as of the same date. Based on the new standards, PEMEX estimated that the proved reserves for the Southern region totaled 7,669 million boe as of December 31, 1997; using the criteria and information previously employed, PEMEX had estimated its proved reserves for this region at 11,374 million boe as of the same date.

The following table sets forth Mexico's proved developed reserves and proved undeveloped reserves of crude oil, condensates and natural gas at the dates indicated, which proved reserves were calculated without reference to the change in methodology referred to above.

	As at December 31,				
	1993	1994	1995	1996	1997
	(in billions of barrels)[1]				
Proved Developed and Undeveloped Reserves					
Crude Oil	44.0	43.1	42.1	42.1	41.4
Condensates[2]	6.7	6.6	6.7	6.4	6.4
Natural Gas[3]	13.8	13.5	13.3	12.4	12.4
Total	64.5	63.2	62.1	60.9	60.1
Reserves / Production ratio (years)	49	48	48	43	40
Proved Developed Reserves					
Crude Oil	26.6	25.9	25.7	25.6	24.9
Condensates[2]	4.3	4.2	4.3	4.1	4.2
Natural Gas[3]	7.1	6.9	6.8	5.9	6.0
Total	38.0	37.0	36.8	35.6	35.1

Note: Numbers may not total due to rounding.

(1) Figures for all years, including 1996 and 1997, do not take into account adjustments that PEMEX has made, beginning in 1996, to its procedures for estimating reserves in order to meet the standards of the SPE and the WPC.

(2) Includes NGL.

(3) Crude oil equivalents calculated on basis of 5,000 cubic feet of natural gas equals one barrel.

Sources: Pemex-Exploration and Production and PEMEX's 1997 Memoria de Labores.

Production

In 1997, production averaged 3.02 million bpd of crude oil, 4.47 billion cfpd of natural gas and 387,760 bpd of condensates.

The production level of crude oil in 1997 was 5.7% higher than that in 1996, and was the highest ever reached in the Mexican petroleum industry. Natural gas production in 1997 increased by 6.4% from 4.20 billion cfpd in 1996 to 4.47 billion cfpd in 1997, while condensates production decreased by 7.4% from 418,950 bpd to 387,760 bpd as a result of the explosions in 1996 at the cryogenic plants at the Cactus Natural Gas Processing Complex.

PEMEX produces three types of crude oil: Maya, a heavy crude oil; Isthmus, a light crude oil; and Olmeca, a very light crude oil. Most of PEMEX's production is Isthmus and Maya crude oil. In 1997, 51.9% of PEMEX's total production of crude oil consisted of heavy crudes and 48.1% consisted of both light and very light crudes. The Marine region produces mostly heavy crude oil (65.7% of its overall production), although significant volumes of light crude oil are also produced (34.3%). The Southern region produces mainly light and very light crudes and 57.5% of the Northern region's production consists of heavy crudes.

The following table sets forth the annual crude oil and natural gas production rates for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	**1994**	**1995**	**1996**	**1997**
	(in millions of barrels per year, except as provided otherwise)				
(A) Crude Oil					
Marine region					
Heavy Crude	461.7	443.4	425.4	481.3	551.5
Light Crude	250.0	287.2	281.8	299.0	287.6
Total	711.7	730.6	707.2	780.3	839.2
Southern region					
Heavy Crude	0.5	0.4	0.4	0.4	0.2
Light Crude	227.7	213.4	212.9	230.2	228.6
Total	228.2	213.8	213.3	230.6	228.8
Northern region					
Heavy Crude	18.4	19.3	19.7	20.1	20.2
Light Crude	17.5	16.4	15.1	15.1	14.9
Total	35.9	35.7	34.8	35.2	35.1
Total Heavy Crude Oil	480.5	463.1	445.5	501.8	572.0
Total Light Crude Oil	495.3	516.9	509.8	544.3	531.1
Total Crude Oil	975.8	980.0	955.3	1,046.1	1,103.1
(B) Condensates (1)	168.1	172.0	163.9	155.9	141.6
Total Liquids (A + B)	1,143.9	1,152.0	1,119.2	1,202.0	1,244.7
Natural Gas (billions of cfpy)	1,305.2	1,323.1	1,372.8	1,535.4	1,630.5

Note: Numbers may not total due to rounding.
(1) Includes NGL.
Sources: *PEMEX's 1995 Statistical Yearbook, February 1998 Indicadores Petroleros, 1997 Memoria de Labores and Pemex-Exploration and Production.*

In 1997, approximately 76.1% of Mexico's crude oil production was attributable to offshore facilities located mainly in the Campeche Sound in the Gulf of Mexico. Approximately 20.7% of production came from onshore facilities in the Southern region. Inland facilities in the Northern region accounted for the remaining 3.2% of total production. Due to the high productivity of certain wells, 8 fields accounted for 73% of Mexico's crude oil production in 1997.

The Marine region covers an area of approximately 21,000 square kilometers located in the Campeche Sound in the Gulf of Mexico. PEMEX's production area in the Campeche Sound comprises 9,000 square kilometers. Geophysical operations began there in 1972 and drilling commenced in 1974. Production began in June 1979, reaching an average of 1.08 million bpd of crude oil in 1981 and 2.3 million bpd in 1997. The oil fields located in the Campeche Sound are less than 100 meters below the sea level and have an average well depth of 3,500 meters.

The Southern region covers an area of approximately 23,000 square kilometers, with PEMEX's production area comprising 9,000 square kilometers in the states of Chiapas and Tabasco. In 1997, the production in the Southern region totaled 627,000 bpd. This production area includes 90 oil fields with an average well depth of 5,500 meters.

During 1997, domestic consumption of crude oil amounted to approximately 1.3 million bpd, which represented 42% of PEMEX's total crude oil production. The remainder of PEMEX's crude oil production was exported. See "—Exports and Imports" below. Heavy crude oil accounted for 65.5% of exported volume in 1997, but only 28.7% of domestic consumption.

Natural gas production associated with crude oil production accounted for approximately 81% of production of natural gas in 1997, with the remainder extracted from fields holding natural gas reserves exclusively. Although natural gas production is more geographically diverse than crude oil production, 20 fields accounted for 63.8% of all production in 1997, with 36.9% of total production originating from the Marine region, 45.8% from the Southern region and the remainder from the Northern region.

Domestic dry gas consumption in 1997 totaled 3.28 billion cfpd, a 210 million cfpd increase (or 6.8%) from the 1996 consumption of 3.07 billion cfpd. PEMEX's own consumption represented approximately 51% of the total domestic dry gas consumption in 1997.

PEMEX imports natural gas to satisfy shortfalls in domestic production and to meet demand in areas of Northern Mexico which, due to the distance from the fields, can be supplied more efficiently by importing natural gas from the United States. PEMEX imported 108.3 million cfpd of natural gas in 1997, a 29.4% increase from the 1996 level of 83.7 million cfpd.

PEMEX obtains and processes both sweet and sour condensates. Sweet condensates are used at the Reynosa facilities of Pemex-Gas and Basic Petrochemicals to produce solvents and leaded gasoline, while sour condensates, which have a higher sulfur content, are used to produce stabilized condensates, such as ethane, propane, butane and certain pentanes. Production of sour condensates amounted to 96,000 bpd in 1997 and 102,000 bpd in 1996. Of these amounts, 86,976 bpd (90.6%) resulted in stabilized condensates during 1997 and 87,006 bpd (85.3%) during 1996. Total production of NGL amounted to 387,760 bpd in 1997 and 418,950 bpd in 1996.

In 1994, Pemex-Gas and Basic Petrochemicals commenced the construction of two facilities at Ciudad PEMEX and one facility at Nuevo PEMEX for the sweetening and stabilizing of condensates in order to increase the production and recovery of NGL by 10%. At the end of 1996, two sweetening liquid plants, each with a capacity of 24,000 bpd, commenced operations at the Ciudad Pemex Gas Processing Complex. In June 1997, a sweetening liquid plant, with a capacity of 24,000 bpd, began operations at the Nuevo Pemex Gas Processing Center. In March 1998, a cryogenic plant, with a 600 million cfpd capacity, began operations at the Nuevo Pemex Gas Processing Center.

On July 26, 1996, three explosions occurred at the Cactus Natural Gas Processing Complex in Reforma, Chiapas, destroying one NGL recovery plant ("Cryogenic Plant No. 2") and damaging another ("Cryogenic Plant No. 1"), each of which had the capacity to process 500 million cfpd of natural gas. The explosions also damaged the system of pipelines connecting these plants with other installations. PEMEX received a total of U.S. $133 million with respect to its insurance claims in connection with the Cactus Natural Gas Processing Complex explosions.

By April 15, 1997, PEMEX's liquids recovery capacity was 330 million cfpd higher than its capacity prior to the explosions, due to the start-up of the 600 million cfpd-capacity Cryogenic Plant No. 1 at the Cactus Natural Gas Processing Complex and the 550 million cfpd-capacity Cryogenic Plant No. 3 at the Nuevo Pemex Gas Processing Center. PEMEX expects the Cryogenic Plant No. 2 at the Ciudad Pemex Gas Processing Complex to be fully operational in the first quarter of 1999.

Refining

PEMEX produces a wide range of oil and natural gas products, including LPG, gasolines, jet fuel, diesel, fuel oil, asphalts, lubricants and other refined products. Production of refined products (excluding NGL and dry gas) totaled 1,226,000 bpd in 1997 as compared to 1,278,000 bpd in 1996. The decrease in production in 1997 is attributable to temporary shutdowns of certain plants for necessary maintenance, delays in the completion of new plants and longer maintenance periods than those previously estimated. PEMEX is one of the major producers of crude oil worldwide that experiences significant domestic demand for its refined products. See "—Commercial Activities" below.

The largest consumers of fuels in Mexico are the *Comisión Federal de Electricidad* (the Federal Electricity Commission or "CFE") and PEMEX. CFE alone consumed approximately 80% of PEMEX's fuel oil production during 1997. Meanwhile, PEMEX consumed approximately 50.1% of its natural gas production during that same year as energy for its own industrial processes and as a raw material in the production of certain refined products and petrochemicals.

At the end of 1997, PEMEX owned and operated six refineries, Cadereyta, Madero, Minatitlán, Salamanca, Salina Cruz and Tula, and one refining unit located in the petrochemical complex of La Cangrejera. PEMEX's refineries are comprised of atmospheric and vacuum distillation units, where the bulk of crude oil input is processed. Secondary processing facilities include desulphurization units and facilities for catalytic cracking, reforming and hydrotreating. During 1997, PEMEX's refineries processed 1.24 million bpd of crude oil.

During 1997, PEMEX imported approximately 127,000 bpd of unleaded gasoline, which represented 30.2% of total domestic demand for unleaded gasoline in that year. Over the last four years, PEMEX's investment program in the area of refining has focused on improving the quality of gasoline and diesel to meet new environmental standards in Mexico, increasing its ability to process heavy crudes and to produce unleaded gasoline and increasing its variable margins (the difference between market prices for petroleum products and variable operating costs), as opposed to increasing its overall production capacity. In the medium-term, however, PEMEX will continue to import unleaded gasoline to satisfy domestic demand.

In 1997, PEMEX added five new refining units: two catalytic plants, each with a capacity of 25,000 bpd, were opened at Cadereyta; two isomerization plants, each with a capacity of 30,000 bpd, were opened at Tula and Salina Cruz; and one alkylation plant with a capacity of 7,700 bpd was opened at Cadereyta. In December 1999, PEMEX currently anticipates opening another alkylation plant with a capacity of 7,700 bpd at Salamanca.

On March 31, 1993, Petróleos Mexicanos, through its subsidiary company P.M.I. Norteamérica, S.A. de C.V., purchased a substantial interest in a refinery located in Deer Park, Texas from Shell Oil Company. P.M.I. Norteamérica, S.A. de C.V. and Shell Oil Company each provides 50% of the refinery crude input and own 50% of its output. The partnership completed a substantial upgrading program in mid-1995.

On March 10, 1998, PEMEX entered into an eight-year crude oil supply agreement (the "Maya Supply Agreement") with Clark USA, Inc. ("Clark"), under which PEMEX expects to supply

Clark between 150,000 and 210,000 bpd of Maya crude oil for refining at Clark's Port Arthur, Texas refinery. Under the Maya Supply Agreement, Clark will maintain 100% ownership of its Port Arthur refinery and will finance completely a new coking unit and related facilities (collectively the "Unit") needed to process the Maya heavy crude oil. The Maya Supply Agreement will go into effect when Clark completes construction of the Unit. The scheduled completion date for the Unit is January 1, 2001.

Pemex-Refining invested approximately Ps. 6,206 million in 1997. Environmental projects comprised Ps. 2,723 million of the total investment, operating projects comprised Ps. 2,524 million and the remaining amount was dedicated mainly to the relocation of loading and storage facilities and the expansion of PEMEX's pipeline system.

Pemex-Refining has budgeted Ps. 8,372 million for investment in 1998, of which 48% will be directed to maintenance and upgrading of refineries, 23% to environmental and industrial safety projects, 10% to the relocation of storage facilities, expansion of the pipeline system and the Salina Cruz docking facilities and marine terminal, and the remaining 19% to acquisitions of equipment, research and development and complementary investments.

On November 17, 1997, Pemex-Refining completed the bidding process for a major project relating to the upgrading and revamping of the Cadereyta refinery, awarding the project to a consortium formed by SK Engineering & Construction Co., Ltd. ("SKEC"), Siemens AG and Triturados Basálticos y Derivados, S.A. de C.V. ("Tribasa"). The Cadereyta project is expected to substantially increase clean fuel production in order to fulfill future demand requirements in Northern Mexico and to comply with future environmental regulations. The plant is expected to be operating by the year 2000.

In addition, Pemex-Refining initiated the bidding process for three major investment projects at the refineries of Madero, Salamanca and Tula, which will focus on increasing PEMEX's capacity for processing heavier crudes and producing distillates in order to meet the projected growth in domestic demand and improving quality and profitability. These investment projects are expected to be completed by June 2001 as a part of a major reconfiguration program for all the refineries (excluding Cadereyta), and will involve total investments estimated at U.S. $3.1 billion.

In January 1998, two refineries at Salamanca and Tula began production and sale of 2% sulphur content fuel oil that meets federal environmental requirements.

The following table sets forth the refining capacity of PEMEX for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(in thousands of barrels per day)				
Primary Distillation					
Madero	195	195	195	195	195
Minatitlán	200	200	200	200	200
Salamanca	240	240	240	240	240
Tula	320	320	320	320	320
Salina Cruz	330	330	330	330	330
Cadereyta	235	235	235	235	235
Total Primary Distillation Capacity	1,520	1,520	1,520	1,520	1,520
Fractionation of Condensates					
Minatitlán	70	70	70	70	70
Poza Rica	22	22	22	22	22
Reynosa	12	12	12	12	12
Cactus(1)	113	113	113	113	113
La Cangrejera(1)	113	113	113	113	113
Nuevo Pemex(1)	113	113	113	113	113
Morelos	113	113	113	113	113
Madero	1	1	1	1	1
Total Condensate Fractionation Capacity	557	557	557	557	557
Total Refining Capacity	2,077	2,077	2,077	2,077	2,077

Note: Numbers may not total due to rounding.
(1) Petrochemical centers.
Sources: Pemex-Refining and Pemex-Gas and Basic Petrochemicals.

As a result of its strategy of investing in technology to improve the quality of its fuels, PEMEX increased its production of unleaded gasoline (including Pemex Premium) by 283,000 bpd in 1997, from 51.6% of total gasoline production in 1996 to 72.9% in 1997. PEMEX has also introduced new products such as Diesel Sin, a low sulfur diesel, which contains 0.05% sulfur, and has encouraged the substitution of current sources of energy with environmentally safer ones. Accordingly, the share of Diesel Sin as a percentage of total diesel produced has increased from 4.6% in 1993 to 88% in 1997. In addition, the electrical sector has begun to use natural gas instead of fuel oil in certain plants, and LPG has been promoted as a substitute fuel for gasoline in vehicles.

The following table shows the average daily production of refined products for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(in thousands of bpd)				
LPG	254.2	266.9	256.9	248.8	215.1
Gasolines(1)	482.5	509.4	492.0	498.2	491.4
Kerosenes	83.8	84.9	77.0	69.1	59.5
Diesel	266.7	284.4	254.8	269.6	275.1
Fuel Oil	419.4	420.0	416.7	418.1	426.3
Others	109.9	110.2	102.8	88.6	84.4
Total	1,616.5	1,675.9	1,600.1	1,592.4	1,555.8

Note: Numbers may not total due to rounding.
(1) Includes naphtha used as industrial raw material for petrochemicals and pentane exports.
Source: PEMEX's February 1998 Indicadores Petroleros.

In January 1993, Pemex-Refining entered into a joint venture with Impulsora Jalisciense, S.A. de C.V., to establish Mexicana de Lubricantes, S.A. de C.V. ("Mexlub"), a company that formulates, bottles, cans and distributes PEMEX's automotive and industrial lubricants and greases. PEMEX has a 49% participation in this venture. Mexlub has contributed to PEMEX's increased participation in the lubricants market both in Mexico and abroad. PEMEX continues to be the sole producer of the basic oils that are used as industrial raw materials in the formulation of greases and lubricants.

Petrochemicals

At the end of 1997, PEMEX operated 121 industrial plants and auxiliary units located in 6 petrochemical complexes and 4 petrochemical units. Pemex-Gas and Basic Petrochemicals operated 61 of these plants and auxiliary units and Pemex-Petrochemicals operated the remaining 60. From 1984 to 1997, the following plants were shut down: the Perchloroethylene, the Methyl Tertiary Butyl Ether and the Oxychlorination II plants at the Pajaritos complex and the Acrylonitrile facility at the Cosoleacaque complex.

PEMEX produces a variety of petrochemicals, including methane and its derivatives such as ammonia and carbon dioxide (44% of total 1997 petrochemical production), ethane and its derivatives (such as ethilene, 26.83% of total 1997 petrochemical production), propylene and its derivatives (3.3% of total 1997 petrochemical production) and aromatics and their derivatives (12.69% of total 1997 petrochemical production) and other products (13.18% of total 1997 petrochemical production).

Total production associated with petrochemical activities, including basic petrochemicals, secondary petrochemicals and other by-products totaled 16.1 million tons in 1997, a decrease of 13.4% from 1996 production of 18.5 million tons. The decrease observed from 1996 to 1997 in the total production of petrochemicals was caused primarily by the reduction in methane and derivatives and aromatics and derivatives. See "—Production" above.

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Pemex-Gas and Basic Petrochemicals and Pemex-Petrochemicals invested approximately Ps. 3,954 million in 1997 (as compared to Ps. 1,651 million in 1996) in projects related to natural gas and condensates processing, transportation and storage. For 1998, these subsidiaries have budgeted Ps. 6,307 million for such investments. These figures include investments intended to increase industrial safety and environmental compliance, investment in plant construction and maintenance, investment in product transportation and investment aimed at increasing operating efficiency.

The following table shows the annual production associated with the petrochemical activities of PEMEX for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(in thousands of tons per year)				
Basic Inputs	5,090	5,385	5,433	4,814	3,684
Gases	4,256	4,329	4,142	3,357	2,807
Ethane	3,530	3,587	3,362	3,042	2,603
Butane	726	742	780	315	204
Liquids	834	1,056	1,291	1,457	877
Pentanes	624	822	1,032	1163	589
Hexanes	75	83	79	81	70
Heptanes	12	13	14	21	19
Carbon Black Feedstocks	123	138	166	192	199
Other Inputs	639	614	603	633	670
Oxygen	490	456	444	476	496
Nitrogen	106	110	110	115	110
Hydrogen	43	48	49	42	64
Petrochemicals	11,065	12,148	12,303	11,902	10,613
Methane Derivatives	5,307	6,058	5,989	6,076	5,205
Ethane Derivatives	3,087	3,048	3,140	3,088	3,089
Aromatics and Derivatives	1,857	2,006	1,981	1,875	1,571
Propylene and Derivatives	538	647	855	796	723
Others	276	389	338	67	25
Other products[1]	981	1,033	1,060	1,110	1,093
Hydrochloric Acid	147	141	135	128	131
Muriatic Acid	23	15	42	61	39
Sulfur	811	877	883	921	923
Total	17,775	19,180	19,399	18,459	16,060

Note: Numbers may not total due to rounding.
(1) By-products obtained during the production of petrochemicals.
Sources: PEMEX's 1995, 1996 and 1997 Memoria de Labores.

PEMEX has a total installed capacity sufficient to produce 20.0 million tpy of the products described above.

Under Mexican law, only PEMEX may produce and engage in the first-hand sale of basic petrochemicals. Before the amendment to the Regulatory Law in November 1996, the Ministry of Energy was responsible for determining which petrochemical products were classified as "basic".

Before 1986, nearly all petrochemicals were classified as basic and, accordingly, PEMEX had a monopoly on the production and first-hand sale of all products so classified. In that regulatory environment, PEMEX expanded its petrochemical division rapidly. From 1986 until November 14, 1996, the number of basic petrochemicals was reduced gradually. On November 14, 1996, the amendment to the Regulatory Law became effective, thereby limiting basic petrochemicals to nine products (down from 34 in 1986 and 19 in 1989) used in the petrochemical production process, such as NGL. The November 1996 amendment further provides that both foreign and domestic private investors may own 100% of any petrochemical plant producing secondary petrochemicals and that companies engaged in the production of secondary petrochemicals which produce basic petrochemicals as by-products may sell them in the production process within plants in the same unit or complex, or deliver them to PEMEX, pursuant to an agreement and under terms established by the Ministry of Energy.

In October 1992, PEMEX and the Government announced their intention to privatize the petrochemical plants owned and operated by Pemex-Petrochemicals. In 1997, the Board of Directors of Petróleos Mexicanos adopted resolutions approving the current secondary petrochemical privatization strategy, which involves the creation of new subsidiaries of Pemex-Petrochemicals to which the assets and liabilities associated with the production of secondary petrochemicals, as well as the real estate related to each complex or plant, will be transferred. Once the affiliated companies are in operation, private sector investors will be invited to participate in up to 49% of their capital and Petróleos Mexicanos will retain, through Pemex-Petrochemicals, 51% of the equity in the new subsidiaries.

When completed, the secondary petrochemical privatization plan will result in the formation of eight variable capital corporations. In 1997, the following seven companies were incorporated: Petroquímica Cosoleacaque, S.A. de C.V., Petroquímica Escolín, S.A. de C.V., Petroquímica Tula, S.A. de C.V., Petroquímica Camargo, S.A. de C.V., Petroquímica Cangrejera, S.A. de C.V., Petroquímica Morelos, S.A. de C.V. and Petroquímica Pajaritos, S.A. de C.V. These seven companies and an additional company that will be incorporated in 1998 will own and operate PEMEX's secondary petrochemical facilities at Cosoleacaque, Escolín (including the assets of Reynosa), Tula, Camargo, La Cangrejera, Morelos, Pajaritos and Independencia.

Commercial Activities

In addition to selling crude oil and natural gas, PEMEX markets a full range of refined products, including gasolines, jet fuel, diesel, fuel oil and petrochemicals. As the supplier of most of the petroleum products consumed in Mexico, PEMEX experiences a strong domestic demand for its products, which in 1996 was equivalent to approximately four-fifths of the domestic demand in France or Italy.[4]

In 1997, PEMEX's sales in domestic and international markets consisted of 1.72 million bpd of crude oil, 1.66 million bpd of refined products (including LPG and pentanes), 1.75 billion cfpd of natural gas and 6.80 million tons of petrochemicals. PEMEX's sales in domestic and international markets in 1996 consisted of 1.54 million bpd of crude oil, 1.57 million bpd of refined products (including LPG and pentanes), 1.67 billion cfpd of natural gas and 7.78 million tons of petrochemicals.

From January to July 1997, the retail price of LPG increased by 2.67%. Beginning August 1997, PEMEX began applying the new formula linked to international reference prices. Accordingly, by the end of 1997 the percentage increase in the retail price for LPG was 31.2%.

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The table below sets forth the real growth rate of domestic prices for selected products sold by PEMEX (excluding the IEPS Tax) for the year ended December 31, 1997.

	Average Price Change 1996-1997
Unleaded Regular (Pemex Magna)	1.8%
Automotive Diesel	4.0%
Jet fuel	(16.2)%
Natural gas for industrial sector	(3.1)%
Fuel Oil #6	(6.6)%

Source: Petróleos Mexicanos.

The following tables show (by product) PEMEX's sales by volume and by value (net of the IEPS Tax) for the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(in thousands, except as provided otherwise)				
Crude Oil (bpd)	1,337.1	1,307.4	1,305.6	1,544.0	1,721.0
Natural Gas (cfpd)(1)	1,379.9	1,450.5	1,570.0	1,669.4	1,752.8
Refined Products (bpd)(2)	1,599.9	1,664.9	1,552.9	1,572.3	1,663.1
Petrochemicals (tpy)(3)	6,782.6	7,621.8	7,519.6	7,780.9	6,798.5

	Year ended December 31, (4)				
	1993	1994	1995	1996	1997
	(in millions of U.S. dollars)				
Crude Oil	$ 6,441.0	$ 6,624.1	$ 7,480.1	$10,705.0	$10,312.5
Natural Gas	1,089.3	1,045.4	819.2	1,347.8	1,623.2
Refined Products	10,821.2	10,675.5	9,826.2	12,248.3	13,566.7
Petrochemicals	1,298.1	1,729.3	1,896.0	1,910.0	1,801.1
Total	$19,649.5	$20,074.4	$ 20,021.5	$26,211.1	$27,303.5

Note: Numbers may not total due to rounding.
(1) In millions.
(2) Includes LPGs and pentanes.
(3) Includes by-products of the petrochemical production process and some insignificant amounts of basic inputs into such process. These figures do not include pentanes.
(4) Does not include crude oil, refined products, petrochemicals and natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.
Source: PEMEX's February 1998 Indicadores Petroleros.

Approximately 42% of the crude oil produced by PEMEX in 1997 was sold in the domestic market in the form of refined products and petrochemicals, and the remainder was exported. In 1997, domestic sales revenues amounted to Ps. 165.3 billion (including the IEPS Tax), or 62.6% of total sales revenues. In 1996, 56.4% of PEMEX's sales revenues (including the IEPS Tax) were obtained in the domestic market, where such sales totaled Ps. 130.8 billion.

The volume of domestic gasoline sales in 1997 increased by 3.6% from 1996 levels, from 482,500 bpd in 1996 to 500,000 bpd in 1997. Due to environmental regulations requiring installation of catalytic converters in all new automobiles starting with the 1993 model year and a price policy aimed to reduce the gap between prices for leaded and unleaded gasoline, sales of unleaded gasoline continued to increase as a percentage of total gasoline sales to an average of

419,000 bpd in 1997, a 43.6% increase over 1996 sales of 291,800 bpd. Meanwhile, sales of leaded gasoline decreased by 58.7%, from 188,800 bpd in 1996 to 78,000 bpd in 1997. By the end of 1997, unleaded gasoline accounted for 84.6% of the value of total gasoline sales. Diesel sales increased by 7.4% from 1996 to 1997, totaling 262,000 bpd in 1997, with the transportation sector accounting for 83.6% of total demand and the industrial, marine, electrical and agricultural sectors accounting for 16.4% of total demand.

Exports and Imports

The PMI Group (as defined in "Management's Discussion and Analysis of Financial Condition and Results of Operations—General—Consolidation") includes PMI Comercio and the PEMEX subsidiaries in charge of international commercial activities, except for natural gas, which is marketed by Pemex-Gas and Basic Petrochemicals. The PMI Group's main objective is to assist in maximizing PEMEX's profitability and optimizing PEMEX's operations through the use of international trade, facilitating the link between PEMEX and the international markets and pursuing new business opportunities in marketing PEMEX's products. The PMI Group manages the international sales of PEMEX's crude oil and petroleum products and acquires in the international markets those petroleum products that PEMEX requires to satisfy domestic demand. Sales and purchases of petroleum products (refined and petrochemical products and LPG) in the international markets are carried out through P.M.I. Trading Ltd. Third-party trading and risk-management activities are also performed by this company. The PMI Group is currently in the process of being restructured in order to maximize cash flow in certain operating subsidiaries.

Crude oil exports are carried out by PMI Comercio, which purchases crude oil from Pemex-Exploration and Production. PMI Comercio was incorporated in 1989. As of December 31, 1997, 97% of PMI Comercio's stock was directly owned by PEMEX and the remaining 3% was owned by *Nacional Financiera, S.N.C.* ("NAFIN") and *Banco Nacional de Comercio Exterior, S.N.C.* ("BANCOMEXT"), both of which are 99%-owned, directly or indirectly, by the Government.

PMI Comercio focuses its marketing effort on strengthening customer relationships by analyzing and understanding specific purchasing patterns, closely monitoring market conditions and reacting promptly to price variations. Its marketing strategy is based on maintaining long-term commercial relationships and customer loyalty. PMI Comercio exported more than 1.7 million bpd of crude oil in 1997, nearly 57% of PEMEX's total production. PMI Comercio exported most of PEMEX's incremental crude oil production for 1997, boosting export volumes by 11.5% over 1996 levels.

As of December 31, 1997, PMI Comercio had 52 customers in 20 countries. In 1997, crude oil exports by volume were distributed as follows:

Country	Percentage of Exports
United States of America	77.95 %
Spain	6.99
Japan	3.64
Netherlands Antilles	3.39
Canada	1.66
Others	6.37
Total	100.00%

Source: PMI Comercio.

Sales prices for Mexican crude oil are based on formulas that vary for each type of crude and for each region in which specific crude oil is sold. These formulas consider market quotations for one or more benchmark crude oil or products and include international market quotations (for these benchmarks) and a constant set by PEMEX's Pricing Committee (which consists of representatives from the Ministry of Energy, *Secretaría de Hacienda y Crédito Público* (Ministry of Finance and Public Credit or "Ministry of Finance"), *Secretaría de Comercio y Fomento Industrial* (Ministry of Commerce and Industrial Development), *Secretaría de Contraloría y Desarrollo Administrativo* (General Comptroller's Office), Banco de México and PEMEX). The pricing formulas differ by consuming regions and the type of crude oil. See "Regulatory Framework and Relationship with the Government".

A significant percentage of crude oil sales are made under evergreen contracts, with a three-month phase-out clause. Most of the remaining quantity exported is sold to customers pursuant to long-term supply contracts, applying the formula included in the aforementioned contracts.

The following table shows the average crude oil prices for oil exported by PEMEX during the five years ended December 31, 1997.

	Year ended December 31,				
	1993	1994	1995	1996	1997
	(U.S. dollars per barrel)				
Weighted Average Price	$13.20	$13.88	$15.70	$18.94	$16.46
Isthmus	15.81	15.33	16.66	20.03	18.19
Maya	11.44	12.57	14.41	17.25	14.65
Olmeca	16.95	16.27	17.51	21.50	19.52

Source: PEMEX's February 1998 Indicadores Petroleros.

The following table sets forth the average unit volume of exports and imports of crude oil, natural gas and petroleum products for the five years ended December 31, 1997.

	Year ended December 31,(1)(2)				
	1993	1994	1995	1996	1997
	(in thousands, except as provided otherwise)				
Exports:					
Crude Oil (bpd)	1,337.1	1,307.4	1,305.6	1,543.9	1,721.0
Refined Products (bpd)	155.9	109.7	118.7	89.7	93.0
Petrochemicals (tpy)	1,324.1	1,559.4	1,226.1	1,146.5	1,062.3
Natural Gas (cfpd)(3)	4.7	19.3	21.4	36.2	36.8
Imports:					
Refined Products (bpd)	176.6	188.7	139.5	174.1	298.8
Petrochemicals (tpy)	86.8	178.1	97.4	90.4	154.4
Natural Gas (cfpd)(3)	96.6	125.1	172.6	83.7	108.3

Note: Numbers may not total due to rounding.
(1) Excludes the activities of P.M.I. Norteamérica, S.A. de C.V.
(2) Does not include crude oil, refined products, petrochemicals and natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.
(3) In millions.
Source: PEMEX's February 1998 Indicadores Petroleros.

The following table sets forth the value of exports and imports of crude oil, natural gas and petroleum products for the five years ended December 31, 1997.

	Year ended December 31,(1)(2)(3)				
	1993	1994	1995	1996	1997
	(in millions of U.S. dollars)				
Exports:					
Crude Oil	$ 6,441.0	$ 6,624.1	$ 7,480.1	$ 10,705.3	$ 10,312.5
Refined Products	827.9	601.7	663.3	708.9	656.6
Petrochemicals	186.3	276.6	247.4	257.3	180.4
Natural Gas	3.4	14.8	12.4	32.0	36.9
Total Exports	$ 7,458.6	$ 7,517.6	$ 8,403.2	$ 11,703.5	$ 11,186.4
Imports:					
Refined Products	$ 1,341.2	$ 1,326.6	$ 1,074.4	$ 1,527.6	$ 2,629.5
Petrochemicals	26.9	57.1	32.2	25.8	26.7
Natural Gas	77.5	82.2	99.1	67.0	93.4
Total Imports	1,445.6	1,465.9	1,205.7	1,619.4	2,749.6
Net Exports	$ 6,013.0	$ 6,051.7	$ 7,197.5	$ 10,084.1	$ 8,436.8

Note: Numbers may not total due to rounding.
(1) Excludes the activities of P.M.I. Norteamérica, S.A. de C.V.
(2) The figures expressed in dollars differ from the amounts contained in the Financial Statements under Net Sales because of the differences in methodology associated with the calculation of exchange rates and other minor adjustments.
(3) Does not include crude oil, refined products, petrochemicals and natural gas purchased by P.M.I. Trading Ltd. from third parties and resold in the international markets.
Source: PEMEX's 1997 Memoria de Labores.

From 1989 through 1997, increasing domestic demand led to a deficit in the petroleum products trade balance. In 1997, PEMEX imported 298,800 bpd of refined products. The largest imports were of gasoline and gasoline components (126,700 bpd) and fuel oil (80,100 bpd). Similar volumes of imports are likely to continue in the short-term since PEMEX is focusing on improving the environmental quality of its products and the capacity to process heavy crude oil, as opposed to increasing overall capacity. Natural gas imports increased by 29%, from 83.7 million cfpd in 1996 to 108.3 million cfpd in 1997. Imports of petrochemical products experienced an important increase from 86,800 tons in 1993 to 178,100 tons in 1994, then declined to 90,400 tons in 1996 and increased again to 154,400 tons in 1997. The 1997 increase was mainly due to a reduction in PEMEX's production of xylenes and a corresponding increase in imports of xylenes, which are used as industrial raw materials in the production of aromatics.

P.M.I. Trading Ltd. engages in hedging operations to cover the variations in the purchase and sale prices for petroleum products. Internal policies establish a limit on the maximum capital at risk; in order to compare the actual figures with the aforementioned limit, capital at risk is calculated daily. Internal controls include a risk comptroller responsible for ensuring compliance, an internal auditing department and a Risk Management Committee. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management and Financial Instruments".

In order to stabilize world crude oil prices, on March 22, 1998, the governments of Mexico, Venezuela and Saudi Arabia announced that the three countries had agreed, beginning on April 1, 1998, to reduce their exports of crude oil by 100,000 bpd, 200,000 bpd and 300,000 bpd, respectively. On June 4, 1998, the same countries announced that they would cut their collective crude output by an additional 450,000 bpd beginning July 1, 1998. Pursuant to the June 4, 1998 agreement, Saudi Arabia will reduce its output by an additional 225,000 bpd, Venezuela by an additional 125,000 bpd and Mexico by an additional 100,000 bpd. Although certain other petroleum-exporting nations have agreed to reduce their crude oil exports, PEMEX cannot predict whether such actions will stabilize world oil prices, and no assurances can be given that oil prices will not drop in the future. Both agreements will be effective until the end of 1998.

Transportation and Distribution

Pipelines owned by PEMEX connect crude oil and natural gas producing centers with refineries and petrochemical plants, and the refineries and petrochemical plants with major cities all over Mexico. At the end of 1997, PEMEX's pipeline network had a length of approximately 55,756 kilometers, which is distributed among the Subsidiary Entities according to the products transported. Of the total network, approximately 4,324 kilometers are crude oil pipelines, approximately 8,353 kilometers are for the delivery of petroleum products and petrochemicals, 9,594 kilometers are for the distribution of natural gas, approximately 1,778 kilometers are for transportation of LPG, 1,190 kilometers are for the transportation of basic petrochemicals and the balance is accounted for by oil and gas gathering pipelines.

During 1997, PEMEX transported approximately 66.5 billion tons-kilometer of crude oil to be processed in the refining system and petroleum products to satisfy domestic demand, 2.3% less than the quantity carried in 1996. Of the total amount of tons-kilometer transported, 62.3% was transported through pipelines, 33.7% through vessels and the balance through railroad tank cars and road tankers.

At the end of 1997, PEMEX owned 20 refined-product-tankers and leased another 13. PEMEX also used the services of 2,640 road tankers during 1997 and owned 78 major wholesale storage centers.

PEMEX's exports of crude oil are generally made on a Free On Board ("FOB") basis. PEMEX exports most of its refined products on a Cost, Insurance and Freight ("CIF") basis and imports most of refined products on an FOB basis, with PEMEX thereby assuming the risk for the transportation of such products.

At the end of 1997, there were 4,050 retail service stations in Mexico, of which 3,856 were privately owned and operated as franchises. Of the remaining 194 stations, PEMEX owned 57 directly while the other 137 were privately owned and awaiting franchises. PEMEX plans to franchise a total of 5,000 retail service stations by the year 2000.

The Regulatory Law was amended effective May 12, 1995 to provide that private and social sector companies (which may be owned by non-governmental, non-Mexican companies or individuals) may participate, upon governmental authorization, in the storage, distribution and transportation of natural gas, and to that end may construct, own and operate natural gas pipelines, installations and equipment. Regulations implementing the Regulatory Law amendment were published on November 8, 1995 and entered into effect on November 9, 1995. The purpose of the amendment is to increase the use of natural gas, particularly among industrial users, which are dependent on fuel oil. Natural gas is a particularly practical substitute for fuel oil due to the low cost of converting existing equipment from fuel oil to natural gas and the existence of significant reserves of natural gas in Mexico. In addition, the increased use of natural gas should promote economies of scale, which will tend to lower its price and enable Mexican industry to comply with the stricter environmental standards effective beginning 1998.

Notwithstanding the amendment to the Regulatory Law, PEMEX retains exclusive authority with respect to the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production. In addition, PEMEX retains exclusive authority over the production of natural gas derivatives classified as basic petrochemicals. PEMEX expects competition from the private sector, mainly in the distribution of natural gas, due to the amendment to the Regulatory Law discussed above; however, it is uncertain whether such competition will be offset by the increased use of natural gas for which PEMEX remains the sole producer.

Under the new regulatory framework, PEMEX maintains an important role in the supply of natural gas given its position as the sole domestic producer. PEMEX is required to apply CRE methodologies for establishing its first-hand sales prices and calculating its transportation rates and must submit such prices and rates to the CRE for approval. Although PEMEX will continue to own and operate certain of its transportation pipelines, PEMEX is required to allow open access of third parties to its transportation system.

The Gradual Open Access Program 1996-1997 approved by the CRE in August 1996 implemented a new regulatory framework. Subsequently, PEMEX allowed private sector access to the domestic market for natural gas as well as opened private sector access to imports of more than 5 million cfpd in Northern Mexico. To that end, the Naco-Hermosillo pipeline was opened for use by the private sector in September 1996 and the first permit for private sector distribution pipelines in Mexicali was granted to the private sector. The Gradual Access Program of 1996-1997 also required PEMEX to sell certain distribution pipelines to the Private Sector. To date, Pemex-Gas and Basic Petrochemicals' pipelines located in the distribution zones in Chihuahua, Cuauhtémoc-Anáhuac, Delicias, Hermosillo, Toluca, Río Pánuco and Norte de Tamaulipas have been sold. The Saltillo and Nuevo Laredo grids have been privatized. Bidding for the geographic zones of Tijuana, Querétaro and El Bajío (Celaya, Salamanca, León and Irapuato) has been initiated. The Distrito Federal, Valle de Cuautitlán-Texcoco, Cd. Juárez and Piedras Negras pipelines will be privatized during 1998.

Employee Matters

At December 31, 1997, PEMEX had 121,220 employees (excluding employees of the PMI Group, as defined below), as compared with 120,945 at December 31, 1996 (including those employed on a temporary basis). Of the total number of PEMEX employees at December 31, 1997, 44,722 (36.9%) were employed by Pemex-Refining, 34,467 (28.4%) by Pemex-Exploration and Production, 12,488 (10.3%) by Pemex-Petrochemicals, 12,507 (10.3%) by Pemex-Gas and Basic Petrochemicals and 17,036 (14%) by Petróleos Mexicanos. At December 31, 1997, the PMI Group had 285 employees.

Approximately 76.8% of PEMEX's work force is represented by the *Sindicato de Trabajadores Petroleros de la República Mexicana* (Petroleum Workers' Union or the "Union"). The leaders of the Union are PEMEX employees and are elected by the members of the Union. Since the Union's official establishment in 1938, PEMEX has experienced no labor strikes. During such period, PEMEX has experienced work stoppages for short periods of time, none of which has had a significant material adverse effect on its operations.

PEMEX's relationship with its employees is regulated by the *Ley Federal del Trabajo* (Federal Labor Law) and the *Contrato Colectivo* (Collective Bargaining Agreement) between PEMEX and the Union. The Collective Bargaining Agreement regulates extensively all aspects of PEMEX's relationship with its employees. The Collective Bargaining Agreement is subject to renegotiation every two years, although salaries are reviewed annually. The present Collective Bargaining Agreement was renewed effective August 1, 1997 and will expire on July 31, 1999. Wages increased 17% in 1998 and 19% in 1997, in line with the Government's price and wage accords.

In accordance with the Collective Bargaining Agreement and the Federal Labor Law, PEMEX is under an obligation to pay seniority premiums to retiring employees and pension and death benefits to retired employees. Retirees are entitled to receive increases in their pensions whenever salary increases are granted to current employees. PEMEX also provides health and medical benefits to employees, retired employees and their families and, subject to PEMEX's overall budgetary constraints, provides an interest rate subsidy on employees' mortgage loans.

Pursuant to the authorizations of the Ministry of Finance and of the Board of Directors of Petróleos Mexicanos dated November 5, 1997, Petróleos Mexicanos and its Subsidiary Entities formed a new trust called the *Fondo Laboral Pemex* (Pemex Labor Fund or "FOLAPE"). FOLAPE was established to create a vehicle to fund labor liabilities, as well as the payment of pensions in effect and seniority premiums. The initial contribution to this fund, which amounted to Ps. 2,249 million, took place in December 1997. Furthermore, a contribution plan will be designed to permit the increase in the funds held in this trust and to continue to make payments for outstanding liabilities. Under this new scheme, beginning in 1998 the payment of obligations in effect for retirement benefits will be undertaken by the new fund.

Corporate Division of Industrial Safety

In November 1996, PEMEX created a Corporate Division of Industrial Safety, which plans, conducts and coordinates programs for the safety of its workers and facilities, for the reduction of risks to the surrounding populations and for the protection of the environment. Through this division, PEMEX intends to develop further the industrial safety and environmental programs for each Subsidiary Entity. Each Subsidiary Entity reports directly to the Corporate Division of Industrial Safety.

Insurance

PEMEX maintains general liability insurance and insurance against environmental risks. PEMEX also maintains insurance to cover potential civil liabilities arising from accidents in compliance with Mexican law as required by international conventions to which Mexico is a party.

Legal Proceedings

PEMEX, in the ordinary course of its business, is a party to various legal actions, including those involving labor claims of former and present employees. These labor disputes relate to severance payments, life insurance benefits, extensions of labor contracts, level of wages, improper termination and employee housing. PEMEX does not expect these lawsuits to have a material adverse effect on its financial condition or future results of operation.

REGULATORY FRAMEWORK AND RELATIONSHIP WITH THE GOVERNMENT

The operations of PEMEX are subject to close regulation and supervision by the Government. Its activities are monitored by the Ministry of Energy, the Secretary of which acts as the Chairman of the Board of Directors of Petróleos Mexicanos. The General Comptroller's Office is responsible for the appointment of PEMEX's external auditors. PEMEX's annual budget and its annual financing program must be approved by the Ministry of Finance. PEMEX's annual budget and annual financing program are subsequently incorporated into the budget of the Government and are subject to approval by the Mexican Congress. The Government is not, however, liable for the financial obligations incurred by PEMEX. PEMEX's activities are also subject to regulation by federal and state environmental authorities. See "—Environmental Regulation" below.

Formulas used to set crude oil export prices and prices of petroleum products sold domestically are set by committees composed of PEMEX officials and representatives of various governmental agencies (including, among others, the Ministry of Finance, the Ministry of Energy, the General Comptroller's Office and the Ministry of Commerce and Industrial Development).

Formulas for determining crude oil export prices are based on international reference prices and a constant that is set according to specific market conditions. Export prices of petroleum products and natural gas are determined by market conditions and direct negotiations with clients.

In setting the price formulas for PEMEX's products sold domestically, the pricing committees pursue the following objectives: (i) consumer and producer prices should reflect opportunity costs in the relevant international markets; (ii) subsidies and premiums should be avoided; (iii) producer and consumer prices should be differentiated to send the correct economic signals to producers and consumers; (iv) the price-setting mechanism should be transparent, lending itself to the use of formulas; and (v) prices should be consistent with macro-economic targets of PEMEX and the Government. Because the retail prices of certain products, such as gasoline, are generally set by the pricing committees prior to the beginning of each fiscal year in conjunction with the preparation of the Government's budget for the year, in late 1997 and early 1998, the Mexican retail prices for these products were, except in border regions, substantially higher than international prices, which fell sharply during that period.

The Government and PEMEX pursue a policy that keeps domestic wholesale prices generally in line with international prices. Accordingly, the prices for PEMEX's domestic products are determined as follows: international prices are used as reference prices, but are adjusted to reflect opportunity costs, transportation expenses and differences in the quality of PEMEX's products relative to international benchmarks, to arrive at Mexican wholesale prices. The VAT, retailer's margin and freight costs are added to reach the retail price to consumers.

Special conditions prevail for setting the price formula for gasoline and diesel. The consumer prices for gasoline and diesel—which are determined by the Ministry of Finance—reflect the addition of the indirect IEPS Tax (which PEMEX collects on behalf of the Government) as well as the VAT. The IEPS Tax is currently only being charged on gasoline, diesel and natural gas for automotive uses, but not on other products. For further discussion of the IEPS Tax, see "—Taxes and Duties" below.

Natural gas prices for domestic sale are calculated according to directives published on March 20, 1996 by the CRE. They reflect gas opportunity costs, competitive conditions in international markets and the location where the sale is made.

Under the Organic Law and related regulations, Petróleos Mexicanos is entrusted with the central planning and strategic management of Mexico's petroleum industry, and PEMEX (with the exception of Pemex-Petrochemicals) is granted the exclusive authority to conduct (i) the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil, (ii) the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production and (iii) the production, storage, transportation, distribution and first-hand sale of the derivatives of petroleum (including petroleum products) and of natural gas used as basic industrial raw materials that are considered basic petrochemicals. The North American Free Trade Agreement ("NAFTA") among the governments of Mexico, the United States and Canada did not affect PEMEX's exclusive rights described above. By 2004, however, the NAFTA will phase in lower tariffs on certain petroleum products, including petrochemicals, and certain materials and equipment imported by PEMEX into Mexico as well as lower tariffs on crude oil and petroleum products exported by PEMEX to the United States and Canada. To the extent that domestic and international prices for PEMEX's products remain constant, lower tariffs on products, materials and equipment imported by PEMEX into Mexico or exported by PEMEX to the United States and Canada will decrease PEMEX's expenses and increase its income.

Lower tariffs on exports of secondary petrochemicals from the United States and Canada to Mexico could, over time, increase competition in the secondary petrochemicals industry in Mexico.

In addition, the Government has initiated a strategy to expand investment in the petrochemical sector by increasing private investment and permitting greater private involvement in the management of this sector. See "Business—Petrochemicals".

The following table compares the average prices in Mexico and in the United States of certain products sold by PEMEX in Mexico during the years indicated.

	1993		1994		1995		1996		1997	
	Mexico	U.S.	Mexico	U.S.	Mexico	U.S.	Mexico	U.S.	Mexico	U.S.
Oil Products										
Unleaded regular gasoline[1]	$ 65.33	$ 42.84	$ 62.75	$ 42.98	$ 47.01	$ 45.60	$ 52.73	$ 48.32	$ 61.82	$ 47.61
Premium gasoline[1]							67.57	56.70	68.17	55.04
Jet Fuel [2]	22.44	22.26	20.83	20.67	19.63	20.79	26.48	25.57	23.68	23.20
Kerosene[3]	41.08	24.37	42.97	22.42	34.12	22.68	38.93	27.32	32.07	25.82
Natural Gas[4]										
Industrial	2.18	2.97	1.94	2.94	1.47	2.61	2.21	3.30	2.44	3.48
Residential	3.69	6.46	4.38	6.66	2.88	6.49	3.57	6.44	4.06	7.01
Selected Petrochemicals[5]										
Ammonia[5]	114.35	129.14	157.47	188.61	132.90	218.84	186.03	205.85	167.63	184.96
Polyethylene L.D. [6]	786.86	798.94	837.49	887.51	959.79	1,097.75	1,057.82	1,021.25	1,083.52	1,131.69
Polyethylene H.D. [7]	644.20	712.60	787.23	838.78	899.65	1,035.94	982.54	935.64	1,059.53	1,042.59
Styrene[8]	526.65	511.87	735.89	696.97	837.48	966.02	618.61	672.07	648.02	579.49

(1) In U.S. dollars per barrel. Prices to final consumers, including taxes. Premium price in Mexico City. U.S. prices for Houston, Texas. *Sources: Pemex-Refining and Lundberg Retail Price Survey (Lundberg Survey Inc.).*

(2) In U.S. dollars per barrel. Mexican prices at the gate of the refineries. U.S. spot prices in Houston, Texas (Jet Fuel Gulf Coast Waterborne). *Sources: Pemex-Refining and Platt's U.S. Market Scan (McGraw-Hill Company).*

(3) In U.S. dollars per barrel. In both countries, prices to final consumers. Mexico prices include taxes, while U.S. prices exclude them. *Sources: Pemex-Refining and Petroleum Marketing Monthly published by the Energy Information Administration (DOE) (Kerosene Type Jet Fuel, end users).*

(4) In U.S. dollars per thousand cubic feet. Excluding taxes. Mexico prices for Mexico City and surrounding areas. Industrial prices to additional volumes with notification. Residential prices reflects the specific cost of transportation and distribution in that area. U.S. prices are national average industrial prices and Texas residential prices. *Sources: Pemex-Gas and Basic Petrochemicals and Petroleum Marketing Monthly published by the Energy Information Administration (DOE).*

(5) In U.S. dollars per ton. Prices exclude taxes. Mexico prices to contract users at Cosoleacaque Petrochemical Plant. U.S. spot prices in Tampa, Florida. *Sources: Pemex-Petrochemicals Fertecon Weekly Ammonia Fax (Fertecon Limited) and Fertilizer Market Bulletin (FMB Consultants Ltd.).*

(6) In U.S. dollars per ton. Film quality. Prices exclude taxes. Mexico prices to spot consumers. U.S. domestic contract average. *Sources: Pemex-Petrochemicals and ICIS-LOR (Icis-Lor Group Ltd.).*

(7) In U.S. dollars per ton. Block Molding Quality. Prices exclude taxes. Mexico prices to spot consumers. U.S. contract prices. *Sources: Pemex-Petrochemicals and ICIS-LOR (Icis-Lor Group Ltd.).*

(8) In U.S. dollars per ton. Prices exclude taxes. Mexico prices to spot consumers. U.S. average of contract and spot prices. *Sources: Pemex-Petrochemicals and ICIS-LOR (Icis-Lor Group Ltd.).*

Equity and Dividends

In March 1990, as a result of the implementation of the 1989-92 Financing Package for Mexico, U.S. $7.58 billion worth of Petróleos Mexicanos' external indebtedness with international commercial banks was exchanged for 30-year Collateralized Fixed Rate Bonds Due 2019 and Collateralized Floating Rate Bonds Due 2019 ("Brady Bonds") issued by the Government. At the same time, Petróleos Mexicanos' indebtedness to the Government was increased by the same amount; the new indebtedness was denominated in currencies other than pesos. In December 1990 the Government and Petróleos Mexicanos agreed to capitalize this indebtedness in the form of equity securities named *certificados de aportación* "A" (certificates of contribution "A", or "CAPs"). As a condition of this capitalization, Petróleos Mexicanos agreed to pay a minimum guaranteed dividend to the Government equal to the debt service on the capitalized debt. The total dividend on the CAPs is approved annually by the Board of Directors of Petróleos Mexicanos after the closing of each fiscal year, although an amount equal to the minimum guaranteed dividend is paid to the Government in monthly advance payments during the year. During 1993, 1994, 1995, 1996 and 1997, Petróleos Mexicanos made advance payments to the Government in the aggregate of Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively, towards the minimum guaranteed dividends for those years. The total dividends paid by Petróleos Mexicanos to the Government relating to the CAPs for the 1993, 1994, 1995, 1996 and 1997 fiscal years amounted to Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million, Ps. 6,782 million and Ps. 5,804 million, respectively.

In December 1997, the Board of Directors of Petróleos Mexicanos and the Government agreed to an equity reduction of CAPs in exchange for a cash payment to the Government of Ps. 12.118 billion (U.S. $1.5 billion). The Ministry of Finance, acting on behalf of the Government, has agreed to a reduction in the minimum guaranteed dividend payable in 1998, 2001 and certain future years. See Note 13 to the Financial Statements.

Taxes and Duties

Instead of paying the income and assets taxes applicable to all Mexican private sector companies, until 1992 PEMEX was subject to a special hydrocarbon extraction duty imposed by the Government. This duty was set as a percentage of revenues and was meant to incorporate a royalty payment for the extraction of hydrocarbons, an income tax and a dividend to its sole owner, the Government.

The rate at which PEMEX's special duty is assessed has varied from year to year. The duty estimate generally has been set after taking into consideration PEMEX's operating budget, its capital expenditure program and its financing needs.

With a view towards providing PEMEX with a more stable fiscal regime, starting in 1993 the Ministry of Finance established a new fiscal regime for PEMEX. For 1998, under the new fiscal regime, PEMEX, in addition to being subject to the payment of all taxes and contributions set forth by the Ministry of Finance (other than the corporate income tax and the asset tax), must pay the following direct and indirect taxes and duties:

Hydrocarbon Extraction Duty – This duty is paid by Pemex-Exploration and Production only. A rate of 52.3% is applied to the net cash flow which results from deducting all cash expenditures (including operating expenses and capital expenditures) from cash revenues generated by Pemex-Exploration and Production by way of sales of goods and services.

Extraordinary Hydrocarbon Extraction Duty – This duty is paid by Pemex-Exploration and Production only. It is calculated on the same basis as the Hydrocarbon Extraction Duty, using a tax rate of 25.5%.

Additional Hydrocarbon Extraction Duty – This duty is paid by Pemex-Exploration and Production only. It is calculated on the same basis as the Hydrocarbon Extraction Duty, using a tax rate of 1.1%.

Hydrocarbon Income Tax – Petróleos Mexicanos pays this direct tax on behalf of itself and the Subsidiary Entities. This tax is equivalent to the regular income tax applied to all Mexican corporations, to which PEMEX is not subject. A tax rate of 34% is applied to net income (determined in accordance with the Income Tax Law) of each of Petróleos Mexicanos and the Subsidiary Entities. Petróleos Mexicanos and the Subsidiary Entities may determine this tax on a consolidated basis.

IEPS Tax – (*Impuesto Especial sobre Producción y Servicios* or Special Tax on Production and Services) – This indirect tax is collected on behalf of the Government by Pemex-Refining and Pemex-Gas and Basic Petrochemicals and is applied to sales of gasolines, diesel and natural gas for automotive use. The IEPS Tax on the sale of gasolines and diesel is equivalent to the difference between the international reference price of each product (adjusted by freight costs and quality factors) and the retail price of such product to its customers (not including VAT, the retailers' margin and freight costs), which is fixed by the Ministry of Finance. Thus, the Government ensures that PEMEX retains an amount reflecting the international prices (adjusted as described above) of these products, while the Government collects the difference between the international prices and the prices at which such products are sold in Mexico. The IEPS Tax in respect of sales of natural gas for automotive use, which does not represent a substantial revenue to the Government, is based on a variable percentage, taking the international reference price of this product but also the reference of the retail price of the unleaded gasoline.

The sum of the Hydrocarbon Extraction Duty, the Extraordinary Hydrocarbon Extraction Duty, the Additional Hydrocarbon Extraction Duty, the Hydrocarbon Income Tax and the IEPS Tax (collectively, the "Taxes and Duties") must equal the Hydrocarbon Duty. This duty is calculated by applying a rate of 60.8% to the hydrocarbons sales revenues of the Subsidiary Entities to third parties, including the IEPS Tax generated by Pemex-Refining, but excluding the VAT. PEMEX makes advance payments to the Government in respect of its liability under the Taxes and Duties up to the amount of the Hydrocarbon Duty. PEMEX's advance payments are, in turn, credited against PEMEX's liability under the Hydrocarbon Extraction Duty, the Extraordinary Hydrocarbon Extraction Duty, the Additional Hydrocarbon Extraction Duty, the Hydrocarbon Income Tax and the IEPS Tax.

In the event that the sum of the Taxes and Duties is not equal to the Hydrocarbon Duty, the rates of the Hydrocarbon Extraction Duty and the Extraordinary Hydrocarbon Extraction Duty will be adjusted to ensure that the sum becomes equal to the Hydrocarbon Duty.

Excess Gains Revenue – This is an administrative duty payable to the Government in addition to the Hydrocarbon Duty and is calculated as an additional 39.2% of revenues in respect of export crude oil sales at prices in excess of a threshold crude oil price of U.S. $15.50 per barrel, which has been effective January 1, 1998. The Government has not reduced that threshold price despite downward revisions to other Government Mexican crude oil price assumptions. However, PEMEX can provide no assurances that the Government will not revise this threshold price in the future.

Since 1994, interest payments by PEMEX on its external debt have not been exempt from withholding taxes. In the fiscal year of 1994, payments made by PEMEX to the Government in respect of withholding taxes were credited against PEMEX's tax liability, but for the years 1995 to 1998, such credit has not been permitted. However, withholding taxes do not represent a substantial proportion of PEMEX's total tax liability.

Beginning in 1995, PEMEX has been subject to municipal and state taxes, such as real property and payroll taxes. Real property taxes do not represent substantial portions of PEMEX's total fiscal charge, as most of PEMEX's properties are located on federal property, which is not subject to municipal taxation. Similarly, payroll taxes do not represent a substantial portion of PEMEX's total tax liability.

In 1997, seven companies created in connection with the privatization of PEMEX's secondary petrochemicals businesses began operations as independent entities. These companies are subsidiaries of Pemex-Petrochemicals, which at the completion of the privatization of PEMEX's secondary petrochemical activities, expects to retain 51% of the equity in each company. See "Business—Petrochemicals". Their fiscal regime is like that of any Mexican private sector corporation, and their main tax obligations are: Federal taxes (income tax, VAT, assets tax and import taxes) and state and municipal taxes (payroll tax and real property tax).

Environmental Regulation

PEMEX is subject to the provisions of the *Ley General de Equilibrio Ecológico y Protección al Ambiente* (General Law on Ecology and Protection of the Environment, or the "Environmental Law"), the regulations issued thereunder and several technical environmental norms issued by the *Secretaría de Medio Ambiente, Recursos Naturales y Pesca* (Ministry of the Environment, Natural Resources and Fisheries or "SEMARNAP"), which is the federal ministry in charge of supervising and regulating environmental matters relating to PEMEX. The SEMARNAP is assisted in its functions by other governmental authorities such as the *Secretaría de Salud* (Ministry of Health), the *Secretaría de Comunicaciones y Transportes* (Ministry of Transportation and Communications), the *Secretaría de Marina* (Ministry of the Navy) and the Ministry of Energy. In addition, it is subject to the environmental laws and regulations issued by the governments of each of the states of Mexico where its facilities are located.

The Environmental Law and regulations thereunder require that authorizations be obtained from SEMARNAP prior to carrying out any activity that may have an adverse effect on the environment. In particular, these environmental regulations address chemical, petrochemical, oil refining and extraction activities, as well as the construction of oil and gas pipelines. Before authorizing a new project, SEMARNAP requires the submission of an environmental impact analysis and any other information that it may request. SEMARNAP is entitled to grant or deny its authorization of any activity.

Since the enactment of the Environmental Law, several technical environmental regulations have been enacted. These regulations are applicable to Mexican industry in general, including PEMEX, and specifically set forth, among other matters, permissible levels of emissions, water discharges and hazardous substances discharges as well as atmospheric pollution level limits. Other technical regulations are issued for specific industries. Some have been issued with respect to the oil and petrochemical industries, setting forth maximum permissible levels and procedures to be followed for determining the level of polluting substances in residual water discharges and gas emissions derived from those industries. The Mexican environmental regulatory framework is generally updated and revised annually and PEMEX participates with the Government in developing environmental regulations that are related to its activities.

In April 1997, the SEMARNAP issued regulations regarding the procedures for obtaining a *Licencia Ambiental Unica* (the Sole Environmental License or "LAU"), under which new industrial facilities can comply with all applicable environmental requirements by way of a single administrative procedure. The LAU integrates all different permits, licenses and authorizations related to environmental matters. PEMEX must obtain a LAU for any new facilities, while existing facilities are not subject to this obligation.

Federal and state authorities in Mexico are authorized to inspect any facility to determine compliance with the Environmental Law, local environmental laws, regulations and technical environmental regulations. Violations or non-compliance with the legal provisions may result in the application of considerable fines, temporary or permanent shutdown of a facility, required capital expenditures to minimize the effect of PEMEX's operations on the environment, cleanup of contaminated land and water, cancellation of a concession or revocation of authorization for carrying out certain activities and, in certain cases, criminal prosecution of employees and individuals.

PEMEX believes that it is currently in substantial compliance with current federal and state environmental laws as such laws have been historically interpreted and enforced. Petróleos Mexicanos maintains an organizational structure that permits it to implement and monitor its environmental program. The Subsidiary Entities have specialized departments, which vary in accordance with the size and geographic distribution of their respective sites, to implement their own environmental programs and environmental audits on their sites and their immediate surroundings based on the *Términos de Referencia* (Reference Terms) of the SEMARNAP and to undertake the necessary actions to correct the deficiencies that are detected.

The Corporate Division of Industrial Safety Systems, created in 1996, developed PEMEX's Industrial Safety Management System. In addition, the Corporate Planning Division developed PEMEX's Integral Environmental Management System. The Board of Directors of Petróleos Mexicanos joined these efforts and introduced a single system for both purposes. As a result, Petróleos Mexicanos has structured the *Sistema Integral de Administración de Seguridad y Protección Ambiental* (the Integral Safety and Environmental Management System or "SIASPA") to be implemented during the second half of 1998.

Prior to 1993, the identification of environmental matters was done by each of PEMEX's operating plant acting individually. In 1993, partly as a result of the enactment of new environmental laws and regulations by the Government, PEMEX began to develop an internal structure to better identify and solve environmental problems. In connection with this new structure, PEMEX has contracted external engineers to perform operational audits that will include environmental assessments of the sites being audited. The assessments include cost estimates for remedying any shortfall in compliance with Mexican environmental laws. Once the audits are completed, they are sent to the Government for approval. Once approved by the Government, PEMEX negotiates an agreement with the Government stipulating the time period, amounts to be expended and the steps to be taken to bring each site into compliance. As a result of this program, *Planes de Acciones Correctivas* (Corrective Action Plans) have been coordinated with the *Procuraduría Federal de Protección al Ambiente* (Federal Attorney for Environmental Protection or "PROFEPA") for the audited sites.

There are currently no material legal or administrative proceedings pending against PEMEX with respect to any environmental matters, and management does not believe that continued compliance with environmental laws will have a material adverse effect on PEMEX's financial condition or results of operations.

During 1997, PEMEX invested Ps. 2,690 million for environmental projects as compared to Ps. 3,311.8 million in 1996. For 1998, PEMEX has budgeted Ps. 2,367 million for environmental projects. The most important of these projects has been directed to the modernization of installations, the implementation of systems and control mechanisms to monitor atmospheric pollution, the acquisition of equipment to address the contingencies of hydrocarbon spills, the expansion of aquatic effluent systems, the restoration and reforestation of affected areas, studies for environmental investigation and the conduct of environmental audits. In addition, PEMEX has engaged in extensive research and development efforts to develop capacity for increased production of unleaded gasoline, diesel and fuel oil with lower sulfur content and alternative fuels, such as industrial oil gas and natural gas. Currently, PEMEX is developing a procedure to determine the costs and expenses attributable to its activities associated with industrial safety and environmental management.

PEMEX does not expect that the cost of maintaining compliance with environmental laws or environmental requirements related to the NAFTA or Mexico's membership in the Organization for Economic Cooperation and Development (the "OECD") will cause a significant increase in PEMEX's environmental expenditures.

MANAGEMENT

Petróleos Mexicanos is governed by its Board of Directors, which has eleven members. Six members, including the Chairman of the Board and its Director General are appointed by the President of Mexico. The remaining five Directors are selected by the Union from among PEMEX's employees. Alternate Directors are authorized to serve on the Board of Directors in place of Directors who are unable to attend meetings or otherwise participate in the activities of the Board of Directors.

Each of the Subsidiary Entities is governed by an eight-member Board of Directors, consisting of the Director General of Petróleos Mexicanos, the Director General of each of the other three Subsidiary Entities and four Directors appointed by the President of Mexico. The Director General of Petróleos Mexicanos serves as Chairman of the Board of each Subsidiary Entity. Neither the members of the Boards of Directors nor the Executive Officers are appointed for a specific term. The members of the Boards of Directors and the Directors General serve subject to the discretion of the President.

The following are the Board Members and Executive Officers of PEMEX as of July 31, 1998:

Name	Position	Year Appointed
	PETROLEOS MEXICANOS	
Board of Directors		
Mr. Luis Téllez Kuenzler	Chairman of the Board of Directors of Petróleos Mexicanos and Secretary of the Ministry of Energy	1997
Mr. José Angel Gurría Treviño	Secretary of the Ministry of Finance	1998
Mr. Herminio Blanco Mendoza	Secretary of the Ministry of Commerce and Industrial Development	1994
Mrs. Rosario Green Macías	Secretary of the Ministry of Foreign Affairs	1998
Mrs. Julia Carabias Lillo	Secretary of the Ministry of the Environment, Natural Resources and Fisheries	1994
Mr. Rogelio Gasca Neri	Director General of the Federal Electricity Commission	1994
Mr. Ramón Hernández Toledo	Union Representative	1992
Mr. Pablo Pavón Vinales	Union Representative	1992
Mr. Antonio Barajas Velarde	Union Representative	1993
Mr. Jesús Olvera Méndez	Union Representative	1995
Mr. Calixto Javier Rivera Díaz	Union Representative	1995
Executive Officers		
Mr. Adrián Lajous Vargas	Director General	1994
Mr. Juan Manuel Romero Ortega	Corporate Director of Finance	1995
Mr. Emilio Marco Aguilar	Deputy Director of Programming and Budget	1996

Mr. Cristóbal S. Gutiérrez Ponce	Deputy Director of Financial Information Systems	1998
Mr. Raúl Esquerra Castañeda	Deputy Director of the Assets Streamlining Unit	1995
Mr. Alfredo Márquez y López	Deputy Director of Finance and Treasury	1998
Mr. Manuel Gomezperalta Damirón	Corporate Director of Administration	1998
Mr. Julio Pindter González	Deputy Director of Labor Relations	1993
Mr. Arturo Pueblita Pelisio	Deputy Director of Services	1998
Mr. Rafael Fernández de la Garza	Deputy Director of Industrial Safety Systems	1997
Mr. Gerardo Rueda Rábago	Corporate Comptroller General	1997
Mr. Raoul Capdevielle Orozco	Deputy Comptroller of Normativity	1997
Mr. Manuel Vázquez Bustillos	Deputy Comptroller of Auditors	1997
Mr. Fernando Flores Macías	Deputy Comptroller of Evaluation and Control	1997

PEMEX-EXPLORATION AND PRODUCTION

Board of Directors

Mr. Adrián Lajous Vargas	Chairman of the Board of Directors of Pemex-Exploration and Production (refer to Petróleos Mexicanos)	1994
Mr. Jaime Mario Willars Andrade	(refer to Pemex-Refining)	1995
Mr. Marcos Ramírez Silva	(refer to Pemex-Gas and Basic Petrochemicals)	1996
Mr. Armando Leal Santa Ana	(refer to Pemex-Petrochemicals)	1998
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance	1994
Mr. Antonio Azuela de la Cueva	Federal Attorney for the Environmental Protection	1997
Mr. Leopoldo Gómez González	Undersecretary of Energetic Operation of the Ministry of Energy	1997
Mr. Raúl Ramos Tercero	Undersecretary of Standardization and Services for Industry and Foreign Trade	1997

Executive Officers

Mr. José A. Ceballos Soberanis	Director General	1995
Mr. Antonio Acuña Rosado	Director of Cantarell Project	1998
[Vacant]	Deputy Director — Northeastern Marine Region	
Mr. Maclovio Yáñez Mondragón	Deputy Director — North Region	1995
Mr. Oscar Romero López	Deputy Director of Commercial Operations	1996
Mr. Héctor Leyva Torres	Deputy Director — Southwestern Marine Region	1997
Mr. Miguel Angel Rivera Villaseñor	Deputy Director of Management and Finance	1995
Mr. Pablo Cruz Helú	Deputy Director of Exploration Strategies	1996
Mr. Carlos Rasso Zamora	Deputy Director of Drilling and Well Maintenance	1997
Mr. Horacio Guevara Montalvo	Deputy Director of Planning	1997
Mr. Carlos A. Morales Gil	Deputy Director - South Region	1998
Mr. Guillermo Domínguez Vargas	Deputy Director of Technology and Professional Development	1996

PEMEX-REFINING

Board of Directors

Mr. Adrián Lajous Vargas	Chairman of the Board of Directors of Pemex-Refining (refer to Petróleos Mexicanos)	1994
Mr. José Antonio Ceballos Soberanis	(refer to Pemex-Exploration and Production)	1995
Mr. Marcos Ramírez Silva	(refer to Pemex-Gas and Basic Petrochemicals)	1996
Mr. Armando Leal Santa Ana	(refer to Pemex-Petrochemicals)	1998
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of the Environment, Natural Resources and Fisheries	1997
Mr. Leopoldo Gómez González	Undersecretary of Energetic Operation of the Ministry of Energy	1997
Mr. Raúl Ramos Tercero	Undersecretary of Standardization and Services for Industry and Foreign Trade	1997

Executive Officers

Mr. Jaime Mario Willars Andrade	Director General	1995
Mr. Armando Leal Santa Ana	Deputy Director of Production	1995
Mr. Emilio Aguado Calvet[5]	Deputy Director of Trading	1995
Mr. Pedro Carlos Gómez Flores	Deputy Director of Distribution	1994
Mr. Rudy Omar Albertos Cámara	Deputy Director of Management and Finance	1995
Mr. Guillermo Ruiz Gutiérrez	Deputy Director of Planning and Evaluation	1994
Mr. Eduardo Vergara Cabrera	Deputy Director of Projects	1996

PEMEX-GAS AND BASIC PETROCHEMICALS

Board of Directors

Mr. Adrián Lajous Vargas	Chairman of the Board of Directors of Pemex-Gas and Basic Petrochemical (refer to Petróleos Mexicanos)	1994
Mr. José Antonio Ceballos Soberanis	(refer to Pemex-Exploration and Production)	1995
Mr. Jaime Mario Willars Andrade	(refer to Pemex-Refining)	1995
Mr. Armando Leal Santa Ana	(refer to Pemex-Petrochemicals)	1998
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of the Environment, Natural Resources and Fisheries	1997
Mr. Leopoldo Gómez González	Undersecretary of Energy Operations of the Ministry of Energy	1997
Mr. Decio de María Serrano	Undersecretary of Industry and Foreign Trade Promotion	1994

5 Mr. Emilio Aguado Calvet is the brother-in-law of Mr. Eduardo Martínez del Río, the Director General of PMI Comercio.

Executive Officers

Mr. Marcos Ramírez Silva	Director General	1996
Mr. Roberto Ramírez Soberón	Deputy Director of Planning	1995
Mr. Salvador García-Luna Rodríguez	Deputy Director of Liquefied Gas and Basic Petrochemicals	1996
Mr. Luis Felipe Luna Melo	Deputy Director of Natural Gas Commercialization	1996
Mr. Jesús Alfredo Sánchez Sánchez	Deputy Director of Management and Finance	1997
Mr. Armando Arenas Briones	Deputy Director of Production	1996
Mr. Claudio Urencio Castro	Deputy Director of Pipelines	1996

PEMEX- PETROCHEMICALS

Board of Directors

Mr. Adrián Lajous Vargas	Chairman of the Board of Directors of Pemex-Petrochemicals (refer to Petróleos Mexicanos)	1994
Mr. José Antonio Ceballos Soberanis	(refer to Pemex-Exploration and Production)	1995
Mr. Jaime Mario Willars Andrade	(refer to Pemex-Refining)	1995
Mr. Marcos Ramírez Silva	(refer to Pemex-Gas and Basic Petrochemicals)	1996
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of the Environment, Natural Resources and Fisheries	1997
Mr. Leopoldo Gómez González	Undersecretary of Energetic Operation of the Ministry of Energy	1997
Mr. Raúl Ramos Tercero	Undersecretary of Standardization and Services for Industry and Foreign Trade	1997

Executive Officers

Mr. Armando Leal Santa Ana	Director General	1998
Mr. Mario Hugo González Petrikowsky	Deputy Director of Planning	1998
Mr. Candelario Fuentes Díaz de León	Deputy Director of Management and Finance	1998
Mr. Carlos López Blumenkron	Deputy Director of Programming and Technical Services	1998

DESCRIPTION OF NEW NOTES AND NEW BONDS

The following summary of certain terms of the New Notes and the New Bonds is not complete and is qualified in its entirety by all of the terms contained in the New Notes and the New Bonds and in the Indenture dated as of August 7, 1998 (the "Indenture") between the Issuer and the Trustee, a copy of which has been filed as an exhibit to the registration statement of which this Prospectus is a part. The form and terms of the New Notes and the New Bonds will be identical in all material respects to the form and terms of the Old Notes and the Old Bonds except that (i) the New Notes and the New Bonds will have been registered under the Securities Act, (ii) holders of the New Notes and the New Bonds will not be entitled to certain rights of holders of the Old Notes and the Old Bonds under the Registration Rights Agreement, (iii) the New Notes and the New Bonds will be issued pursuant to and entitled to the benefits of the Indenture and not the Fiscal Agency Agreement, and (iv) the New Notes and the New Bonds will not be issued under the Program.

General

The New Notes and the New Bonds will be issued pursuant to the Indenture. A copy of the Indenture is available for inspection during normal business hours at the corporate trust office of the Trustee, which is currently located at 4 Albany Street, 7th Floor, New York, New York 10006, and at the specified office of the Luxembourg Paying Agent and Transfer Agent.

The following statements relating to the New Notes and the New Bonds and the Indenture are summaries and are subject to the detailed provisions of the Indenture, to which reference is hereby made for a complete statement of those provisions.

The New Notes will be redeemed at par on March 30, 2005. Interest on the New Notes will accrue at $8^3/_8$% per annum from September 30, 1998, the last day to which interest on Old Notes tendered in the Exchange Offers will be paid.

The New Bonds will be redeemed at par on March 30, 2018. Interest on the New Bonds will accrue at $9^1/_4$% per annum from September 30, 1998, the last day to which interest on Old Bonds tendered in the Exchange Offers will be paid.

Interest on the New Notes and the New Bonds will be computed on the basis of a 360-day year consisting of 12 months of 30 days each. Interest on the New Notes and the New Bonds will be payable in arrears in consecutive semiannual installments on each March 30 and September 30, commencing on March 30, 1999, after withholding for, or on account of, certain Mexican withholding taxes (see "—Additional Amounts"), to the person in whose name such New Note or New Bond is registered, until the principal amount thereof has been paid or made available for payment. Principal will be payable, and the New Notes and the New Bonds may be presented for registration of transfer or exchange, at the office or agency of the Issuer maintained for such purpose in the Borough of Manhattan, The City of New York, or at the office of any Paying Agent or Transfer Agent, as the case may be, including the Paying Agent and Transfer Agent in Luxembourg. Until otherwise designated by the Issuer, such office or agency in the Borough of Manhattan will be the corporate trust office of the Trustee, which will act as Paying Agent, Transfer Agent and Registrar, and such Paying Agent and Transfer Agent in Luxembourg will be Bankers Trust Luxembourg S.A.

The New Notes and the New Bonds are not redeemable at the option of the Issuer prior to maturity except in the event of certain changes in Mexican law. See "—Tax Redemption" below. The New Notes and the New Bonds will not have the benefit of any sinking fund. At maturity, the New Notes and the New Bonds will be redeemed at par.

Ranking of New Notes and New Bonds

The New Notes and the New Bonds will constitute direct, unsecured and unsubordinated Public External Indebtedness (as defined under "—Negative Pledge" below) of the Issuer and will rank *pari passu* with each other. The payment obligations of the Issuer under the New Notes and the New Bonds will, except as may be provided by applicable law and subject to "—Negative Pledge" below, at all times rank equally with all other present and future unsecured and unsubordinated Public External Indebtedness for money borrowed of the Issuer. The payment of principal of and interest on the New Notes and the New Bonds will be unconditionally guaranteed, jointly and severally, by the Guarantors pursuant to the Guaranty Agreement and Certificates of Designation (as defined below) delivered by the Issuer to each Guarantor designating the New Notes, the New Bonds and the Indenture as subject to the Guaranty Agreement. See "—Guaranties" below. The Guaranty of the New Notes and the New Bonds by each Guarantor will constitute direct, unsecured and unsubordinated Public External Indebtedness of such Guarantor and will rank *pari passu* with each other and with all other present and future unsecured and unsubordinated Public External Indebtedness of such Guarantor. *The New Notes and the New Bonds are not obligations of, or guaranteed by, Mexico.*

Form and Denomination

The New Notes and the New Bonds will be represented by one or more permanent global notes and global bonds, respectively, in fully registered form without coupons (each, a "Global Security") in minimum denominations of U.S. $1,000 and integral multiples in excess thereof. Each Global Security will be deposited with the Trustee at its corporate trust office as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC, for credit to the respective accounts at DTC, Euroclear and Cedel Bank of the holders of Old Notes and Old Bonds participating in the Exchange Offers (or to such accounts as they may direct).

Except in the limited circumstances described below under "—Certificated Notes and Certificated Bonds", owners of beneficial interests in a Global Security will not be entitled to receive physical delivery of New Notes or New Bonds in registered, certificated (*i.e.*, non-global) form without interest coupons ("Certificated Notes" and "Certificated Bonds", respectively). The New Notes and the New Bonds are not issuable in bearer form.

The Issuer has agreed to maintain a Paying Agent and Transfer Agent in the Borough of Manhattan, The City of New York and, so long as the New Notes and the New Bonds are listed on the Luxembourg Stock Exchange and the rules of Luxembourg Stock Exchange so require, a Paying Agent and a Transfer Agent in Luxembourg. The Issuer has initially appointed the Trustee at its corporate trust office as principal Paying Agent, Transfer Agent, Authenticating Agent and Registrar for all of the New Notes and the New Bonds. The Registrar will keep a register in which, subject to such reasonable regulations as the Issuer may prescribe, the Issuer will provide for the registration of transfers of the New Notes and the New Bonds.

No service charge will be imposed for any registration of transfer of New Notes or New Bonds, but the Issuer may require payment by a Holder of a New Note or a New Bond of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

The terms "New Note" and "New Bond" as used in this Prospectus mean any Certificated Note or Certificated Bond, as the case may be, and any Global Security. Only the person or persons registered as owner(s) of a New Note or a New Bond will be deemed the "Holder" of such New Note or New Bond under the Indenture and only Cede & Co. or its successor-in-interest, as nominee of DTC, will be deemed the Holder of New Notes or New Bonds represented by a Global Security. The Issuer, the Trustee and any of their respective agents may treat the registered Holder of a New Note or a New Bond as the absolute owner thereof (whether or not such New Note or New Bond may be overdue) for the purpose of making payment and for all other purposes.

Global Securities

The statements set forth herein include summaries of certain rules and operating procedures of DTC, Euroclear and Cedel Bank, which affect transfers of interests in the Global Securities.

Except as set forth below, a Global Security may be transferred, in whole or part, only to DTC, another nominee of DTC or a successor of DTC or its nominee.

Beneficial interests in a Global Security will be represented, and transfer of such beneficial interests will be effected, through accounts of financial institutions acting on behalf of beneficial owners as direct and indirect participants in DTC. Such beneficial interests will be in denominations of U.S. $1,000 and integral multiples thereof. Investors may hold such beneficial interests directly through DTC, Euroclear or Cedel Bank, if they are participants in such systems, or indirectly through organizations that are participants in such systems. Euroclear and Cedel Bank hold securities on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries, which in turn hold such securities in customers' securities accounts in the depositaries' names on the books of DTC. The Chase Manhattan Bank initially will act as depositary for Euroclear, and Citibank, N.A. initially will act as depositary for Cedel Bank.

DTC has advised the Issuer that it is a limited-purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities of its participants and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book-entry changes in accounts of the participants, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers, banks (including the Trustee), trust companies, clearing corporations and certain other organizations, some of which and/or their representatives own DTC. Access to DTC's book-entry system is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly. Persons who are not participants may beneficially own securities held by DTC only through participants.

Upon the issuance of the Global Securities, DTC will credit, on its book-entry registration and transfer system, the respective principal amounts of the New Notes and the New Bonds represented by such Global Securities to the accounts of the participants designated by the holders of the Old Notes and Old Bonds participating in the Exchange Offers.

Persons who are not DTC participants may beneficially own New Notes and New Bonds held by DTC only through direct or indirect participants in DTC (including Euroclear and Cedel Bank). So long as Cede & Co., as the nominee of DTC, is registered owner of the Global Securities, Cede & Co. for all purposes will be considered the sole Holder of the New Notes and the New Bonds represented by the Global Securities under the Indenture and under the New Notes and the New Bonds. Except as provided below, owners of beneficial interests in the Global Securities will not be entitled to have New Notes or New Bonds represented thereby registered in their names, will not receive or be entitled to receive physical delivery of such New Notes or New Bonds in definitive form and will not be considered the Holders thereof under the Indenture or the New Notes or New Bonds. Accordingly, any person owning a beneficial interest in any of the Global Securities must rely on the procedures of DTC and, to the extent relevant, Euroclear or Cedel Bank, and, if such person is not a participant, on the procedures of the participant through which such person owns its interest, to exercise any rights of a Holder represented thereby. The Issuer understands that, under existing industry practice, in the event that any owner of a beneficial interest in a Global Security desires to take any action that Cede & Co., as the Holder of such Global Security, is entitled to take, Cede & Co. would authorize the participants to take such action, and the participants would authorize beneficial owners owning through such participants to take such action or would otherwise act upon the instructions of beneficial owners owning through them.

DTC may grant proxies or otherwise authorize DTC participants (or persons holding beneficial interests in the New Notes or the New Bonds through such DTC participants) to exercise any rights of a Holder or take any other actions which a Holder is entitled to take under the Indenture or the New Notes or the New Bonds, as the case may be. Under its usual procedures, DTC would mail an omnibus proxy to the Issuer assigning Cede & Co.'s consenting or voting rights to those DTC participants to whose accounts the New Notes or the New Bonds are credited on a record date as soon as possible after such record date. Euroclear or Cedel Bank, as the case may be, will take any action permitted to be taken by a Holder under the Indenture or the New Notes or the New Bonds on behalf of a Euroclear participant or Cedel Bank participant only in accordance with its relevant rules and procedures and subject to its depositary's ability to effect such actions on its behalf through DTC. In order to attend meetings of Holders, owners of beneficial interests in the Global Securities may obtain a certificate from DTC, a DTC participant, a Euroclear participant or a Cedel Bank participant stating the principal amount of New Notes or New Bonds beneficially owned by such person and deposit such certificate with the Issuer at least three business days prior to the date on which the relevant meeting of Holders is to be held. The Issuer will then grant the appropriate receipts of such deposit which will allow such persons to attend the meeting and to exercise their voting rights in respect of the principal amount of New Notes or New Bonds beneficially owned by them as stated in their respective certificate.

The Global Securities will not be exchangeable for Certificated Notes or Certificated Bonds, as the case may be, except as provided below under "—Certificated Notes and Certificated Bonds".

Certificated Notes and Certificated Bonds

If DTC or any successor depositary is at any time unwilling or unable to continue as a depositary for a Global Security or ceases to be a "clearing agency" registered under the Exchange Act and a successor depositary is not appointed by the Issuer within 90 days after the Issuer receives notice from such depositary to that effect, the Issuer will issue or cause to be issued, authenticate and deliver Certificated Notes or Certificated Bonds, as the case may be, in registered form in exchange for such Global Security. In addition, the Issuer may determine that any Global Security will be exchanged for Certificated Notes or Certificated Bonds, as the case may be. Such Certificated Notes and Certificated Bonds will be mailed to such addresses as are specified by the registered holder of the Global Securities, or (if so specified by the registered holder thereof) may be available for pick-up at the office of the Trustee or any Transfer Agent (including the Luxembourg Transfer Agent), in each case not later than 30 days following the date of surrender of the relevant Global Security (duly endorsed by the registered holder) to the Trustee or any Transfer Agent.

A Holder of Certificated Notes or Certificated Bonds may transfer such Certificated Notes or Certificated Bonds or exchange them for Certificated Notes or Certificated Bonds of any other authorized denomination by surrendering them at the office or agency maintained by the Issuer for such purpose in the Borough of Manhattan, The City of New York, which initially will be the office of the Trustee, or at the office of any Transfer Agent.

Neither the Registrar nor any Transfer Agent will be required to register the transfer or exchange of any Certificated Notes or Certificated Bonds for a period of 15 days preceding any interest payment date, or register the transfer or exchange of any Certificated Notes or Certificated Bonds previously called for redemption.

In the event any Certificated Note or Certificated Bond is mutilated, defaced, destroyed, lost or stolen, the Issuer will execute and, upon the Issuer's request, the Trustee will authenticate and deliver, a new Certificated Note or Certificated Bond, as the case may be, of like tenor (including the same date of issuance) and equal principal amount, registered in the same manner, dated the date of its authentication and bearing interest from the date to which interest has been paid on such Certificated Note or Certificated Bond, in exchange and substitution for such Certificated Note or Certificated Bond (upon surrender and cancellation thereof) or in lieu of and substitution for such Certificated Note or Certificated Bond. In case such Certificated Note or Certificated Bond is destroyed, lost or stolen, the applicant for a substitute Certificated Note or Certificated Bond must furnish to the Issuer and the Trustee such security or indemnity as may be required by them to hold each of them harmless, and, in every case of destruction, loss or theft of such Certificated Note or Certificated Bond, the applicant shall also furnish to the Issuer satisfactory evidence of the destruction, loss or theft of such Certificated Note or Certificated Bond and of the ownership thereof. Upon the issuance of any substitute Certificated Note or Certificated Bond, the Issuer may require the payment by the registered Holder thereof of a sum sufficient to cover fees and expenses connected therewith.

Payment of Principal and Interest

The interest payable on a New Note or a New Bond, including any Additional Amounts (as defined under "—Additional Amounts"), other than at maturity will be paid to the Holder in whose name such New Note or New Bond is registered at the close of business on the March 15 or September 15 (whether or not a business day) (each such day, a "Regular Record Date"), as the case may be, next preceding the due date for such payment. Any such interest not so punctually paid or duly provided for will cease to be payable to the Holder of such New Notes or New Bonds on such Regular Record Date and may either be paid to the persons in whose name such New Notes or New Bonds are registered at the close of business on a special record date for the payment of such defaulted interest to be fixed by the Trustee, notice of which shall be given to the Holders of such New Notes or New Bonds not less than ten days prior to such special record date, or be paid at any time in any other lawful manner not inconsistent with the requirements of any securities exchange on which such new Notes or new Bonds are then listed. Interest payable at maturity, including any Additional Amounts, will be payable to the person to whom principal is payable.

Payments of principal of and any interest due with respect to the New Notes and the New Bonds at maturity will be made in immediately available funds against surrender of the New Notes and the New Bonds at the corporate trust office of the Trustee or at the offices of one of the other Paying Agents appointed pursuant to the Indenture.

Payments of interest on the Global Securities to be paid other than at maturity will be made to DTC or its nominee as the registered owner thereof in immediately available funds. See "—Global Securities". Upon receipt of any payment of principal of or interest on a Global Security, DTC will credit DTC participants' accounts with payment in amounts proportionate to their respective beneficial interests in the principal amount of such Global Security as shown on the records of DTC. Payments by DTC participants to owners of beneficial interests in such Global Security held through such participants will be the responsibility of such participants, as is the case with securities held for the accounts of customers registered in "street name". Distributions with respect to New Notes or New Bonds held through Euroclear or Cedel Bank will be credited to the cash accounts of Euroclear participants or Cedel Bank participants in accordance with the relevant system's rules and procedures, to the extent received by its depositary. Neither the Issuer nor the Trustee will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Global Securities or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

If any New Notes or New Bonds have been issued in other than global form, payments of interest on such New Notes or New Bonds to be paid other than at maturity will be made by check mailed to the Holder thereof at such Holder's address appearing on the Register. Payments of any interest on the New Notes or the New Bonds may also be made, in the case of a Holder of at least U.S. $10,000,000 aggregate principal amount of New Notes or New Bonds, by wire transfer to a U.S. dollar account maintained by the payee with a bank in the United States; *provided* that such Holder elects payment by wire transfer by giving written notice to the Trustee or a Paying Agent to such effect designating such account no later than the Regular Record Date immediately preceding the relevant due date for payment (or such other date as the Trustee may accept in its discretion).

Any monies paid by the Issuer to the Trustee for the payment of the principal of or any interest or Additional Amounts on any New Notes or New Bonds and remaining unclaimed at the end of two years after such principal, interest or Additional Amounts become due and payable will be repaid to the Issuer upon its written request, and upon such repayment all liability of the Trustee with respect thereto will cease. Unless otherwise provided by applicable law, the right to receive payment of principal of any New Note or New Bond (whether at maturity or otherwise) or interest thereon (including any Additional Amounts) will become void at the end of five years after the due date thereof.

If the due date for payment of principal, interest or Additional Amounts in respect of any New Note or New Bond is not a Business Day, the Holder thereof will not be entitled to payment of the amount due until the next succeeding Business Day and will not be entitled to any further interest or other payment in respect of any such delay. "Business Day" means each Monday, Tuesday, Wednesday, Thursday and Friday which is not a day on which banking institutions in The City of New York are authorized or obligated by law or executive order to close. If any New Note or New Bond is presented for payment on a date that is not a business day in the place of payment, the Holder thereof will not be entitled to payment of the amount due until the next succeeding business day in such place of payment, and will not be entitled to any further interest or other payment in respect of any such delay.

Subject to certain limitations set forth in the Indenture, the Issuer reserves the right at any time to vary or terminate the appointment of any Paying Agent or Transfer Agent with or without cause and to appoint another additional or other Paying Agents or Transfer Agents and to approve any change in the specified offices through which any Paying Agent or Transfer Agent acts; *provided* that the Issuer will at all times maintain a Paying Agent, Transfer Agent and Registrar in New York, New York and, so long as the New Notes and the New Bonds are listed on the Luxembourg Stock Exchange and the rules of Luxembourg Stock Exchange so require, a Paying Agent and a Transfer Agent in Luxembourg. Notice of any such termination or appointment and of any changes in the specified offices of the Paying Agents or Transfer Agents will be given to the Holders as described under "—Notices" below.

Guaranties

Pursuant to a Guaranty Agreement dated July 29, 1996 (the "Guaranty Agreement"), among the Issuer and the Guarantors, each of the Guarantors is jointly and severally liable with the Issuer for all payment obligations incurred by the Issuer under any international financing agreement entered into by the Issuer and designated by the Issuer as entitled to the benefit of the Guaranty Agreement in a certificate of designation. Each of the Indenture, the New Notes and the New Bonds has been designated by the Issuer in certificates of designation, dated March 25, 1998 (the "Certificates of Designation"), to benefit from the Guaranty Agreement. Accordingly, each of the Guarantors will be unconditionally liable for the due and punctual payment of the principal of and interest on the New Notes and the New Bonds, as and when the same shall become due and payable, whether at maturity, by declaration of acceleration or otherwise. Under the terms of the Guaranty Agreement, each Guarantor will be jointly and severally liable for the full amount of each payment under the New Notes and the New Bonds. Although the Guaranty Agreement may be terminated in the future, the Guaranties will remain in effect with respect to all agreements designated prior to such termination until all amounts payable under such agreements have been paid in full, including, with respect to the New Notes and the New Bonds, the entire principal thereof and interest thereon. Any amendment to the Guaranty Agreement which would affect the rights of any party to or beneficiary of any designated international financing agreement (including the Indenture, the New Notes and the New Bonds) will be valid only with the consent of each such party or beneficiary (or percentage of parties or beneficiaries) as would be required to amend such agreement.

Additional Amounts

The Issuer, or in the case of a payment by a Guarantor, such Guarantor, will pay to the Holder of any New Note or New Bond such additional amounts ("Additional Amounts") as may be necessary in order that every net payment made by the Issuer or a Guarantor on such New Note or New Bond after deduction or withholding for or on account of any present or future tax, assessment or other governmental charge imposed upon or as a result of such payment by Mexico or any political subdivision or taxing authority thereof or therein ("Mexican Withholding Taxes") will not be less than the amount then due and payable on such New Note or New Bond. The foregoing obligation to pay Additional Amounts, however, will not apply to:

(a) any Mexican Withholding Taxes which would not have been imposed or levied on a Holder of New Notes or New Bonds but for the existence of any present or former connection between the Holder of New Notes or New Bonds and Mexico or any political subdivision or territory or possession thereof or area subject to its jurisdiction, including, without limitation, such Holder of New Notes or New Bonds (i) being or having been a citizen or resident thereof, (ii) maintaining or having maintained an office, permanent establishment, fixed base or branch therein, or (iii) being or having been present or engaged in trade or business therein, except for a connection solely arising from the mere ownership of, or receipt of payment under, such New Notes or New Bonds;

(b) except as otherwise provided, any estate, inheritance, gift, sales, transfer, or personal property or similar tax, assessment or other governmental charge;

(c) any Mexican Withholding Taxes that are imposed or levied by reason of the failure by the Holder of New Notes or New Bonds to comply with any certification, identification, information, documentation, declaration or other reporting requirement which is required or imposed by a statute, treaty, regulation, general rule or administrative practice as a precondition to exemption from, or reduction in the rate of, the imposition, withholding or deduction of any Mexican Withholding Taxes; *provided* that at least 60 days prior to (i) the first payment date with respect to which the Issuer or any Guarantor shall apply this clause (c) and, (ii) in the event of a change in such certification, identification, information, documentation, declaration or other reporting requirement, the first payment date subsequent to such change, the Issuer or any Guarantor, as the case may be, shall have notified the Trustee in writing that the Holders of New Notes or New Bonds will be required to provide such certification, identification, information or documentation, declaration or other reporting;

(d) any Mexican Withholding Taxes imposed at a rate in excess of (x) 10%, if Additional Amounts are payable on or before January 1, 1999 (*i.e.*, the period during which such rate is effective under the Tax Treaty (as defined under "Taxation") or (y) 4.9%, if such Additional Amounts are payable thereafter, in either case in the event that such Holder has failed to provide on a timely basis, at the reasonable request of the Issuer, information or documentation (not described in clause (c) above) concerning such holder's eligibility for benefits under an income tax treaty to which Mexico is a party that is necessary to determine the appropriate rate of deduction or withholding of Mexican taxes under any such treaty;

(e) any Mexican Withholding Taxes that would not have been so imposed but for the presentation by the Holder of such New Note or New Bond for payment on a date more than 15 days after the date on which such payment became due and payable or the date on which payment thereof is duly provided for, whichever occurs later; or

(f) any payment on such New Note or New Bond to any Holder who is a fiduciary or partnership or other than the sole beneficial owner of any such payment, to the extent that a beneficiary or settlor with respect to such fiduciary, a member of such a partnership or the beneficial owner of such payment would not have been entitled to the Additional Amounts had such beneficiary, settlor, member or beneficial owner been the Holder of such New Note or New Bond.

All references herein to principal and interest in respect of New Notes and New Bonds shall, unless the context otherwise requires, be deemed to mean and include all Additional Amounts, if any, payable in respect thereof as set forth in this paragraph.

Notwithstanding the foregoing, the limitations on the Issuer's and the Guarantors' obligation to pay Additional Amounts set forth in clauses (c) and (d) above shall not apply if the provision of the certification, identification, information, documentation, declaration or other evidence described in such clauses (c) and (d) would be materially more onerous, in form, in procedure or in the substance of information disclosed, to a Holder or beneficial owner of a New Note or New Bond (taking into account any relevant differences between United States and Mexican law, regulation or administrative practice) than comparable information or other applicable reporting requirements imposed or provided for under United States federal income tax law (including the United States-Mexico Income Tax Treaty), regulation (including proposed regulations) and administrative practice. In addition, the limitations on the Issuer's and the Guarantors' obligation to pay Additional Amounts set forth in clauses (c) and (d) above shall not apply if Rule 3.32.11 published in the *Diario Oficial* on March 21, 1997 or a substantially similar successor of such rule is in effect, unless (i) the provision of the certification, identification, information, documentation, declaration or other evidence described in clauses (c) and (d) is expressly required by statute, regulation, general rules or administrative practice in order to apply Rule 3.32.11 (or a substantially similar successor of such rule), the Issuer or the relevant Guarantor cannot obtain such certification, identification, information, or satisfy any other reporting requirements, on its own through reasonable diligence and the Issuer or the relevant Guarantor otherwise would meet the requirements for application of Rule 3.32.11 (or such successor of such rule) or (ii) in the case of a Holder or beneficial owner of a New Note or New Bond that is a pension fund or other tax-exempt organization, such Holder or beneficial owner would be subject to Mexican Withholding Taxes at a rate less than that provided by Rule 3.32.11 if the information, documentation, or other evidence required under clause (d) above were provided. In addition, clause (c) above shall not be construed to require that a non-Mexican pension or retirement fund, a non-Mexican tax-exempt organization or a non-Mexican financial institution or any other Holder or beneficial owner of a New Note or New Bond register with the Ministry of Finance for the purpose of establishing eligibility for an exemption from or reduction of Mexican Withholding Taxes.

The Issuer or the relevant Guarantor, as the case may be, will, upon written request, provide the Trustee, the Holders and the Paying Agent with a duly certified or authenticated copy of an original receipt of the payment of Mexican Withholding Taxes which the Issuer or such

Guarantor has withheld or deducted in respect of any payments made under or with respect to the New Notes or the New Bonds or the Guaranty of the New Notes or the New Bonds, as the case may be.

In the event that Additional Amounts actually paid with respect to the New Notes or the New Bonds pursuant to the preceding paragraph are based on rates of deduction or withholding of Mexican Withholding Taxes in excess of the appropriate rate applicable to the Holder of such New Notes or New Bonds, and, as a result thereof, such Holder is entitled to make a claim for a refund or credit of such excess, then such Holder shall, by accepting the New Note or the New Bond, as the case may be, be deemed to have assigned and transferred all right, title and interest to any such claim for a refund or credit of such excess to the Issuer or a Guarantor, as the case may be. However, by making such assignment, the Holder makes no representation or warranty that the Issuer or such Guarantor will be entitled to receive such claim for a refund or credit and incurs no other obligation with respect thereto.

Tax Redemption

The New Notes and the New Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time, together, if applicable, with interest accrued to but excluding the date fixed for redemption, at par, on giving not less than 30 but not more than 60 days' notice to the holders of the New Notes and the New Bonds (which notice shall be irrevocable), if (i) the Issuer satisfies the Trustee immediately prior to the giving of such notice that it has or will become obligated to pay Additional Amounts in excess of the Additional Amounts that it would be obligated to pay if payments on the New Notes and the New Bonds were subject to a tax at a rate of 15%, as a result of any change in, or amendment to, or lapse of, the laws, regulations or rulings of Mexico or any political subdivision or any taxing authority thereof or therein affecting taxation, or any change in, or amendment to, an official interpretation or application of such laws, regulations or rulings, which change or amendment becomes effective on or after the date of issuance of the New Notes and the New Bonds and (ii) prior to the publication of any notice of redemption, the Issuer shall deliver to the Trustee a certificate signed by two Authorized Officers of the Issuer stating that the obligation referred to in (i) above cannot be avoided by the Issuer taking reasonable measures available to it, and the Trustee shall be entitled to accept such certificate as sufficient evidence of the satisfaction of the condition precedent set out in (i) above in which event it shall be conclusive and binding on the holders of the New Notes and the New Bonds; *provided* that no such notice of redemption will be given earlier than 90 days prior to the earliest date on which the Issuer would be obligated but for such redemption to pay such Additional Amounts were a payment in respect of the New Notes or the New Bonds then due and at the time such notice is given, such obligation to pay such Additional Amounts remains in effect.

Negative Pledge

So long as any New Note or New Bond remains outstanding, the Issuer will not create or permit to subsist, and will not permit its Subsidiaries or the Guarantors or any of their respective Subsidiaries to create or permit to subsist, any Security Interest upon the whole or any part of its or their crude oil or receivables in respect of crude oil to secure (i) any of its or their Public External Indebtedness; (ii) any of its or their Guarantees in respect of Public External Indebtedness; or (iii) the Public External Indebtedness or Guarantees in respect of Public External Indebtedness of any other person; without at the same time or prior thereto securing the New Notes and the New Bonds equally and ratably therewith or providing such other Security Interest for the New Notes and the New Bonds as shall be approved by the holders of at least 66 2/3% in aggregate principal amount of the outstanding New Notes or outstanding New Bonds, as the case may be; *provided* that the Issuer and its Subsidiaries, and the Guarantors and their respective Subsidiaries, may create or permit to subsist a Security Interest upon its or their receivables in respect of crude oil if (i) on the date of creation of such Security Interest the aggregate of (a) the amount of principal and interest payments secured by Oil Receivables due during such calendar year in respect of Receivables Financings entered into or before such date, (b) the total amount of revenues during such calendar year from the sale of crude oil or gas transferred, sold, assigned or otherwise disposed of in Forward Sales (other than Governmental Forward Sales) entered into on or before such date and (c) the total amount of payments of the purchase price of crude oil, gas or Petroleum Products foregone during such calendar year as a result of all Advance Payment Arrangements entered into on or before such date, shall not exceed in such calendar year U.S. $4,000,000,000, or its equivalent in other currencies, less the amount of Governmental Forward Sales during that calendar year, (ii) the aggregate amount outstanding in all currencies at any one time under all Receivables Financings, Forward Sales (other than Governmental Forward Sales) and Advance Payment Arrangements shall not exceed U.S. $12,000,000,000, or its equivalent in other currencies, and (iii) the Issuer has given a certificate to the Trustee certifying that on the date of creation of such Security Interest there is no default under any Financing Document (as defined in the Indenture) resulting from a failure to pay principal or interest, as described more particularly in the Indenture.

For this purpose:

"Advance Payment Arrangement" means any transaction involving the receipt by the Issuer, the Guarantors or any of their Subsidiaries of payment of the purchase price of crude oil or gas or Petroleum Products not yet earned by performance.

"External Indebtedness" means Indebtedness which is payable or at the option of its holder may be paid, (i) in a currency or by reference to a currency other than the currency of Mexico, (ii) to a person resident or having its head office or its principal place of business outside Mexico and (iii) outside the territory of Mexico.

"Forward Sale" means any transaction involving the transfer, sale, assignment or other disposition by the Issuer, the Guarantors or any of their Subsidiaries of any right to payment under a contract for the sale of crude oil or gas not yet earned by performance, or any interest therein, whether in the form of an account receivable, negotiable instrument or otherwise.

"Governmental Forward Sale" means a Forward Sale to (i) Mexico or Banco de México or (ii) the Bank for International Settlements or another multilateral monetary authority or central bank or treasury of a sovereign state.

"Guarantee" means any obligation of a person to pay the Indebtedness of another person including without limitation:

(i) an obligation to pay or purchase such Indebtedness; or

(ii) an obligation to lend money or to purchase or subscribe for shares or other securities or to purchase assets or services in order to provide funds for the payment of such Indebtedness; or

(iii) any other agreement to be responsible for such Indebtedness.

"Indebtedness" means any obligation (whether present or future, actual or contingent) for the payment or repayment of money which has been borrowed or raised (including money raised by acceptances and leasing).

"Oil Receivables" means amounts payable to the Issuer, the Guarantors or any of their Subsidiaries in respect of the sale, lease or other provision of crude oil or gas, whether or not yet earned by performance.

"Person" means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having a separate legal personality.

"Petroleum Products" means the derivatives and by-products of crude oil and gas (including basic petrochemicals).

"Public External Indebtedness" means any External Indebtedness which is in the form of, or represented by, notes, bonds or other securities which are for the time being quoted, listed or ordinarily dealt in on any stock exchange.

"Receivables Financings" means any transaction resulting in the creation of a Security Interest on Oil Receivables to secure new External Indebtedness incurred by, or the proceeds of which are paid to or for the benefit of, the Issuer, any Guarantor or any of their Subsidiaries.

"Security Interest" means any mortgage, pledge, lien, hypothecation, security interest or other charge or encumbrance including, without limitation, any equivalent thereof created or arising under the laws of Mexico.

"Subsidiary" means, in relation to any person, any other person (whether or not now existing) which is controlled directly or indirectly, or more than 50 percent of whose issued equity share capital (or equivalent) is then held or beneficially owned by, the first person and/or any one or more of the first person's Subsidiaries, and "control" means the power to appoint the majority of the members of the governing body or management of, or otherwise to control the affairs and policies of, that person.

The negative pledge does not restrict the creation of Security Interests over any assets of the Issuer or its Subsidiaries or of the Guarantors or any of their respective Subsidiaries other than crude oil and receivables in respect of crude oil. Under Mexican law, all domestic reserves of crude oil belong to Mexico and not to the Issuer, but the Issuer (together with the Guarantors) has been established with the exclusive purpose of exploiting the Mexican petroleum and gas reserves, including the production of oil and gas, oil products and basic petrochemicals. In addition, the negative pledge does not restrict the creation of Security Interests to secure obligations of the Issuer, the Guarantors or their Subsidiaries payable in pesos. Further, the negative pledge does not restrict the creation of Security Interests to secure any type of obligation (e.g., commercial bank borrowings) regardless of the currency in which it is denominated, other than obligations similar to the New Notes and the New Bonds (e.g., issuances of debt securities).

Events of Default; Waiver and Notice

If any of the following events (each, an "Event of Default") occurs and is continuing, the Trustee, if so requested by the Holders of at least one-fifth in principal amount of the New Notes or the New Bonds then outstanding, shall give notice to the Issuer that the New Notes or the New Bonds, as the case may be, are, and they shall immediately become, due and payable at their principal amount together with accrued interest:

(a) *Non-Payment:* default is made in payment of principal (or any part thereof) of or any interest on any of the New Notes or the New Bonds, as the case may be, when due and such failure continues, in the case of non-payment of principal for seven days, and of interest for fourteen days after the due date; or

(b) *Breach of Other Obligations:* the Issuer defaults in performance or observance of or compliance with any of its other obligations set out in the New Notes or the New Bonds, as the case may be, or the Indenture, which default is incapable of remedy or, if capable of remedy, is not remedied within 30 days after notice of such default shall have been given to the Issuer and the Guarantors by the Trustee; or

(c) *Cross-Default:* default by the Issuer or any of its Material Subsidiaries (as defined below) or the Guarantors or any of them or any of their respective Material Subsidiaries in the payment of the principal of, or interest on, any Public External Indebtedness (as defined under "—Negative Pledge" above) of, or guaranteed by, the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries, in an aggregate principal amount exceeding U.S. $40,000,000 or its equivalent, when and as the same shall become due and payable, if such default shall continue for more than the period of grace, if any, originally applicable thereto; or

(d) *Enforcement Proceedings:* a distress or execution or other legal process is levied or enforced or sued out upon or against any substantial part of the property, assets or revenues of the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries and is not discharged or stayed within 60 days of having been so levied, enforced or sued out; or

(e) *Security Enforced:* an encumbrancer takes possession or a receiver, manager or other similar officer is appointed of the whole or any substantial part of the undertaking, property, assets or revenues of the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries; or

(f) *Insolvency:* the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries becomes insolvent or is generally unable to pay its debts as they mature or applies for or consents to or suffers the appointment of an administrator, liquidator or receiver of the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries or the whole or any substantial part of the undertaking, property, assets or revenues of the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries or takes any proceeding under any law for a readjustment or deferment of its obligations or any part of them for bankruptcy, reorganization ("*suspensión de pagos*"), dissolution or liquidation or makes or enters into a general assignment or an arrangement or composition with or for the benefit of its creditors or stops or threatens to cease to carry on its business or any substantial part of its business; or

(g) *Winding-up:* an order is made or an effective resolution passed for winding up the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries; or

(h) *Moratorium*: a general moratorium is agreed or declared in respect of any External Indebtedness (as defined under "—Negative Pledge" above) of the Issuer or any of its Material Subsidiaries or the Guarantors or any of them or any of their respective Material Subsidiaries; or

(i) *Authorization and Consents:* any action, condition or thing (including the obtaining or effecting of any necessary consent, approval, authorization, exemption, filing, license, order, recording or registration) at any time required to be taken, fulfilled or done in order (i) to enable the Issuer lawfully to enter into, exercise its rights and perform and comply with its obligations under the New Notes, the New Bonds, the Indenture and the Guaranty Agreement or any of the Guarantors lawfully to enter into, perform and comply with its obligations under the Guaranty Agreement in relation to the New Notes and the

New Bonds and (ii) to ensure that those obligations are legally binding and enforceable, is not taken, fulfilled or done within 30 days of its being so required; or

(j) *Illegality:* it is or becomes unlawful for (i) the Issuer to perform or comply with one or more of its obligations under any of the New Notes, the New Bonds, the Indenture or the Guaranty Agreement or (ii) for the Guarantors or any of them to perform or comply with one or more of its obligations under the Guaranty Agreement with respect to the New Notes, the New Bonds or the Indenture; or

(k) *Control:* the Issuer shall cease to be a decentralized public entity of the Government or the Government shall otherwise cease to control the Issuer or any Guarantor, or the Issuer or any of the Guarantors shall be dissolved, disestablished or shall suspend its respective operations, and such dissolution, disestablishment or suspension of operations is material in relation to the business of the Issuer and the Guarantors taken as a whole, or the Issuer or any Guarantor shall cease to be the entities which have the exclusive right and authority to conduct on behalf of Mexico the activities of exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil and exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production; or

(l) *Disposals:*

(i) the Issuer ceases to carry on all or a substantial part of its business, or sells, transfers or otherwise disposes (whether voluntarily or involuntarily) of all or substantially all of its assets (whether by one transaction or a series of transactions whether related or not) other than (i) solely in connection with the implementation of the *Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios* or (ii) to a Guarantor; or

(ii) any Guarantor ceases to carry on all or a substantial part of its business, or sells, transfers or otherwise disposes (whether voluntarily or involuntarily) of all or substantially all of its assets (whether by one transaction or a series of transactions whether related or not) and such cessation, sale, transfer or other disposal is material in relation to the business of the Issuer and the Guarantors taken as a whole; or

(m) *Analogous Events:* any event occurs which under the laws of Mexico has an analogous effect to any of the events referred to in paragraphs (d) to (g) above; or

(n) *Guaranty:* the Guaranty Agreement is not (or is claimed by any of the Guarantors not to be) in full force and effect.

"Material Subsidiaries" means, at any time, each of the Guarantors and any Subsidiary of the Issuer or any of the Guarantors having, as of the end of the most recent fiscal quarter of the Issuer, total assets greater than 12% of the total assets of the Issuer, the Guarantors and their Subsidiaries on a consolidated basis. As of the date of this Prospectus, there were no Material Subsidiaries other than Pemex-Exploration and Production, Pemex-Refining and Pemex-Gas and Basic Petrochemicals.

After any such acceleration has been made, but before a judgment or decree for the payment of money due based on acceleration has been obtained by the Trustee, the Holders of a majority in aggregate principal amount of the New Notes or the New Bonds, as the case may be, then outstanding may rescind and annul such acceleration if all Events of Default, other than the non-payment of the principal of such New Notes or New Bonds, as the case may be, that have become due solely by such declaration of acceleration, have been cured or waived as provided in the Indenture.

The Indenture contains provisions entitling the Trustee, subject to the duty of the Trustee during an Event of Default to act with the required standard of care, to be indemnified by the Holders of the New Notes or the New Bonds, as the case may be, before proceeding to exercise any right or power under the New Notes or the New Bonds, as the case may be, at the request of the Holders thereof. The Indenture provides that the Holders of a majority in principal amount of the New Notes or the New Bonds, as the case may be, may direct the time, method and place of conducting proceedings for remedies available to the Trustee, or exercising any trust or power conferred on the Trustee, to the extent that such direction does not conflict with law or the Indenture or would not be unjustly prejudicial to the Holders of the New Notes or the New Bonds, as the case may be, not joining in such direction.

No Holder of any New Note or New Bond will have any right to institute any proceeding with respect to the Indenture or for any remedy thereunder, unless such holder shall have previously given to the Trustee written notice of a continuing Event of Default, the holders of at least 20% in aggregate principal amount of the New Notes or the New Bonds, as the case may be, shall have made a written request to the Trustee to institute such proceeding in respect of such Event of Default, such holder has offered to the Trustee reasonable indemnity, the Trustee for 60 days after receipt of such notice has failed to institute such proceeding and no direction inconsistent with such written request shall have been given to the Trustee during such 60-day period by the Holders of a majority in principal amount of the outstanding New Notes or New Bonds, as the case may be. However, such limitations do not apply to a suit instituted by a Holder of a New Note or a New Bond for the enforcement of payment of the principal of or interest on such New Note or New Bond on or after the respective due dates expressed in such New Note or New Bond.

The Holders of a majority in principal amount of the outstanding New Notes or New Bonds may on behalf of the Holders of all New Notes or New Bonds, as the case may be, waive any past default and any Event of Default arising therefrom, except a default not theretofore cured in the payment of the principal of or interest on the New Notes or the New Bonds, as the case may be, or in respect of a covenant or provision in the Indenture that cannot be modified or amended without the consent of the Holder of each outstanding New Note or New Bond affected.

The Issuer will be required to furnish to the Trustee annually a statement as to the performance by the Issuer of certain of its obligations under the Indenture and as to any default in such performance.

Purchase of Notes and Bonds

The Issuer or any of the Guarantors may at any time purchase New Notes or New Bonds at any price in the open market, in privately negotiated transactions or otherwise. New Notes or New Bonds so purchased by the Issuer or any Guarantor may be held, resold or surrendered to the Trustee for cancellation.

Modification and Amendment

With the approval of Holders of the New Notes or the New Bonds (a) at a meeting duly called and held, upon the affirmative vote, in person or by proxy thereunto duly authorized in writing, of the Holders of a majority in aggregate principal amount of the New Notes or the New Bonds, as the case may be, then outstanding represented at such meeting or (b) with the written consent of the Holders of a majority (or of such other percentage as may be set forth in the text of the New Notes or the New Bonds, as the case may be, with respect to the action being taken) in aggregate principal amount of the New Notes or the New Bonds, as the case may be, then outstanding, the Issuer and the Trustee may modify, amend or supplement the terms of the New Notes or the New Bonds, as the case may be, or the Indenture, in any way, and such Holders may make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided by the Indenture or the New Notes or the New Bonds, as the case may be, to be made, given or taken by Holders of New Notes or New Bonds, as the case may be; *provided* that no such action may, without the consent of the Holder of each New Note or New Bond affected thereby, (i) change the due date for the payment of the principal of or any installment of interest on such New Note or New Bond, (ii) reduce the principal amount of such New Note or New Bond, the portion of such principal amount which is payable upon acceleration of the maturity of such New Note or New Bond or the interest rate thereon, (iii) change U.S. dollars as the currency in which or the required places at which payment with respect to interest or principal in respect of such New Note or New Bond is payable, (iv) permit the Issuer to redeem such New Note or New Bond prior to maturity, except as permitted under "—Tax Redemption" above, (v) reduce the percentage of the principal amount of the New Notes or New Bonds, as the case may be, the vote or consent of the holders of which is necessary to modify, amend or supplement the Indenture or the terms and conditions of the New Notes or the New Bonds, as the case may be, or to make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided thereby to be made, taken or given, (vi) change the obligation of the Issuer or any Guarantor to pay Additional Amounts or (vii) modify any of the above provisions or those relating to the waiver of past defaults except to increase any such percentage or to provide that certain other provisions of the Indenture cannot be modified or waived without the consent of the Holder of each outstanding New Note or New Bond affected thereby.

The Issuer and the Trustee may, without the vote or consent of any Holder of New Notes or New Bonds, modify or amend the Indenture or New Notes or the New Bonds, as the case may be, for the purpose of (a) adding to the covenants of the Issuer for the benefit of the Holders of the New Notes or the New Bonds, (b) surrendering any right or power conferred upon the Issuer, (c) securing the New Notes or the New Bonds pursuant to the requirements of the New Notes or the New Bonds, as the case may be, or otherwise, (d) curing any ambiguity or curing, correcting or supplementing any defective provision thereof, (e) evidencing the succession of another corporation to the Issuer and the assumption by any such successor of the covenants and obligations of the Issuer in the New Notes and the New Bonds and in the Indenture, (f) amending the Indenture, the New Notes or the New Bonds in any manner which the Issuer and the Trustee may determine and which shall not adversely affect the rights of any Holder of New Notes or New Bonds, as the case may be, in any material respect or (g) modifying, eliminating or adding to the provisions of the Indenture to such extent as shall be necessary to effect the qualification of the Indenture under the Trust Indenture Act or under any similar U.S. federal statute hereafter enacted and adding to the Indenture such provisions as may be expressly permitted by the Trust Indenture Act.

Governing Law, Jurisdiction and Waiver of Immunity

The New Notes, the New Bonds and the Indenture will be governed by and construed in accordance with the laws of the State of New York, except that authorization and execution of such documentation by the Issuer will be governed by the laws of Mexico. The payment obligations of the Guarantors under the Guaranties will be governed by and construed in accordance with the laws of the State of New York.

The Issuer and the Guarantors will each appoint the Consul General of Mexico in New York City and his successors as its agent (the "Process Agent") upon whom process may be served in any action based upon the New Notes, the New Bonds or the Indenture which may be instituted in any federal court in the Borough of Manhattan, The City of New York by the Holder of any New Note or New Bond, and the Issuer, the Guarantors and the Trustee will each irrevocably submit to the jurisdiction of any such court in respect of any such action and each of them will irrevocably waive, to the fullest extent permitted by law, any objection which it may now or hereafter have to the laying of venue of any such action in any such court, and the Issuer and each of the Guarantors will waive any right to which they may be entitled on account of residence or domicile. The Issuer and each of the Guarantors reserve the right to plead sovereign immunity under the Immunities Act with respect to actions brought against any of them under U.S. federal securities laws or any state securities laws, and the Issuer's and each of the Guarantors' appointment of the Process Agent as its agent for service of process will not extend to such actions. In the absence of a waiver of immunity by the Issuer and each of the Guarantors with respect to such actions, it would not be possible to obtain a judgment in an action brought in a U.S. court against the Issuer or such Guarantor unless such court were to determine that the Issuer or such Guarantor is not entitled under the Immunities Act to sovereign immunity with respect to such action. However, even if a United States judgment could be obtained in any such action under the Immunities Act, it may not be possible to obtain in Mexico a judgment based on such a United States judgment. Moreover, execution upon property of the Issuer or such Guarantor located in the United States to enforce a judgment obtained under the Immunities Act may not be possible except under the limited circumstances specified in the Immunities Act.

Article 27 of the Constitution, Articles 16 and 60 of the General Law on National Patrimony (and other related articles), Articles 1, 2, 3, 4 (and related articles) of the Regulatory Law, Articles 15, 16 and 19 of the Regulations to the Regulatory Law, Articles 1, 2, 3, 4 (and other related articles) of the Organic Law of Petróleos Mexicanos and Subsidiary Entities and Article 4 of the Federal Code of Civil Procedure of Mexico set forth, *inter alia*, that (i) attachment prior to judgment, attachment in aid of execution and execution of a final judgment may not be ordered by Mexican Courts against property of the Issuer or any Guarantor, (ii) all domestic petroleum and hydrocarbon resources (whether solid, liquid or in gas form) are permanently and inalienably vested in Mexico (and, to that extent, subject to immunity); (iii) (a) the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil, (b) the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production, and (c) the production, storage, transportation, distribution and first-hand sale of the derivatives of petroleum (including petroleum products) and of natural gas used as basic industrial raw materials and considered "basic petrochemicals" (the "Petroleum Industry") are reserved exclusively to Mexico (and, to that extent, assets related thereto are entitled to immunity); and (iv) the public entities created and appointed by the Federal Congress of Mexico to conduct, control, develop and operate the Petroleum Industry of Mexico are the Issuer and the Guarantors (and, therefore, entitled to immunity in respect to such exclusive rights and power). *As a result, notwithstanding the Issuer's and the Guarantors' waiver of immunity described in the preceding paragraph, a Mexican court may not enforce a judgment against the Issuer or any Guarantor by ordering the attachment of its assets.*

Meetings

The Indenture contains provisions for convening meetings of the holders of New Notes and New Bonds. A meeting may be called at any time by the Trustee under the Indenture, and also, upon written request to the Trustee setting forth in reasonable detail the action proposed to be taken at the meeting, by the Issuer or, after the occurrence and during the continuance of an Event of Default, the Holders of at least 10% in principal amount of the outstanding New Notes and New Bonds, in any such case upon notice given in accordance with the Indenture. At any meeting of Holders, the presence of persons holding or representing New Notes and New Bonds in an aggregate principal amount sufficient under the appropriate provision of the Indenture to take action upon the business for the transaction of which such meeting was called shall constitute a quorum. Any meeting of Holders duly called at which a quorum is present may be adjourned from time to time by persons entitled to vote a majority in principal amount of the outstanding New Notes and New Bonds represented at the meeting and the meeting may be held as so adjourned without further notice. Any resolution passed or decision taken at any meeting of Holders of New Notes and New Bonds duly held in accordance with the Indenture will be binding on all Holders of New Notes and New Bonds.

Notices

All notices to Holders of the New Notes and the New Bonds will be given by mail to their respective addresses appearing in the register maintained by the Trustee. In addition, if and for so long as the New Notes and New Bonds are listed on the Luxembourg Stock Exchange and the rules of such exchange require, such notices will be published in a daily newspaper of general circulation in Luxembourg (expected to be the *Luxembourger Wort*). If publication as aforesaid is not practicable, notice will be validly given if made in accordance with the rules of the Luxembourg Stock Exchange.

TAXATION

The following summary contains a description of the principal Mexican and U.S. federal income tax consequences of the ownership and disposition of the New Notes and the New Bonds and the exchange of Old Notes or Old Bonds for New Notes or New Bonds, respectively, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to exchange Old Notes or Old Bonds for New Notes or New Bonds. This summary is based on the federal tax laws in force on the date of this Prospectus (which are subject to change, which change may have retroactive effect), and does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than Mexico and the United States.

Each holder or beneficial owner of Old Notes or Old Bonds considering an exchange of Old Notes or Old Bonds for New Notes or New Bonds, respectively, should consult its tax advisor as to the Mexican, United States or other tax consequences of the ownership and disposition of the New Notes or New Bonds, as the case may be, and the exchange of Old Notes or Old Bonds for New Notes or New Bonds, respectively, including the effect of any foreign, state or local tax laws.

A Convention for the Avoidance of Double Taxation and a Protocol thereto (the "Tax Treaty") between the United States and Mexico was entered into and became effective on January 1, 1994. Provisions of the Tax Treaty that may affect the taxation of certain U.S. holders of Old Notes and Old Bonds are summarized below. The United States and Mexico have also entered into an agreement that covers the exchange of information with respect to tax matters.

Mexico has also entered into, or is registering, tax treaties with various other countries that may have effects on holders of Notes and Bonds. This summary does not discuss the consequences of such treaties.

Mexican Taxation

This summary of certain Mexican federal tax considerations refers only to holders of New Notes and New Bonds that are not residents of Mexico for Mexican tax purposes and that do not conduct a trade or business through a permanent establishment or fixed base in Mexico (any such non-resident holder a "Foreign Holder"). For purposes of Mexican taxation, an individual is a resident of Mexico if he has established his domicile in Mexico, unless he has resided in another country for more than 183 calendar days, whether consecutive or not, in any one calendar year and can demonstrate that he has become a resident of that other country for tax purposes, and a legal entity is a resident of Mexico if it has been incorporated under the laws of Mexico. A Mexican citizen is presumed to be a resident of Mexico for tax purposes unless such person can demonstrate otherwise. If a person has a permanent establishment or fixed base in Mexico, such permanent establishment or fixed base shall be required to pay taxes in Mexico on income attributable to such permanent establishment or fixed base in accordance with Mexican federal tax law.

Taxation of Interest and Principal. Under the Mexican Income Tax Law, payments of interest made by a Mexican issuer in respect of notes or bonds (including payments of principal in excess of the issue price of such notes or bonds, which, under Mexican law, are deemed to be interest) to a Foreign Holder will generally be subject to a Mexican withholding tax assessed at a rate of 15% if the relevant notes are registered with the Special Section of the Registry.

Pursuant to the Mexican Income Tax Law, payments of interest made by the Issuer or the Guarantors in respect of the New Notes and the New Bonds to a Foreign Holder will be subject to a reduced 4.9% Mexican withholding tax rate (the "Reduced Rate") until December 31, 1998 if (i) the effective beneficiary is a resident, for tax purposes, of a country which has entered into a treaty to avoid double taxation with Mexico which is in effect, (ii) the requirements for the application of a lower rate established in the applicable treaty are satisfied, and (iii) the New Notes and the New Bonds are registered with the Special Section of Registry. Under the Tax Treaty, Foreign Holders that are United States Holders, as defined below, may be eligible for the reduced rates (which are not currently lower than the Reduced Rate).

Pursuant to general rules (the "Reduced Rate Regulations") issued by the Ministry of Finance, payments of interest made by the Issuer or the Guarantors in respect of the New Notes and the New Bonds made by the Issuer to Foreign Holders will be subject to withholding taxes imposed at the Reduced Rate, regardless, generally, of the identity of the holder of the New Notes or New Bonds, if (i) the New Notes and the New Bonds are registered with the Special Section of the Registry, (ii) the Issuer timely files with the Ministry of Finance certain information relating to the issuance of the New Notes and the New Bonds and this Prospectus after completion of the transactions contemplated by this Prospectus, (iii) the Issuer timely files with the Ministry of Finance, after the date of each interest payment on the New Notes and the New Bonds, information representing that no party related to the Issuer (defined under the Reduced Rate Regulations as parties that are (x) shareholders of the Issuer that own, directly or indirectly, individually or collectively with related persons (within the meaning of the Reduced Rate Regulations) more than 10% of the voting stock of the Issuer or (y) corporations more than 20% of the stock of which is owned, directly or indirectly, individually or collectively, by related persons of the Issuer), directly or indirectly, is the effective beneficiary of five percent (5%) or more of the aggregate amount of each such interest payment, and (iv) the Issuer maintains records that evidence compliance with (i), (ii) and (iii) above. The Reduced Rate Regulations, together with other tax regulations, are promulgated on an annual basis, and there can be no assurance that the Reduced Rate Regulations described above for the application of the Reduced Rate will be extended beyond December 31, 1998.

Apart from the Reduced Rate, other special rates of Mexican withholding tax may apply. In particular, under the Tax Treaty, the Mexican withholding tax rate is reduced to 10% (the "Treaty Rate") for certain holders that are residents of the United States (within the meaning of the Tax Treaty) under certain circumstances contemplated therein. The Treaty Rate will be further reduced to 4.9% on January 1, 1999.

Payments of interest made by the Issuer or the Guarantors in respect of the New Notes and the New Bonds to non-Mexican pension or retirement funds will be exempt from Mexican withholding taxes, provided that any such fund (i) is duly incorporated pursuant to the laws of its country of origin, is exempt from income tax in such country and is registered with the Ministry of Finance for that purpose, (ii) the relevant interest income is exempt from taxes in such country and (iii) there is reciprocity between such country and Mexico.

Under existing Mexican law and regulations, payments of principal made by the Issuer or the Guarantors in respect of the New Notes and the New Bonds to a Foreign Holder are not subject to Mexican withholding taxes.

Additional Amounts. The Issuer has agreed, subject to specified exceptions and limitations, to pay Additional Amounts to the holders of the New Notes and the New Bonds in respect of the Mexican withholding taxes mentioned above. If the Issuer pays Additional Amounts in respect of such Mexican withholding taxes, any refunds received with respect to such Additional Amounts will be for the account of the Issuer. See "Description of New Notes and New Bonds—Additional Amounts".

Holders or beneficial owners of New Notes and New Bonds may be requested to provide certain information or documentation necessary to enable the Issuer to establish the appropriate Mexican withholding tax rate applicable to such holders or beneficial owners. In the event that the specified information or documentation concerning the holder or beneficial owner, if requested, is not provided on a timely basis, the obligation of the Issuer to pay Additional Amounts will be limited. See "Description of New Notes and New Bonds—Additional Amounts".

Taxation of Dispositions. Capital gains resulting from the sale or other disposition of the New Notes and the New Bonds by a Foreign Holder (including an exchange of Old Notes or Old Bonds for New Notes or New Bonds pursuant to the Exchange Offers) will not be subject to Mexican income or other taxes.

Transfer and Other Taxes. There are no Mexican stamp, registration, or similar taxes payable by a Foreign Holder in connection with the purchase, ownership or disposition of the New Notes or the New Bonds. A Foreign Holder of New Notes or New Bonds will not be liable for Mexican estate, gift, inheritance or similar tax with respect to the New Notes or the New Bonds.

United States Federal Income Taxation

This summary of certain U.S. federal income tax considerations deals principally with persons that will hold New Notes or New Bonds as capital assets and whose functional currency is the United States dollar. This summary generally does not address the tax treatment of holders that may be subject to special tax rules, such as banks, insurance companies, tax-exempt organizations, dealers in securities or currencies, traders in securities electing to mark to market, or persons that hold (or will hold) the New Notes or the New Bonds as a position in a "straddle" for tax purposes or as part of a "synthetic security" or a "conversion transaction" or other integrated investment comprised of the New Notes or the New Bonds and one or more other investments, nor does it address the tax treatment of holders that do not acquire New Notes or New Bonds at their issue price as part of the initial distribution. Investors who purchase the New Notes or the New Bonds at a price other than the issue price should consult their tax advisor as to the possible applicability to them of the amortizable bond premium or market discount rules.

As used in this section "Taxation," the term "United States Holder" means a beneficial owner of a New Note or a New Bond that is a United States person or that otherwise will be subject to U.S. federal income taxation on a net income basis in respect of the New Notes or the New Bonds. The term "United States person" means a holder of a New Note or New Bond that is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, (iii) an estate the income of which is subject to United States federal income taxation regardless of its source or (iv) a trust if (A) a U.S. court is able to exercise primary supervision over the trust's administration and (B) one or more United States persons have the authority to control all of the trust's substantial decisions.

Taxation of Interest and Additional Amounts. A United States Holder will treat the gross amount of interest and Additional Amounts (*i.e.*, without reduction for Mexican withholding taxes, determined utilizing the appropriate Mexican withholding tax rate applicable to the United States Holder) as ordinary interest income in respect of the New Notes and the New Bonds. Mexican withholding taxes paid at the appropriate rate applicable to the United States Holder will be treated as foreign income taxes eligible for credit against such United States Holder's U.S. federal income tax liability, subject to generally applicable limitations and conditions, or, at the election of such United States Holder, for deduction in computing such United States Holder's taxable income. Interest and Additional Amounts will constitute income from sources without the United States for U.S. foreign tax credit purposes. Such income generally will constitute "passive income" or, in the case of certain United States Holders, "financial services income" for U.S. foreign tax credit purposes unless the Mexican withholding tax applicable to the United States Holder is imposed at a rate of at least 5%, in which case such income generally will constitute "high withholding tax interest".

The calculation of foreign tax credits and, in the case of a United States Holder that elects to deduct foreign taxes, the availability of deductions, involves the application of rules that depend on a United States Holder's particular circumstances. United States Holders should consult their own tax advisors regarding the availability of foreign tax credits and the treatment of Additional Amounts.

Taxation of Dispositions. A United States Holder's tax basis in a New Note or a New Bond generally will be the basis of the Old Note or Old Bond exchanged therefor. Upon the sale, exchange or retirement of a New Note or a New Bond, a United States Holder will generally recognize gain or loss equal to the difference between the amount realized (not including any amounts attributable to accrued and unpaid interest) and the holder's tax basis in the New Note or the New Bond. Gain or loss recognized by a United States Holder on the sale, redemption or other disposition of New Notes or New Bonds generally will be long-term capital gain or loss if, at the time of disposition, the New Notes or New Bonds, as the case may be, have been held for more than one year. Under recently enacted legislation, long-term capital gains recognized by an individual holder generally are subject to a maximum rate of 20% in respect of property held for more than one year, effective for amounts properly taken into account on or after January 1, 1998.

Exchange Offers. Pursuant to the Exchange Offers contemplated by the Issuer herein, an exchange of Old Notes or Old Bonds for New Notes or New Bonds, as the case may be, will not be a taxable event for U.S. federal income tax purposes because the New Notes and the New Bonds should not be considered to differ materially in kind or extent from the Old Notes and the Old Bonds, respectively. As a result, no material U.S. federal income tax consequences should result to United States Holders exchanging Old Notes or Old Bonds for New Notes or New Bonds. A United States Holder's tax basis in the New Notes or New Bonds will be the same as such holder's tax basis in its Old Notes or Old Bonds, respectively.

Non-United States Holders. Holders of New Notes or New Bonds that are not United States persons will not be subject to United States federal income taxes, including withholding taxes, on payments of interest on the New Notes or New Bonds so long as the requirements described under "Backup Withholding and Information Reporting" are satisfied, unless:

(i) the holder is an insurance company carrying on a United States insurance business, within the meaning of the United States Internal Revenue Code of 1986, to which the interest is attributable, or

(ii) the holder has an office or other fixed place of business in the United States to which the interest is attributable and the interest either (a) is derived in the active conduct of a banking, financing or similar business within the United States or (b) is received by a corporation the principal business of which is trading in stock or securities for its own account, and certain other conditions exist.

The gain realized on any sale or exchange of the New Notes or New Bonds by a holder that is not a United States person will not be subject to United States federal income tax, including withholding tax, unless (i) such gain is effectively connected with the conduct by the holder of a trade or business in the United States or (ii) in the case of gain realized by an individual holder, the holder is present in the United States for 183 days or more in the taxable year of the sale and either (A) such gain or income is attributable to an office or other fixed place of business maintained in the United States by such holder or (B) such holder has a tax home in the United States.

A New Note or New Bond held by an individual holder who at the time of death is a nonresident alien will not be subject to United States federal estate tax.

Backup Withholding and Information Reporting. The principal Paying Agent will be required to file information returns with the Internal Revenue Service with respect to payments made to certain United States Holders of New Notes and New Bonds. In addition, certain United States Holders may be subject to a 31 percent backup withholding tax in respect of such payments if they do not provide their accurate taxpayer identification numbers to the principal Paying Agent or in certain other circumstances. Persons holding New Notes or New Bonds who are Non-U.S. Holders may be required to comply with applicable certification procedures to establish that they are not United States Holders in order to avoid the application of such information reporting requirements and backup withholding tax.

PLAN OF DISTRIBUTION

Each broker-dealer that receives New Notes or New Bonds for its own account pursuant to the Exchange Offers (each, a "Restricted Holder") must acknowledge that it will deliver this Prospectus in connection with any resale of such New Notes or New Bonds. This Prospectus, as it may be amended or supplemented from time to time, may be used by a Restricted Holder in connection with resales of New Notes or New Bonds received in exchange for Old Notes or Old Bonds where such Old Notes or Old Bonds were acquired as a result of market-making activities or other trading activities. For a period of 180 days after the Expiration Date, the Issuer will use its best efforts to keep the Exchange Offer Registration Statement continuously effective and to amend and supplement the Prospectus contained therein in order to permit such Prospectus to be lawfully delivered by any Restricted Holder for use in connection with any such resale, *provided* that such Restricted Holder indicates in its Letter of Transmittal that it is a broker-dealer and makes the representations required to be included in the Letters of Transmittal. See "Exchange Offers —Terms of the Exchange Offers—Procedures for Tendering Old Notes and Old Bonds". However, if any holder is acquiring New Notes or New Bonds in the Exchange Offers for the purpose of distributing or participating in a distribution of the New Notes or the New Bonds, such holder cannot rely on the position of the staff of the Commission enunciated in the no-action letters regarding *Morgan Stanley & Co., Incorporated* (available June 5, 1991) and *Exxon Capital Holdings Corporation* (available May 13, 1988), or interpreted in the Commission interpretive letter to *Shearman & Sterling* (available July 2, 1993), or similar no-action or interpretive letters, and must comply with the registration and prospectus delivery requirements of the Securities Act, including the maintenance of an effective registration statement containing the selling securityholder information required by Item 507 of Regulation S-K, in connection with any secondary resale transaction, unless an exemption from registration is otherwise available.

The Issuer will not receive any proceeds from the exchange of Old Notes or Old Bonds for New Notes or New Bonds (including proceeds from any sale of New Notes or New Bonds by Restricted Holders). New Notes or New Bonds received by Restricted Holders for their own account pursuant to the Exchange Offers may be sold from time to time in one or more transactions in the over-the-counter market, in negotiated transactions, through the writing of options on the New Notes or the New Bonds or a combination of such methods of resale, and at market prices prevailing at the time of resale, at prices related to such prevailing market prices or at negotiated prices. Any such resale may be made directly to purchasers or to or through Restricted Holders who may receive compensation in the form of commissions or concessions from any such Restricted Holder and/or the purchasers of any New Notes or New Bonds. Any Restricted Holder that resells New Notes or New Bonds that were received by it for its own account pursuant to the Exchange Offers and any person that participates in the distribution of such New Notes or New Bonds may be deemed to be an "underwriter" within the meaning of the Securities Act and any profit on any such resale of New Notes or New Bonds or any commissions or concessions received by any such Restricted Holders may be deemed to be underwriting compensation under the Securities Act. The Letters of Transmittal state that by acknowledging that it will deliver and by delivering a Prospectus, a Restricted Holder will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act.

For a period of 180 days after the Expiration Date, the Issuer will promptly send additional copies of this Prospectus and any amendment or supplement to this Prospectus to any Restricted Holder that requests such document in the Letter of Transmittal.

By acceptance of the Exchange Offers, each Restricted Holder that receives New Notes or New Bonds pursuant to the Exchange Offers agrees that, upon receipt of notice from the Issuer of the happening of any event which makes any statement in this Prospectus untrue in any material respect or which requires the making of any changes in this Prospectus in order to make the statements therein not misleading (which notice the Issuer agrees to deliver promptly to such

Restricted Holder), such Restricted Holder will suspend use of this Prospectus until the Issuer has amended or supplemented this Prospectus to correct such misstatement or omission and has furnished copies of the amended or supplemented Prospectus to such Restricted Holder or until such Restricted Holder is advised in writing by the Issuer that the use of the Prospectus may be resumed, and such Restricted Holder has received copies of any additional or supplemental filings that are incorporated by reference in the Prospectus. If the Issuer gives any such notice to suspend the use of this Prospectus, it will extend the 180-day period referred to above by the number of days during the period from and including the date of the giving of such notice up to and including when Restricted Holders shall have received copies of the supplemented or amended Prospectus or until such Restricted Holders have received a statement in writing from the Issuer that the use of the Prospectus may be resumed and have received copies of any additional or supplemental filings that are incorporated by reference in the Prospectus necessary to permit resales of the New Notes or the New Bonds.

The New Notes and the New Bonds are each a new issue of securities with no established trading market. The Issuer has made application to list the New Notes and the New Bonds on the Luxembourg Stock Exchange. There can be no assurance that an active market for the New Notes or the New Bonds will exist at any time and, if any such market develops, there can be no assurance as to its liquidity.

VALIDITY OF SECURITIES

The validity under New York law of the New Notes, the New Bonds and the Guaranties offered hereby will be passed upon for the Issuer and the Guarantors by Cleary, Gottlieb, Steen & Hamilton, United States counsel for the Issuer. Certain legal matters governed by Mexican law will be passed upon for the Issuer and the Guarantors by Francisco Javier Zenteno Barrios, General Counsel and Head of the Legal Department of Petróleos Mexicanos.

PUBLIC OFFICIAL DOCUMENTS AND STATEMENTS

The information included herein under the heading "Exchange Rates" and in "Annex A —United Mexican States" hereto and identified as having been extracted or derived from a publication of or sourced from Mexico or one of its agencies or instrumentalities is included herein on the authority of such publication or source as a public official document of Mexico. All other information herein is included as a public official statement made on the authority of the Director General of the Issuer, Adrián Lajous Vargas.

EXPERTS

The Financial Statements have been audited by Coopers & Lybrand, Despacho Roberto Casas Alatriste, independent accountants, as stated in their report included herein. All of such Financial Statements have been included herein in reliance upon the authority of said firm as experts in accounting and auditing in giving said report.

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INDEX TO FINANCIAL STATEMENTS

Report of Independent Accountants

To the Mexican Comptroller and
Administrative Development Office
and to the Board of Directors of
Petróleos Mexicanos:

We have audited the accompanying consolidated balance sheets of Petróleos Mexicanos, Subsidiary Entities and Subsidiary Companies as of December 31, 1997 and 1996, and the related consolidated statements of income, changes in equity and changes in financial position for each of the years in the three-year period ended December 31, 1997. These consolidated financial statements are the responsibility of the Management of Petróleos Mexicanos. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Mexico, which are substantially the same as those in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

A new strategy for the petrochemical industry was disclosed on October 13, 1996. This strategy consisted of incorporating seven affiliated companies in a first stage, with a majority state interest. PEMEX contributed the assets and liabilities required for operations to these seven companies. In a second stage, private investors will be invited to participate with 49% of the capital in each one of the affiliated companies.

The effects of inflation are recognized in conformity with Financial Reporting Standard (NIF) 06 BIS/A (Note 2b to the consolidated financial statements) which affect the equity caption titled revaluation surplus. The difference between this standard and Bulletin B-10 of Generally Accepted Accounting Principles is disclosed in Note 14 to the consolidated financial statements.

In our opinion, the aforementioned consolidated financial statements, stated in Mexican pesos, present fairly, in all material respects, the consolidated financial position of Petróleos Mexicanos, Subsidiary Entities and Subsidiary Companies as of December 31, 1997 and 1996, and the consolidated results of operations, changes in consolidated equity and changes in consolidated financial position for each of the years in the three-year period ended December 31, 1997, in conformity with accounting principles generally accepted in Mexico and, as to the recognition of inflation, in accordance with NIF-06 BIS/A (see Notes 2b and 14 to the consolidated financial statements).

Generally accepted accounting principles in Mexico vary in certain significant respects from accounting principles generally accepted in the United States. In our opinion, based on our audits, the application of accounting principles generally accepted in the United States would have affected the determination of income in each of the three years in the period ended December 31, 1997, and total equity at December 31, 1997 and 1996 to the extent summarized in Note 16 to the consolidated financial statements.

COOPERS & LYBRAND

DESPACHO ROBERTO CASAS ALATRISTE

Manuel Alatriste
Contador Público

Mexico, D.F., Mexico
March 20, 1998 (except for Note 16 to the consolidated financial statements, for which the date is June 26, 1998)

PETROLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 1997 and 1996
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3, and 14)

	1997	1997	1996
ASSETS:			
Current assets:			
Cash and cash equivalents	US$ 2,156,156	Ps. 17,428,855	Ps. 17,999,663
Accounts and notes receivable, net (Note 4)	3,918,644	31,675,575	32,945,987
Investment fund for specific projects (Note 2n)	—	—	8,108,636
Inventories, net (Note 5)	1,895,735	15,323,797	15,266,749
Total current assets	7,970,535	64,428,227	74,321,035
Properties, net (Note 7)	29,371,264	237,416,741	206,665,398
Other assets (Notes 6 and 11)	5,274,415	42,634,682	31,062,654
Total assets	US$42,616,214	Ps.344,479,650	Ps.312,049,087
LIABILITIES:			
Current liabilities:			
Short-term debt and current portion of Long-term debt (Note 9)	US$ 4,420,423	Ps. 35,731,604	Ps. 36,867,064
Suppliers	631,035	5,100,845	7,815,868
Accounts payable and accrued expenses (Note 8)	1,171,970	9,473,386	3,301,118
Taxes payable	1,353,158	10,937,984	16,689,885
Total current liabilities	7,576,586	61,243,819	64,673,935
Long-term debt (Note 9)	6,969,794	56,338,936	42,534,637
Reserve for sundry credits and others (Note 12)	429,206	3,469,399	3,439,949
Reserve for retirement payments, Pensions and indemnities (Notes 2h and 11)	8,075,537	65,276,990	45,621,029
Commitments and contingencies (Note 12)	—	—	—
Total liabilities	US$23,051,123	Ps.186,329,144	Ps.156,269,550
EQUITY:			
Certificates of Contribution "A" (Note 13)	1,264,640	10,222,463	22,340,513
Specific oil-field exploration and depletion reserve (Notes 2c, 2d and 13)	1,017,784	8,227,056	8,636,897
Revaluation surplus	13,974,429	112,959,504	99,225,314
Retained earnings:			
Prior years	2,325,201	18,795,296	9,082,212
Current year income	983,037	7,946,187	16,494,601
	3,308,238	26,741,483	25,576,813
Total equity	19,565,091	158,150,506	155,779,537
Total liabilities and equity	US$42,616,214	Ps.344,479,650	Ps.312,049,087

Mexico is the owner of the hydrocarbon reserves being developed by PEMEX (Note 1); accordingly, such reserves are not reflected in these financial statements. According to technical studies (unaudited), Mexico's proved hydrocarbon reserves were 60,160 million barrels at December 31, 1997 and 60,900 million barrels at December 31, 1996.

The accompanying notes are an integral part of these consolidated financial statements.

PETROLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3 and 14)

	1997	1997	1996	1995
Net sales:				
Domestic	US$20,454,782	Ps.165,342,136	Ps.130,843,862	Ps.92,125,412
Export	12,208,902	98,688,221	101,149,072	65,184,186
	32,663,684	264,030,357	231,992,934	157,309,598
Foreign exchange gain, net (Note 2g)	45,178	365,190	474,671	1,601,151
Other revenues	632,383	5,111,740	3,352,319	2,636,276
Total revenues	33,341,245	269,507,287	235,819,924	161,547,025
Costs and operating expenses:				
Cost of sales	9,758,438	78,880,379	56,739,019	45,723,632
Transportation and distribution expenses	917,545	7,416,791	4,880,592	4,497,313
Administrative expenses	1,661,096	13,427,140	11,662,348	8,510,409
Interest, net	108,605	877,887	(773,248)	(1,052,045)
Other expenses	182,273	1,473,364	1,844,354	1,472,113
Special tax on production and services (IEPS)	4,667,441	37,728,329	19,766,891	17,703,170
Hydrocarbon extraction duties and other	15,062,810	121,757,210	125,205,367	74,883,795
Total costs and operating expenses	32,358,208	261,561,100	219,325,323	151,738,387
Income for the year (Note 13)	US$ 983,037	Ps. 7,946,187	Ps. 16,494,601	Ps. 9,808,638

The accompanying notes are an integral part of these consolidated financial statements.

PETROLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, and 14)

	Certificates Of Contribution "A" (Note 13)	Reserve for Oil Field Exploration and Depletion (Notes 2c and 2d)	Revaluation Surplus	Retained Earnings (Note 13): Prior Years	Retained Earnings (Note 13): Current Year Income	Total Equity
Balances at December 31,1994	Ps.22,340,513	Ps.8,421,110	Ps.82,624,862	Ps.1,518,822	Ps.3,326,259	Ps.118,231,566
Dividends paid to the Federal Government approved by the Board of Directors on June 28 1995 (Note 13)				(1,661,022)		(1,661,022)
Transfer to prior years' retained earnings approved by the Board of Directors (Note 13)				3,196,272	(3,196,272)	
Transfer to prior years' retained earnings				129,987	(129,987)	
Increase in (allocations of) reserve for oil field exploration and depletion (Notes 2c and 2d):						
Increase charged to cost of sales		3,609,444				3,609,444
Capitalized exploration and drilling cost of producing oil wells		4,458,827				4,458,827
Exploration and drilling costs		(7,229,128)				(7,229,128)
Effect of restatement in the year, net			(616,332)			(616,332)
Income for the year					9,808,638	9,808,638
Balances at December 31, 1995	22,340,513	9,260,253	82,008,530	3,184,059	9,808,638	126,601,993
Transfer to prior years' retained earnings approved by the Board of Directors (Note 13)				10,182,548	(10,182,548)	
Transfer to prior years' retained earnings				(373,910)	373,91	
Dividends paid to the Federal Government approved by the Board of Directors on May 29, 1996 (Note 13)				(4,289,362)		(4,289,362)
Recognition of income related to prior years received from the Ministry of Finance and Public Credit (Note 13)				11,331,000		11,331,000
Recognition of tax debts related to prior years payable to the Ministry of Finance and Public Credit (Note 13)				(10,952,123)		(10,952,123)
Increase in (allocations of) reserve for oil field exploration and depletion (Notes 2c and 2d):						
Increase charged to cost of sales		4,397,509				4,397,509
Capitalized exploration and drilling cost of producing oil wells		4,802,150				4,802,150
Exploration and drilling costs		(9,823,015)				(9,823,015)
Effect of restatement in the year, net			17,216,784			17,216,784
Income for the year					16,494,601	16,494,601
Balances at December 31, 1996	22,340,513	8,636,897	99,225,314	9,082,212	16,494,601	155,779,537
Transfer to prior years' retained earnings approved by the Board of Directors (Note 13)				16,516,973	(16,516,973)	
Transfer to prior years' retained earnings				(22,372)	22,372	
Dividends paid to the Federal Government approved by the Board of Directors on April 28, 1997 (Note 13)				(6,781,517)		(6,781,517)
Reduction of Certificates of Contribution "A" approved by the Board of Directors (Note 13) through cash payment to the Federal Government	(12,118,050)					(12,118,050)
Increase in (allocations of) reserve for oil field exploration and depletion (Notes 2c and 2d):						
Increase charged to cost of sales		6,043,048				6,043,048
Capitalized exploration and drilling cost of producing oil wells		4,589,827				4,589,827
Exploration and drilling costs		(11,042,716)				(11,042,716)
Effect of restatement in the year, net			13,734,190			13,734,190
Income for the year					7,946,187	7,946,187
Balances at December 31, 1997	Ps. 10,222,463	Ps. 8,227,056	Ps.112,959,504	Ps. 18,795,296	Ps. 7,946,187	Ps.158,150,506

The accompanying notes are an integral part of these consolidated financial statements.

PETROLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
STATEMENTS OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3 and 14)

		1997		1997		1996		1995
Funds provided by (applied in):								
Operations:								
Income for the year	US$	983,037	Ps.	7,946,187	Ps.	16,494,601	Ps.	9,808,638
Add charges to income not requiring the use of funds:								
Depreciation and amortization		1,319,835		10,668,623		10,398,324		9,385,382
Increase in the reserves for:								
Retirement payments, pensions and indemnities		1,746,806		14,119,953		8,030,441		6,999,057
Oil-field exploration and depletion		747,597		6,043,048		4,397,509		3,609,444
Environmental liabilities		10,408		84,130		453,871		1,674,852
		4,807,683		38,861,941		39,774,746		31,477,373
Decrease (increase) in:								
Accounts and notes receivable		157,165		1,270,412		(11,245,025)		(7,608,895)
Inventories		(7,058)		(57,048)		(5,041,083)		(3,192,699)
Other assets		(8,076)		(65,282)		(923,060)		(1,867,625)
Increase (decrease) in:								
Accounts payable and accrued expenses		427,702		3,457,245		3,960,116		999,045
Taxes payable		(711,578)		(5,751,901)		10,565,836		2,496,398
Reserve for sundry credits		(6,765)		(54,680)		768,068		43,035
Net Reduction to the reserve for retirement, pensions and indemnities		(738,651)		(5,970,738)		(3,093,996)		(2,322,066)
Exploration and drilling expenses charged to the reserve for oil-field exploration and depletion (net)		(798,299)		(6,452,889)		(5,020,865)		(2,770,301)
Funds provided by operations		3,122,123		25,237,060		29,744,737		17,254,265
Financing:								
Net increase in financing		1,567,285		12,668,839		5,777,949		23,560,193
Dividends paid to the Federal Government		(838,954)		(6,781,517)		(4,289,362)		(1,661,022)
Reduction of the Certificates of Contribution "A"		(1,499,146)		(12,118,050)		—		—
Effect of settlements with the Ministry of Finance and Public Credit (Note 13)		—		—		378,877		—
Funds (applied in) provided by financing activities		(770,815)		(6,230,728)		1,867,464		21,899,171
Investment:								
Net investment at cost in properties (includes capitalized interest and exchange loss)		(3,425,058)		(27,685,776)		(17,291,129)		(33,147,694)
Investment fund for specific projects		1,003,134		8,108,636		(8,108,636)		—
Funds applied in investment activities		(2,421,924)		(19,577,140)		(25,399,765)		(33,147,694)
Increase (decrease) in cash and cash equivalents		(70,616)		(570,808)		6,212,436		6,005,742
Cash and cash equivalents at beginning of the year		2,226,772		17,999,663		11,787,227		5,781,485
Cash and cash equivalents at end of the year	US$	2,156,156	Ps.	17,428,855	Ps.	17,999,663	Ps.	11,787,227

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 1997, 1996 and 1995
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1. STRUCTURE AND ACTIVITIES OF PEMEX:

As a result of the nationalization of the foreign-owned oil companies then operating in the United Mexican States ("Mexico"), Petróleos Mexicanos was established by a decree of the Mexican Congress passed on June 7, 1938. Petróleos Mexicanos and the Subsidiary Entities ("PEMEX") together comprise Mexico's state oil company.

The activities of Petróleos Mexicanos, Subsidiary Entities and Subsidiary Companies are regulated by the *Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo* (the Regulatory Law to the Constitutional Article 27 in the Petroleum Sector, or "Regulatory Law"), effective November 30, 1958, as amended effective May 12, 1995 and November 14, 1996, and PEMEX's statutory charter, the *Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios* (the Organic Law of Petróleos Mexicanos and Subsidiary Entities, or "Organic Law"), effective July 17, 1992, as amended effective January 1, 1994. Pursuant to the Organic Law and related regulations, PEMEX's principal objectives are the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil, natural gas and their derivatives and by-products, as well as the production, storage, transportation, distribution and first-hand sale of the derivatives of petroleum (including petroleum products) and of natural gas used as basic industrial raw material and considered a basic petrochemical. Under the Organic Law and related regulations, Petróleos Mexicanos is entrusted with the central planning and the strategic management of Mexico's petroleum industry. The Organic Law separates the operating functions of Petróleos Mexicanos into four Subsidiary Entities, which are controlled by (and have characteristics of subsidiaries of) Petróleos Mexicanos, a Decentralized Public Entity of the Federal Government of Mexico.

The Organic Law establishes a structure which consists of decentralized legal entities of a technical, industrial and commercial nature, with their own corporate identity and equity. The Subsidiary Entities, which are empowered to own property and conduct business in their names, are:

Pemex-Exploración y Producción (Exploration and Production);
Pemex-Refinación (Refining);
Pemex-Gas y Petroquímica Básica (Gas and Basic Petrochemicals); and
Pemex-Petroquímica (Petrochemicals).

The strategic activities entrusted to Petróleos Mexicanos and Subsidiary Entities, except for Pemex-Petroquímica, by the Organic Law can be performed only by PEMEX and cannot be delegated or subcontracted.

On October 13, 1996, the Ministry of Energy disclosed a new strategy for the privatization of the petrochemical industry. In 1997, the Board of Directors of Petróleos Mexicanos adopted the following resolutions related to the new strategy:

a) The incorporation by Pemex-Petroquímica of seven wholly owned corporations with variable capital through the contribution of assets associated with the production of non-basic petrochemicals, as well as the real estate related to each complex or plant, and the transfer of the corresponding rights and obligations.

b) The transfer of all related personnel to the new corporations along with the corresponding liabilities.

c) Once the subsidiary corporations are operational, private investors will be invited to participate in up to 49% of their capital.

The 1995 amendment to the Regulatory Law allows for private participation in transportation, distribution, and storage of natural gas.

2. ACCOUNTING POLICIES:

The principal accounting policies followed by PEMEX in the preparation of these financial statements are summarized below:

a. Consolidation.

The consolidated financial statements include the accounts of Petróleos Mexicanos, of the Subsidiary Entities (which include the seven wholly owned corporations) and of subsidiary companies in which it owns more than a 50% ownership interest. All material intercompany transactions have been eliminated in the consolidation.

The subsidiary companies that are consolidated are: P.M.I. Comercio Internacional, S.A. de C.V., P.M.I. Trading Ltd., P.M.I. Holdings, N.V., P.M.I. Holdings B.V., P.M.I. Norteamérica, S.A. de C.V., KOT Insurance Co. Ltd., Integrated Trade Systems, Inc. and P.M.I. Marine Limited. Including these subsidiaries in the consolidation, after eliminations, increased total assets by Ps.1,108 million (Ps.1,865 million in 1996); decreased equity by Ps.601 million (Ps.1,061 million in 1996); and increased income for the year by Ps.136 million (decrease of Ps.22 million in 1996 and a decrease of Ps. 374 million in 1995).

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Certain investments in other subsidiaries and associated companies, due to their immateriality in relation to PEMEX's total assets and income, are accounted for under the cost method.

During 1997, PEMEX began investing in certain capital expenditure projects, which are assets financed with long-term debt obligations. Such investment expenses and related liabilities will be accounted for in subsequent years. These projects have been denominated "Investment Projects with Deferred Impact on the Expense Register" ("PIDIREGAS").

Based on Financial Reporting Standard (NIF) 09 applicable to *Entidades Paraestatales de la Administración Pública* (State-owned Entities of the Federal Public Administration) for the purpose of a special financial report, PEMEX accounted for the assets and liabilities related to those projects in memorandum accounts (off balance sheet) in the separate financial statements issued in accordance with Financial Reporting Standards. Such investment expenses and related liabilities will be accounted for in subsequent years. However, for these consolidated financial statements, following the guidelines for consolidation in accordance with generally accepted accounting principles in Mexico ("Mexican GAAP"), the necessary reclassifications were made to recognize the effects of the PIDIREGAS projects, thereby fully recording the assets acquired and the related debt incurred.

b. *Effects of Inflation on the Financial Information.*

The financial statements of PEMEX are prepared in conformity with Mexican GAAP and, as to the recognition of inflation, in accordance with the guidelines established in Financial Reporting Standard (NIF-06 BIS/A) issued by the Ministry of Finance and Public Credit and the Comptroller and Administrative Development Office. The principal requirements of NIF-06 BIS/A are as follows:

(a) Fixed assets (property and equipment) and accumulated depreciation are restated for balance sheet presentation at net replacement cost, based upon annual appraisals made by independent appraisers or based upon the use of a specific price index (the "SPI") calculated by the Instituto Mexicano del Petróleo (the Mexican Petroleum Institute or "IMP") a Decentralized Public Entity of the Federal Government of Mexico. The difference between the historical cost and the restated costs is recorded as Revaluation Surplus in equity.

(b) Materials and supplies inventory must be restated based upon the last purchase price.

c. *Specific Oil Field Exploration and Depletion Reserve*.

The specific oil field exploration and depletion reserve is established to cover current and future exploration and drilling costs. As oil and gas are extracted from existing wells, the equity reserve is increased based on a exploration and drilling cost per barrel, with a corresponding amount charged to cost of sales. Accumulated drilling costs related to successful wells are capitalized as fixed assets and a corresponding amount is added back to the reserve.

As a result of the findings of a technical study of budgeted exploration costs per barrel, PEMEX increased the budgeted exploration and drilling cost per barrel from Ps.3.25 to Ps.4.23 in 1997, Ps.2.92 to Ps.3.25 in 1996 and Ps.1.47 to Ps.2.92 in 1995. This increase resulted in an additional charge to cost of sales of Ps.1,400,000 in 1997, Ps.447,000 in 1996 and Ps.1,792,000 in 1995.

d. *Exploration and Drilling Costs*.

The successful efforts method of accounting is followed through the specific oil field exploration and depletion reserve as discussed in Note 2c. Geological and geophysical costs are expensed through the reserve.

e. *Inventory Valuation*.

Crude oil for export is valued at net realizable value, determined on the basis of average export prices less a provision for distribution expenses and shrinkage.

Crude oil inventories for domestic sales, refined products and petrochemicals are valued at cost, as calculated based on realizable market prices.

Materials, spare parts and supplies are restated at the last purchase price.

f. *Properties*.

PEMEX's assets are initially recorded at acquisition or construction cost. Exchange losses arising from the impact of foreign currency fluctuations on the value of foreign currency denominated debt and incurred interest costs are capitalized as part of the cost. The book values of these assets are restated annually based on appraisals made by independent appraisers or based upon a specific price index calculated by IMP. The recorded value of these assets cannot exceed the annual appraisal value or specific price index value as calculated by IMP. In the case of capitalized lease assets, the carrying cost is the sum of the lease payments less interest, subject to revaluation based on appraisals.

(In thousands of pesos and thousands of U.S. dollars)

Property, plant and equipment are depreciated using the straight-line method at annual rates based on studies performed by appraisers. The depreciation rates used by PEMEX are as follows:

	%
Buildings	3
Plant, wells and drilling equipment	3 - 5
Furniture and fixtures	10
Offshore platforms	4
Transportation equipment	4 - 20
Pipelines	2
Software/computers	10 - 25

The related gains or losses from the sale or disposal of fixed assets are recognized in the income of the year.

g. *Foreign Currency Balances and Transactions*.

Transactions in foreign currency are recorded at the exchange rates in effect on the date the transactions are entered into and the related asset or liability is recorded. Assets and liabilities in foreign currencies are stated in pesos at the rates in effect at the balance sheet date. Exchange losses arising from the impact of foreign currency fluctuations on the value of the foreign currency denominated debt and incurred interest costs are capitalized as part of fixed assets. Foreign exchange losses that are not capitalized and all foreign exchange gains are charged or credited to income, which generated net exchange gains reflected in income of Ps.365,190, Ps.474,671, and Ps.1,601,151 in 1997, 1996 and 1995 respectively.

h. *Retirement Benefits and Seniority Premiums*.

In 1989, PEMEX established a pension plan for retirement and seniority premiums for its employees. The related liability and contribution to the fund are calculated by the projected unit credit method established by Mexican GAAP Bulletin D-3.

Payments for seniority pensions and premiums are debited to the reserve created for that purpose.

Payments for indemnities to dismissed personnel are charged to income in the year in which they are paid.

i. *Net Sales and Cost of Sales*.

PEMEX records sales when products are shipped to customers under terms of FOB shipping point. Cost of sales is determined by adding to the beginning inventories the increase in the reserve for exploration and depletion of oil fields (a fixed charge per extracted barrel), the operating cost of oil fields, refineries and plants, the purchases of crude oil and refined and other products, and deducting the ending inventories.

j. *Taxes and Federal Duties*.

PEMEX is subject to special tax laws, which are based on petroleum revenues and do not generate temporary differences, or deferred income taxes. Petróleos Mexicanos and Subsidiary Entities are not subject to the *Ley del Impuesto Sobre la Renta* (Income Tax Law) or the *Ley del Impuesto al Activo* (Assets Tax Law). Some of the Subsidiary Companies are subject to the income tax but they do not generate significant deferred taxes.

PEMEX is subject to the following duties and taxes: hydrocarbon extraction duties, hydrocarbon income tax and a special tax on production and services (IEPS tax).

Effective January 1, 1994, hydrocarbon extraction duties are calculated at a rate of 52.3% on the net cash flows of the difference between crude oil sales and extraction costs and expenses. Extraordinary and additional hydrocarbon extraction duties are calculated at a rate of 25.5% and 1.1%, respectively, on the same basis.

The sum of such duties and taxes must equal 60.8% of PEMEX's annual sales revenues to third parties (and an additional 39.2% of the portion of revenues in respect of crude oil sales at prices in excess of US$14.50 per barrel for 1997). Therefore, to the extent that the sum of hydrocarbon extraction duties is less than 60.8% of sales to third parties, additional taxes are paid to reach that level.

The hydrocarbon extraction duties and the special tax on production and services are reflected in the income statement under the caption costs and operating expenses.

k. *Special Tax on Production and Services*.

The special tax on production and services is a tax on the sales of gasolines and diesel and jet fuel. The applicable rates depend, among other factors, on the product, producer's price, freight costs, commissions and the region in which each product is sold.

Net sales include amounts collected from customers for special tax on production and services for 1997, 1996 and 1995.

l. *Financial Statement Presentation*.

For financial statement purposes, the special tax on production and services is presented in sales when charged to customers and, at the same time, as an operating expense.

m. *Risk Management Instruments*.

The income statement effects of entering into "swap" transactions are recorded as incurred and the settlement amounts are known. The income statement effect of other derivative instruments, including premiums paid or received, is recognized at the date of receipt or payment. Such amounts are included in the income statement whithin Interest, net. See Note 10 for further disclosure regarding derivative instruments.

n. *Investment fund for specific projects*.

The investment fund for specific projects was authorized by the Ministry of Finance and Public Credit. With this fund, PEMEX increased its investments in capital improvement in 1997, mainly relating to oil extraction projects.

o. *Use of Estimates*.

The consolidated financial statements are prepared in conformity with Mexican GAAP, which require management to make estimates and assumptions that affect the amounts of assets and liabilities and the disclosures of contingent liabilities as of the financial statement date and the amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

p. *Convenience Translation*.

United States dollar amounts shown in the balance sheets, the income statements and the statements of changes in financial position have been included solely for the convenience of the reader. Such amounts are translated from pesos, as a matter of arithmetic computation only, at an exchange rate of 8.0833 pesos per U.S. dollar, which is the December 31, 1997 exchange rate for the settlement of obligations in foreign currencies provided by Banco de México and the Ministry of Finance and Public Credit. Translations herein should not be construed as a representation that the peso amounts have been or could be converted into U.S. dollars at the foregoing rate or any other rate.

(In thousands of pesos and thousands of U.S. dollars)

3. FOREIGN CURRENCY POSITION:

PEMEX and subsidiary companies participate in international markets and carry out transactions in different currencies.

All foreign currency transactions are recorded at the exchange rate required to settle obligations denominated in foreign currencies payable in Mexico, provided by Banco de México and the Ministry of Finance and Public Credit. PEMEX's foreign currency transactions are all handled by Banco de México.

PEMEX and subsidiary companies have the following assets (in addition to crude oil inventories for export) and liabilities denominated in foreign currencies which are stated in pesos at the exchange rate at December 31, 1997 and 1996:

	Exchange Rates (stated in pesos) at December 31,		Amounts (thousands of pesos) at December 31,	
Currency	1997	1996	1997	1996
ASSETS				
U.S. dollars	Ps.8.0833	Ps.7.8509	Ps.21,817,299	Ps.29,132,469
Dutch guilders	3.9908	4.5394	9,912	9,731
Other currencies	Various	Various	15,495	335
LIABILITIES				
U.S. dollars	Ps.8.0833	Ps. 7.8509	Ps.90,664,517	Ps.72,967,813
Pounds sterling	13.3682	13.4133	698,633	710,458
Japanese yen	0.0621	0.0675	7,544,555	8,728,503
Deutsche marks	4.5127	5.0929	94,195	256,636
Austrian schillings	0.6400	0.7168	324,019	362,900
Other currencies	Various	Various	51,574	32,047

As of March 20, 1998, the peso/U.S. dollar exchange rate was Ps. 8.5638 = US$1.00.

(In thousands of pesos and thousands of U.S. dollars)

4. ACCOUNTS AND NOTES RECEIVABLE:

Accounts and notes receivable are as follows:

	1997	1996
Trade:		
Domestic (a)	Ps.14,563,494	Ps.11,569,460
Foreign	6,220,261	9,451,794
Mexican Federal Government:		
Advance payments on minimum guaranteed dividends (Note 13)	5,803,941	6,781,517
Other accounts receivable	5,633,909	5,708,349
Less, allowance for doubtful accounts	(546,030)	(565,133)
	Ps.31,675,575	Ps.32,945,987

(a) These balances include loans to gas station operators for the purchase of gasoline from PEMEX. The operators can borrow the cost of four days' worth of gasoline sales. The loans are for terms of six months and are generally renewed. At December 31, 1997 and 1996 the balance of such loans was Ps.136,000 and Ps.1,081,000, respectively.

5. INVENTORIES:

Inventories are as follows:

	1997	1996
Crude oil, refined products, derivatives and petrochemical products	Ps.11,371,426	Ps.11,635,761
Materials and supplies in stock	5,522,740	4,879,000
Less, allowance for slow-moving inventory and obsolescence	(2,122,045)	(2,141,644)
	3,400,695	2,737,356
Materials in transit	551,676	893,632
	Ps.15,323,797	Ps.15,266,749

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6. OTHER ASSETS:

Other assets include long-term investments as follows:

	1997	1996
Shares of other non-consolidated subsidiaries and affiliates	Ps.1,316,135	Ps.1,157,800

In 1997, Petróleos Mexicanos sold its participation in an associated company, from which it recorded a gain of approximately Ps.516,000 (recorded within other income in the statements of income).

PEMEX has a joint venture with Shell Oil Company, in which it owns a 50% interest in a petroleum refinery located in Deer Park, Texas. The investment is accounted for under the equity method and amounts to Ps.545,781 as of December 31, 1997 (Ps.570,281 in 1996). During 1997, 1996 and 1995, PEMEX recorded Ps.274,715, (Ps.152,597) and (Ps.549,017), respectively, of its equity in the earnings and (losses) of the joint venture. During 1997, 1996 and 1995, PEMEX paid the joint venture Ps.2,097,123, Ps.1,448,059 and Ps.677,813, respectively, for the processing of petroleum. During 1997, 1996 and 1995, PEMEX, through its subsidiary, paid Ps.359,880, Ps.446,187 and Ps.417,464, respectively, to the joint venture under terms of the contract which call for contributions from PEMEX based on the refinery's operating margin.

Other subsidiaries and affiliates are not consolidated as their effect on the financial position and results of operations are not material. The effect of such non-consolidated subsidiaries and affiliates on the 1997, 1996 and 1995 consolidated equity and earnings is less than 1% in each of the three years.

During 1994, through a finance transaction amounting to US$467,000 (approximately Ps.1,597,000), Petróleos Mexicanos sold to a trust substantially all of its share holdings representing 5% of the outstanding shares of Repsol S.A. The trust assets collateralize a bank loan obtained by PEMEX. PEMEX has the right of first refusal to reacquire the shares by May 14, 1999. PEMEX also retained the voting rights associated with the Repsol shares. The finance transaction was renewed on May 9, 1996 and the Repsol shares remain in trust.

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7. PROPERTIES:

The components of this caption are as follows:

	1997	1996
Land	Ps. 9,570,286	Ps. 13,028,077
Buildings	20,885,720	18,587,663
Wells and drilling equipment	101,688,058	75,160,539
Plants	112,019,623	114,734,935
Pipelines	101,929,380	85,014,635
Furniture and fixtures	10,696,803	8,898,848
Land and ocean transportation equipment	7,896,621	8,000,360
Offshore platforms	15,853,383	31,836,405
Leased equipment	1,111,346	1,749,017
	381,651,220	357,010,479
Less, accumulated depreciation and amortization	184,733,922	178,288,536
	196,917,298	178,721,943
Other	1,219,989	1,578,025
Construction in progress	39,279,454	26,365,430
	Ps.237,416,741	Ps.206,665,398

For 1997, fixed assets, excluding furniture and fixtures, transportation equipment and construction in progress, were restated based on appraisals performed by IMP and by an independent appraiser. The appraisals were performed utilizing the specific index method considering usage, a factor for obsolescence, specific costs, remaining useful lives and the relative classification of the fixed assets.

For 1996, these same fixed assets (other than pipelines and related assets discussed below) were restated based on appraisals performed by the IMP utilizing the specific index method as adjusted for obsolescence and usage.

In 1996, the pipelines and assets related to distribution, transportation and storage of natural gas were restated by an independent appraiser through the specific cost method, and useful lives were reviewed. This was done based on the regulation issued by the Energy Regulatory Commission in the matter of natural gas. In 1995, these assets were restated based on appraisals performed by IMP utilizing the specific index method. The impact of the change in method was not significant.

Debt interest costs capitalized as part of construction in progress and wells were Ps.2,282,605 in 1997, Ps.2,285,784 in 1996 and Ps.3,184,997 in 1995. Foreign currency losses associated with PEMEX's debt are capitalized as part of the cost of fixed assets.

(In thousands of pesos and thousands of U.S. dollars)

Foreign currency losses capitalized in 1997, 1996 and 1995 were Ps.1,360,150, Ps.1,043,296, and Ps.20,951,523, respectively.

Depreciation and amortization expenses recorded for 1997, 1996 and 1995 were Ps.10,668,273, Ps.10,398,324 and Ps.9,385,382, respectively.

In 1997, construction in progress includes Ps.4,891,508 of capital projects which are being developed in the Cantarell and Burgos fields, and Ps.132,768 of capitalized interest. These projects constitute the PIDIREGAS projects.

Leased equipment includes drilling and transportation equipment and offshore platforms.

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES:

Accounts payable and accrued expenses are as follows:

	1997	1996
Accounts payable	Ps. 7,247,395	Ps. 1,419,389
Salaries and wages	219,640	107,503
Other accrued expenses	2,006,351	1,774,226
	Ps. 9,473,386	Ps. 3,301,118

9. BORROWINGS:

During 1997, PEMEX contracted several lines of credit totaling Ps.20,248,666 (US$2,505,000) to finance trade operations for the import and export of crude oil and petrochemical products, as well as pre-export of crude oil. At December 31, 1997, the unused, uncommitted amount was Ps.7,978,217 (US$987,000), principally with the syndicated credit of banks represented by Chase Manhattan Bank, Bancomext, Bladex, Swiss Bank and Banesto, among others.

In 1997, PEMEX obtained a line of credit totaling Ps.6,683,307 (US$662,113) granted principally by Société Générale, KFW, Texas Commerce Bank, Standard Chartered Bank and Midland Bank for purchasing loans. Total commitment fees were Ps.577 (US$71) in 1997 and were generally based on undisbursed amounts. The unused uncommitted amount was Ps.2,354,238 (US$291,247) at December 31, 1997.

PEMEX financed certain projects through lines of credit totaling Ps.301,715 (US$38,190) with Nafinsa and Export Import Bank of Japan. The unused and uncommitted amount was Ps.767,422 (US$94,939) at December 31, 1997. The lines of credit required commitment fees of Ps.1,058 (US$131) in 1997 based on undisbursed amounts.

During 1997, the lines of commercial paper program with Bank of America were increased to US$620 million, US$610,000 of which was outstanding at December 31, 1997.

In 1997, five bond issues were placed in the euromarkets: one for ItL 350 billion (Ps.1,659,889, equivalent to US$209,706) with a seven-year maturity at the rate of three month ItL LIBOR plus 165 basis points, one for US$300,000 (Ps.2,372,550) with a ten-year maturity at a rate of 8.5% per annum payable semi-annually, one for ItL 750 billion (Ps.3,306,359, equivalent to US$423,600) with a ten-year maturity and a step-down coupon structure and one for US$250 million (Ps.1,977,450) with a ten-year maturity at a rate of 9% per annum payable semi-annually. Finally, PEMEX issued US$1 billion (Ps.1,977,450) of global notes and bonds with registration rights and divided into two tranches: one for US$600,000 (Ps.4,660,200) with a ten-year maturity at a rate of 8.85% and the other for US$400,000 (Ps.3,106,800) with a thirty-year maturity at a rate of 9.5% per annum.

In 1996, several lines of credit were contracted to finance trade operations for the import and export of oil and petrochemical products, for a total amount of Ps.8,336.7 million, (US$1,137,000), with maturities in the short term; Ps.2,364,100 (US$308,700) was obtained via purchasing loans in the United States. During 1996 PEMEX issued bonds of Ps.6,090,400 (US$792,600) in the European market. The bond issues were two Eurobond transactions for Ps.2,348,900 and Ps.2,289,700 (US$300,000 each) and one issuance of bonds for 300 billion Italian Lira (US$192,600) at rates ranging between 7.75% and 9.084% with a maturity ranging between two and three years. After issuing the Italian Lira bonds, PEMEX entered into a cross currency swap transaction of Ps.1,451,800 (US$192,600), thereby converting its foreign currency risk on the bonds from Lira to dollars.

During 1996, the line of the commercial paper program with Bank of America was increased to US$500,000 with short-term maturity at discount rate in effect in the market plus 5 basis points.

At December 31, 1996, PEMEX has lines of credit for a total amount of Ps.38,024,656 (US$4,843,350).

At December 31, 1997 and 1996, the majority of short-term borrowings were denominated in foreign currencies. The weighted average interest rate for short-term borrowings was approximately 6.46% and 6.20% as of December 31, 1997 and 1996, respectively.

As of December 31, 1997 and 1996, long-term debt is as follows:

	Rate of Interest	Maturity	1997 pesos (thousands)	1997 Foreign currency (thousands)	1996 pesos (thousands)	1996 Foreign currency (thousands)
U.S. dollars (at Ps.8.0833 pesos per dollar in 1997 and Ps.7.8509 pesos in 1996):						
Unsecured loans (1)	Mainly LIBOR plus 0.8125	Several to 2006	Ps. 7,254,884	US$ 897,515	Ps. 7,419,909	US$ 945,103
Unsecured loans	LIBOR plus 1.7	In 1998	323,332	40,000	1,903,971	242,510
Acceptance lines	Acceptance rate plus 0.875% and plus 1%	In 1998	8,948,213	1,107,000	9,892,134	1,260,000
Bonds	Several from 6.873% to 10.252% and LIBOR plus 1.0 and 1.06	Several to 2023	28,869,126	3,571,453	25,289,123	3,221,175
Bonds (financing assigned to the Productive Infrastructure Projects of Deferred Impact in the Expense Register (PIDIREGAS)	8.85% and 9.50%	Several to 2027	8,083,300	1,000,000	—	—
Purchasing loans	Several from 4.77% to 8.28 % and LIBOR plus 0.225 to 0.125	Several to 2006	4,444,202	549,800	3,995,558	508,930
Leasing contracts	Several from 8.89% to 11.74% and LIBOR plus 1.1 to 2.25	Several to 2011	3,972,429	491,437	3,599,708	458,509
Commercial paper	Discount rate in force in the market plus 5 basis points	From 7 to 270 days, renewable	6,345,390	785,000	1,766,452	225,000
Sale of future accounts receivable	7.53%	In 2000	1,947,808	240,967	2,308,478	294,040
External trade loans	LIBOR plus 0.25 and plus 0.5	Several 2002	12,270,449	1,518,000	12,365,167	1,575,000
Total financing denominated in U.S. Dollars			82,459,133	US$ 10,201,172	68,540,500	US$ 8,730,267
Japanese yen (at Ps.0.0621 per yen in 1997 and Ps.0.0675 in 1996):						
Purchasing Loans	Several from 2.22% to 6.1%, 2.9% and PRIME in yen from 3.8% to 6.6%	Several to 2015	7,515,185	121,017,459	8,654,331	128,212,310
Leasing contracts	8.9%	In 1997	—	—	42,355	627,481
Total financing denominated in Japanese yen			7,515,185	121,017,459	8,696,686	128,839,791
Other currencies (2)		Several to 2016	1,111,254		1,326,227	
Total Principal(3)			91,085,572		78,563,413	
Plus: Accrued interest			984,968		838,288	
Total debt			92,070,540		79,401,701	
Less: Short-term debt and Short-term maturities			35,731,604		36,867,064	
Long-term debt			Ps.56,338,936		Ps.42,534,637	

	1998	1999	2000	2001	2002	2003	Over 6 years	Total principal amount of Debt
Maturities (in thousands of Pesos)	Ps. 34,746,636	Ps. 8,432,434	Ps. 9,048,310	Ps. 3,562,023	Ps. 7,380,861	Ps. 2,623,063	Ps. 25,292,245	Ps. 91,085,572

Note:

(1) Unsecured loans remained after a debt restructuring in 1987, which extended maturities which were from 1987 through 1997 to a period from 1994 to 2004 and those which were maturing in 1998 to 2005 and 2006.

(2) Includes market operations, unsecured loans, purchasing loans and project financing in Pounds sterling, Deutsche marks, Swiss francs, Austrian schillings, French francs and Belgian francs at different rates.

(3) Includes foreign financing for Ps.70,132,506 and Ps.68,870,159 in 1997 and 1996, respectively.

(4) At December 31, 1997 the LIBOR rate was 5.60156%, the EURODOLLAR rate was 5.6250%, the Discount rate was 5.5%, the Prime rate in yen was 2.5%, and the acceptance rates ranged from 5.25% to 6.57%.

10. FINANCIAL INSTRUMENTS:

PEMEX operates internationally, which significantly exposes it to market risk associated with interest rates, commodity prices, and foreign exchange rates. PEMEX uses derivative financial instruments to manage interest rate and foreign exchange rate risks, as explained in this note:

a) Notional Amounts and Credit Exposures of Derivatives

The notional amount of derivatives, as summarized in section (b) does not represent amounts that are exchanged by the parties and thus is not a measure of PEMEX's exposure. The amounts exchanged are calculated on the basis of the notional contract amounts, as well as on other terms of the derivatives, which relate to interest rates, exchange rates, securities prices, and the volatility of these rates and prices. PEMEX's cross currency swaps imply an exchange of notional amounts; therefore these swaps are generally entered into with creditors on the underlying debt to avoid credit risk in the notional amounts. All instruments are held for purposes other than trading.

As a creditor, PEMEX faces the risk that counterparties might fail to meet payment obligations, which could cause credit-related losses in the event of nonperformance by the counterparties that issued the financial instruments. The maximum exposure for such loss is the premium paid for the instrument and any unrealized gains or losses on the instrument. To minimize this risk, PEMEX monitors the credit worthiness and exposure to derivative instruments of counterparties, while dealing exclusively with major financial institutions and maintaining a diversified portfolio. As of December 31, 1997, the cash required from counterparties, if they all were to fail to pay their interest rate swap obligations is Ps.1,722 including the established netting agreements. On the other hand, PEMEX as a debtor posts collateral for certain derivative contracts exceeding a threshold amount.

PEMEX's Risk Management Committee, composed of representatives of the PEMEX Finance Department, Banco de México, the Ministry of Finance and Public Credit and P.M.I. Comercio Internacional, S.A. de C.V., authorizes PEMEX's risk management policies and strategies and supervises the investment activities carried out by PEMEX.

b) Interest Rate Risk Management

Interest rate derivatives allow PEMEX to raise long-term borrowings at fixed rates and to select the appropriate level of variable and fixed rate debt for PEMEX.

Approximately 63% of the aggregate of PEMEX debt and the minimum guaranteed dividend rate on the Certificates of Contribution "A" were contracted at floating interest rate terms that re-price every six months. PEMEX has adopted various strategies for interest rate risk management that aim to achieve a desired interest rate mix (fixed versus floating). Interest rate derivatives allow PEMEX to modify the characteristics of its liabilities in a cost efficient manner. At December 31, 1997, the effective interest rate on approximately 76% of PEMEX's debt was converted to fixed rates as stipulated in the debt agreements or through the use of derivatives.

i) Hedging Activities:

The derivative financial instruments used in PEMEX's interest hedging activities consist primarily of: (i) interest rate swaps, in which PEMEX is obligated to make payments based on a fixed interest rate and entitled to receive payments generally based on the three month LIBOR interest rate; and to a lesser extent, (ii) interest rate caps, which set a fixed ceiling.

The level of variable-rate debt is determined by senior management, primarily based on the average expected duration of assets, the shape of the yield curve, and management's outlook for interest rate changes. In order to reduce the volatility of cash flows, PEMEX uses financial derivatives to exchange floating rate debt for fixed rate debt.

In October 1997, PEMEX entered into a LIBOR Basket Swap where US LIBOR was exchanged for a basket of LIBOR rates in other currencies (payable in US dollars). To avoid the negative effects of fixing the interest rate in those currencies under a steep yield curve environment, PEMEX decided to pay floating rate in the LIBOR Basket Swap.

PEMEX has purchased interest rate caps to reduce its exposure to floating interest rates. Interest rate caps entitle PEMEX to receive the amount, if any, by which the three month LIBOR interest rate exceeds the rate specified in the cap agreement on the exercise date of the cap. PEMEX entered into these transactions to take advantage of a reduction in interest rates and to protect itself if interest rates rise.

Average variable rates are based on rates that are implied by the yield curve at the reporting date; these rates may change significantly, affecting future cash flows.

ii) Non-Hedging Activities:

During 1994, PEMEX sold interest rate caps, which are still in place, to synthetically remove the fixed rate leg of the interest rate swaps once the market interest rates increase above the swap fixed rate in exchange for a premium.

PEMEX purchased interest rate floors to synthetically remove the fixed rate leg of the swaps once the market interest rates increase above the swap fixed rate in exchange for a premium. The interest rate floor entitles the holder to receive the amount, if any, by which the 3-month LIBOR rate is less than the rate specified in the floor agreement on the exercise date of the floor.

The following table indicates the types of swaps used, their duration, and their respective interest rates:

Interest Rate Derivatives
Hedging Activities(1)
(In thousands of pesos)

	Notional Amount 1996(2)	Fair Value 1996(3)	Notional Amount 1997(2)	Fair Value 1997(3)
Receive fixed swaps	Ps.52,208,485	Ps.(937,216)	Ps.52,137,285	Ps.(848,610)
Weighted average (maturity years)	2.59		1.64	
Average receive rate	6.13%		6.07%	
Average pay rate	6.82%		6.90%	
Receive variable swaps	—	—	5,052,063	(45,389)
Weighted average (maturity years)	—		2.55	
Average receive rate	—		6.06%	
Average pay rate	—		6.50%	
Caps Purchased	3,140,360	2,261	3,233,320	8
Weighted average (maturity years)	1.70		1.47	
Average receive rate	5.97%		5.95%	
Average pay rate	7.67%		7.72%	

The following table indicates the interest rate options used, the fair values, and the respective interest rates as of December, 1997:

Interest Rate Derivatives
Non-hedging Activities[1]
(In thousands of pesos)

	Notional Amount 1996[2]	Fair Value 1996[3]	Notional Amount 1997[2]	Fair Value 1997[3]
Caps Written	Ps.7,850,900	Ps.(12,148)	Ps.7,274,970	Ps. (905)
Weighted average (maturity years)	2.30		0.66	
Average receive rate	8.70%		6.05%	
Average pay rate	6.17%		8.90%	
Floors Written	5,495,630	(15,720)	4,445,815	(2,503)
Weighted average (maturity years)	1.60		0.88	
Average receive rate	5.99%		5.97%	
Average pay rate	5.50%		5.49%	
Floors Purchased	5,495,630	21,875	5,658,310	4,424
Weighted average (maturity years)	1.90		1.43	
Average receive rate	5.60%		5.60%	
Average pay rate	6.01%		5.97%	

(1) The carrying values these instruments are all nil under Mexican GAAP because PEMEX records premiums paid and received in the income statement.

(2) The notional amounts (actual amounts with respect to foreign currency exchange contracts) shown for the contracts represent the underlying amounts upon which the instruments are based and do not represent the amounts exchanged by the parties to the instruments. In addition, these amounts do not measure PEMEX's exposure to credit and market risks.

(3) Quoted market prices are used as the fair values of financial instruments. If quoted market prices are not available, fair values are estimated on the basis of pricing models, or quoted prices for financial instruments with similar characteristics.

iii) Foreign Exchange Risk Management:

PEMEX enters into cross-currency swaps to manage its foreign exchange risk. The purpose of the Company's foreign-currency hedging activities is to protect PEMEX from changes in exchange rates. Because a significant portion of PEMEX's revenues is denominated in U.S. dollars, PEMEX's borrowings are generally denominated in dollars. To the extent that, since 1991, PEMEX has borrowed in currencies other than U.S. dollars, PEMEX generally enters into cross-currency swaps to hedge against movements in U.S. dollar exchange rates. Substantially all of PEMEX's cross-currency swaps are entered into with its creditors on underlying debt.

The following table indicates the types of cross-currency swaps used and their respective fair values at December 31 (amounts in thousands of pesos):

	1996		1997	
	Notional Amount	**Fair Value**	**Notional Amount**	**Fair Value**
Cross-Currency Swaps				
French Francs to U.S. Dollars	1,047,252	156,907	1,078,253	(50,833)
Swiss Francs to U.S. Dollars	1,808,620	(12,055)	787,079	78,413
Canadian Dollars to U.S. Dollars	604,380	19,785	622,271	(29,908)
Austrian Schillings to U.S. Dollars	747,209	186,720	769,327	(27,872)
Italian Liras to U.S. Dollars	1,512,212	178,276	6,675,954	(295,304)
Japanese Yen to U.S. Dollars	1,603,861	(177,632)	1,653,650	(389,346)
British Pounds to U.S. Dollars	889,880	129,526	916,222	109,080
	8,213,414	481,527	12,502,756	(605,770)

11. RESERVE FOR RETIREMENT PAYMENTS, PENSIONS AND SENIORITY PREMIUMS:

PEMEX has labor obligations for seniority premiums and pensions, according to regulations established by the Federal Labor Law, and provisions in the individual and collective labor contracts. These compensations are only payable after the worker or employee has worked a certain number of years. Benefits are based on the employee's compensation as of his retirement date, as well as years of service (Note 2h). Since 1996, the calculation of the labor obligations of active personnel is made on the basis of the new salary scheme applied in each year, due to the effect of the Employee Income Tax. In 1995, PEMEX increased certain of its post-retirement benefits to existing and future retirees. As a result of such increase, such benefits were included in the determination of the reserve for labor obligations and the related charge to earnings for the year ended December 31, 1995 was Ps.2,400,701, of which Ps.1,101,180 represented 1995 costs and Ps.1,299,521 represented prior service costs.

(In thousands of pesos and thousands of U.S. dollars)

As of December 31, 1997 and 1996, the amount of the benefits projected for pensions and seniority premiums, determined by independent actuaries according to Bulletin D-3, is as follows:

	1997	1996
Obligations for current benefits	Ps. 71,180,503	Ps. 48,487,257
Additional amount for projected benefits	21,430,448	19,994,037
Obligations for projected benefits	92,610,951	68,481,294
Less, plan assets (trust funds)	5,903,602	2,866,370
	86,707,349	65,614,924
Transition liability to be amortized over 15 years, for retirement payment and seniority premium and other effects of the actuarial calculations	57,676,064	44,732,854
Net projected liability	29,031,285	20,882,070
Additional liability derived from the excess of obligations for current benefits over plan assets and net projected liability	36,245,705	24,738,959
Accumulated obligation	Ps.65,276,990	Ps. 45,621,029

The December 31, 1997 accumulated obligation includes Ps.3,459,674 of obligations calculated using real rates related to the subsidiary companies incorporated by Pemex-Petroquímica.

The additional liability is offset by recording an intangible asset and accordingly has no impact on income or equity. The net cost of the plan amounted to Ps.14,119,953, including Ps.257,956 calculated using real rates, in 1997 (Ps.8,030,441 and Ps.6,992,412 in 1996 and 1995, respectively).

12. COMMITMENTS AND CONTINGENCIES:

Economic Stabilization Agreement

Under the Economic Stabilization Agreements (the "Agreements") entered into in 1995 between the governments of the United States of America and Mexico providing the latter with financial resources, PEMEX and certain of its affiliates agreed to instruct foreign buyers of crude oil and oil derivatives, with specific exceptions, to make payments to designated accounts of PEMEX with a bank in New York and to instruct such bank to transfer the amounts received to the account of Banco de México with the Federal Reserve Bank of New York (FRBNY). Simultaneously, Banco de México credits the accounts of PEMEX and its affiliates for such deposits. The FRBNY, as fiscal agent for the United States, had the right of set-off against the account of Banco de México with the FRBNY for any amounts due and unpaid from Mexico to the United States under the Agreements, which did not confer upon the United States any right over PEMEX's assets and did not affect the volume of production, the destination of exports or the setting of crude oil prices.

On August 5, 1996, the Mexican Government made and entered into a contract in the amount of US$6 billion with the Deutsche Bank in the capacity of beneficiary to legalize a financial transaction intended to substitute the creditor of a portion of the debt it had with the Government of the United States. On this same date, the Mexican Government made an advance payment on the debt. On January 17, 1997, the Mexican Government paid the full remainder of the debt with the Government of the United States; hence, as of this latter date, the only beneficiary of the financial mechanism of the guarantee of the debt is the Deutsche Bank (in its capacity as beneficiary).

Environmental Contingencies

PEMEX is subject to the Ecological Balance and Environmental Protection Law. To comply with this law, PEMEX has contracted environmental audits for its larger operating, storage and transportation facilities. To date, audits of refineries, secondary petrochemical plants and certain other facilities have been concluded.

Following the completion of such audits, PEMEX signed an agreement with the Federal Agency of Environmental Protection ("PROFEPA") to implement remediation plans. Such plans consider remediation for environmental damages caused as well as related investment in equipment, maintenance, labor and materials.

PEMEX had obligations for environmental remediation as of December 31,1997 and 1996 of Ps.2,085,244 and Ps.2,128,723, respectively, which are presented in the Reserve for Sundry Credits and Others.

Turn-Key Contracts

The subsidiary entity Pemex-Exploración y Producción ("PEP") has entered into turn-key contracts with various contractors for the exploration and drilling development of oil wells. As of December 31, 1997, PEP has potential obligations for these contracts amounting to Ps.1,465,000 approximately (Ps.93,000 in 1996), which will be paid, provided that the terms set forth in the contracts are met.

Others

PEMEX is involved in several lawsuits from dismissed personnel, which in the event these are resolved in favor of these dismissed personnel, any payments will also be charged to income in the year in which payment is made.

As of December 31, 1997, the subsidiary entities PEP and Pemex-Refinación have entered into contracts with various contractors for an approximate amount of Ps.31,724,180, for the development of productive infrastructure projects (PIDIREGAS), which will be concluded in 2001. These capital expenditure projects will be financed with long-term debt obligations with maturities up to 30 years.

During 1997, Pemex Exploración y Producción has entered into an agreement for the acquisition of nitrogen in the amount of Ps.21,593,970. The supply will begin in year 2000, when the supplier finishes the construction of its plant.

13. EQUITY AND INCOME:

On December 31, 1990, certain debt owed to the Mexican Government was capitalized as equity. This capitalization amounted to Ps.22,334,195 (US$7,577,000) and was authorized by the Board of Directors of Petróleos Mexicanos. The capitalization agreement between Petróleos Mexicanos and the Mexican Government stipulates that the Certificates of Contribution "A" constitute permanent capital. As a condition of this capitalization, Petróleos Mexicanos agreed to pay a minimum guaranteed dividend ("rendimiento mínimo garantizado") to the Mexican Government equivalent to the debt service, for the capitalized debt. The minimum guaranteed dividend comprises the payment of principal and interest in the same terms and conditions as those originally agreed upon with creditors, at the exchange rates in effect as of the date they are made. Such payments must be approved annually by the Board of Directors.

In December 1997, the Board of Directors of Petróleos Mexicanos and the Government agreed to an equity reduction of the Certificates of Contribution "A" in exchange for a cash payment to the Federal Government of Ps.12,118,050 (US$1,500,000). Petróleos Mexicanos and the Ministry of Finance and Public Credit have agreed upon a corresponding reduction in the future payments of the minimum guaranteed dividend.

On April 28, 1997, the Board of Directors approved the financial statements for the year ended December 31, 1996, and the payment made in 1996 to the Mexican Government of the minimum guaranteed dividend of Ps. 6,781,517.

During 1997, Petróleos Mexicanos paid Ps.5,803,941 (Ps.6,781,517 during 1996) to the Mexican Government in advance payments on account of the minimum guaranteed dividend. These payments will be applied to the final amount that the Board of Directors approves for 1997 which is expected to occur in 1998.

During 1996, the Ministry of Finance and Public Credit assessed PEMEX Ps.10,952,000 in payroll withholding taxes dating back to 1990 - 1995. The assessment was recorded as a charge against retained earnings in 1996. However, the Federal Government, in light of PEMEX's being subject to price controls during 1990 through 1995 authorized the Ministry of Finance and Public Credit to grant PEMEX a credit of Ps.11,331,000 as authorized by the Ministry of Finance and Public Credit. The credit was recorded as an increase to retained earnings and PEMEX immediately offset the related accounts receivable against the withholding taxes payable. As a result, PEMEX has a Ps.378,877 receivable from the Federal Government which is to be used to offset accounts payable due to the Government.

As part of the settlement with the Ministry of Finance and Public Credit, PEMEX applied a new withholding scheme for Employee Income Tax for 1996 amounting to Ps.1,950,654, of which Ps.1,774,935 was recorded against 1996 income. The balance was capitalized as part of construction in progress as the salaries were paid to PEMEX construction personnel.

The excess of revenues over total costs and operating expenses is considered income or "rendimiento" under Mexican Law.

14. EFFECTS OF INFLATION ON THE FINANCIAL INFORMATION:

The recognition of inflation in the financial statements of PEMEX is made in accordance with guidelines of NIF-06 BIS/A applicable to public sector entities. These guidelines differ from Mexican GAAP Bulletin B-10 in the following manner:

(a) NIF-06 BIS/A does not require the recognition of a monetary gain or loss; Bulletin B-10 requires such items to be reflected in the income statement caption: "integral cost of financing".

(b) The capitalization of interest and exchange gains or losses are allowed by NIF-06 BIS/A; Bulletin B-10 only allows for the capitalization of the "integral cost of financing" on qualifying construction in progress.

(c) NIF-06 BIS/A does not require the restatement of the equity accounts; Bulletin B-10 requires such restatement to pesos of constant purchasing power.

(d) The effects of inflation on fixed assets, inventories and cost of sales under NIF-06 BIS/A are recognized in an equity account "revaluation surplus" with no effects of inflation recognized in the income statement related to the net monetary balance sheet position. Bulletin B-10 requires effects of inflation to be reflected in the following accounts:

In the equity section: Restatement of equity, result from accumulated monetary position, equity monetary results, result from holding non-monetary assets.

In the income statement: gain or loss from monetary position.

In accordance with NIF-06 BIS/A (Note 2b) the balance sheets as of December 31, 1997 and 1996 are stated in pesos with a purchasing power as of those dates and the related statements of income in pesos of average purchasing power for those years.

Under Mexican GAAP Bulletin B-10, prior year balance sheets are presented in constant pesos as of the most recent period-end. In addition, statement of income amounts are restated from the periods in which the transactions occurred to the most recent period end. Amounts are restated using the NCPI index.

The following table reflects the approximate effects of inflation on PEMEX's financial information in accordance with Bulletin B-10 (Restated Amounts columns). The Basic Financial Statements column is prepared in accordance with NIF-06 BIS/A.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)

	1997		1996
	Basic Financial Statements	Restated Amounts	
EQUITY			
Certificates of Contribution "A"	Ps. 10,222,463	Ps. 10,222,463	Ps. 22,340,513
Reserve for oil field exploration and depletion	8,227,056	8,227,056	8,636,897
Revaluation surplus	112,959,504	—	—
Accumulated earnings (deficit):			
Prior years	18,795,296	9,285,980	(11,692,386)
Income for the year	7,946,187	13,015,235	27,759,883
	26,741,483	22,301,215	16,067,497
Restatement of equity	—	427,412,159	362,684,368
Insufficiency in the restatement of equity:			
Loss from accumulated monetary position	—	(51,190,471)	(44,237,068)
Equity monetary result	—	5,804,280	5,015,862
Accumulated deficit from holding non-monetary assets	—	(264,626,196)	(214,728,532)
	—	(310,012,387)	(253,949,738)
	Ps. 158,150,506	Ps. 158,150,506	Ps. 155,779,537

	1997	1996	1995
EFFECT ON INCOME			
Integral cost of financing:			
Interest and exchange loss capitalized in fixed assets	Ps. (3,642,755)	Ps. (3,329,080)	Ps. (24,709,314)
Gain from monetary position, net	8,711,803	14,594,362	20,543,669
	Ps. 5,069,048	Ps. 11,265,282	Ps. (4,165,645)

The above table was prepared using the following procedures and assumptions:

(a) Exchange differences arising from the impact of foreign currency fluctuations on the foreign currency denominated debt, and interest capitalized as part of fixed assets under NIF-06 BIS/A are, because of the restatement, charged to income for the year under Bulletin B-10. The aforementioned items are part of the integral cost of financing.

(b) The gain from monetary position represents the effect that inflation has produced on the monetary assets and liabilities. Holding these assets produces a loss; holding liabilities, a gain.

The initial accumulated result upon implementation of B-10 arising from the restatement is presented in equity. The result for the year is applied to the integral cost of financing which includes interest and exchange losses.

(c) The Certificates of Contribution "A" have been restated by applying the factor derived from the NCPI Index to the contributions according to the year in which they were made, in order to present them in terms of the same purchasing power. The same procedure was applied to the equity reserves and retained earnings. The figure for these items is presented under the caption Restatement of Equity.

(d) The deficit or surplus from holding non-monetary assets represents the result of comparing these assets, restated as discussed in Note 2b, to the result from applying indexes to them (by comparison with the NCPI index).

15. SUBSEQUENT EVENT:

As of March 20, 1998, the date of issuance of the December 31, 1997 financial statements, the average prices of Mexican crude oil exports had decreased approximately 31% compared to the average prices as of the closing date of 1997, and 47% compared to the average prices prevailing during 1997.

16. DIFFERENCES BETWEEN MEXICAN GAAP AND U.S. GAAP:

A summary of the significant differences between accounting principles followed by PEMEX and generally accepted accounting principles in the United States ("U.S. GAAP") is presented below.

The accompanying financial statements have been prepared in accordance with Mexican GAAP, and, as to the recognition of inflation, in accordance with NIF-06 BIS/A applicable to public sector entities which differ in certain respects from U.S. GAAP. Such differences involve methods for measuring the amounts shown in the financial statements, as well as additional disclosures required by U.S. GAAP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)

I. Differences in measurement methods:

The principal differences between Mexican GAAP and US GAAP are disclosed below. Income represents pre-tax income, because PEMEX is not subject to Mexican income taxes, and is reconciled as follows:

	1997	1996	1995
Income for the year reported under Mexican GAAP	Ps. 7,946,187	Ps.16,494,601	Ps.9,808,638
U.S. GAAP adjustments:			
Exploration and drilling costs (a)	2,886,040	803,677	1,782,782
Units-of-production amortization (b)	(1,283,618)	(472,607)	—
Pensions and seniority premiums(c)	(232,140)	(13,565)	(1,121,045)
Post retirement benefits (c)	(2,448,712)	(1,731,615)	(574,208)
Accrued vacation (d)	(24,121)	(8,065)	(14,660)
Fixed asset depreciation (f)	3,780,851	3,367,153	2,421,193
Foreign currency exchange losses (g)	(1,360,150)	(1,043,296)	(20,951,523)
Capitalization of interest (h)	998,768	(73,887)	(1,447,595)
Environmental matters (i)	68,500	—	1,535,286
Accounting for derivatives (j)	(50,702)	(44,159)	244,398
Sale of air transport assets (l)	68,194	110,808	41,113
Fixed asset impairment (n)	(348,350)	(7,157,949)	—
Total approximate U.S. GAAP adjustments, net	2,054,560	(6,263,505)	(18,084,259)
(Loss) income for the year under U.S. GAAP	Ps. 10,000,747	Ps.10,231,096	Ps.(8,275,621)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 1997, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)

		1997		1996
Equity is reconciled as follows:				
Equity under Mexican GAAP	Ps.	158,150,506	Ps.	155,779,537
U.S. GAAP adjustments:				
Advanced payments on minimum guaranteed dividend (m)		(5,803,941)		(6,781,517)
Exploration and drilling costs (a)		6,254,966		2,959,085
Fixed asset-units-of-production accumulated amortization (b)		(1,756,225)		(472,607)
Pensions and seniority premiums (c)		(2,973,748)		(2,741,608)
Postretirement benefits (c)		(4,754,535)		(2,305,823)
Accrued vacation (d)		(94,292)		(70,171)
Inflation accounting - fixed assets valuation (e)		(41,746,576)		(28,012,386)
Fixed assets-accumulated depreciation (f)		9,569,197		5,788,346
Fixed assets-foreign currency exchange losses (g)		(44,574,755)		(43,214,605)
Fixed assets-capitalization of interest (h)		(6,245,510)		(7,244,278)
Environmental matters (i)		—		(68,500)
Accounting for derivatives (j)		24,870		75,572
Sale of shares of Repsol (k)		(242,408)		(242,408)
Sale of air transport assets (l)		(102,291)		(170,485)
Fixed asset-impairment (n)		(7,506,299)		(7,157,949)
Accounting for investment securities (o)		3,804,370		3,136,586
Total U.S. GAAP adjustments, net		(96,147,177)		(86,522,748)
Equity under U.S. GAAP	Ps.	62,003,329	Ps.	69,256,789

Explanation of Reconciling Items:

a) Exploration and Drilling Costs

As discussed in Notes 2c and 2d, under Mexican GAAP, exploration and drilling costs are charged to the equity reserve for exploration and depletion of oil fields. Exploration and drilling costs related to successful oil wells are credited to the equity reserve and recorded as fixed assets. Cost of sales is recognized by recording a per-barrel quota charge in the statement of income and recording a credit to the equity reserve. The equity reserve may be increased by a charge to income. Capitalized costs of wells and related equipment are amortized on a straight-line basis over periods ranging from 25 to 30 years.

Under U.S. GAAP, costs of drilling exploratory wells and exploratory-type stratigraphic test wells are initially capitalized and are charged to expense if proved reserves are not found. Development costs, including the costs of drilling development wells and development-type stratigraphic test wells are capitalized. The capitalized costs of wells and related equipment are amortized as the related oil and gas reserves are extracted on a units-of-production method; costs of unproved properties are assessed periodically and a loss is recognized if the properties are impaired (See also note 16 I (n)). PEMEX has accordingly adjusted income and equity to reflect the impact of U.S. GAAP on exploration and drilling costs.

(b) Units-of-Production Amortization

For Mexican GAAP purposes PEMEX amortizes its well and platform assets using the straight line method. For U.S. GAAP purposes PEMEX amortizes such assets using the units of production method. For the year ended December 31, 1997 and 1996 the units of production method generated Ps.1,283,618 and Ps.472,607 more in amortization expense respectively, than the straight line method and PEMEX has accordingly adjusted income and equity for such effect.

In 1997 and 1996, PEMEX revised its procedures for estimating reserves to meet the standards of the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC). In 1997 and 1998, revised procedures to reserves were applied in the marine regions and the southern region onshore, respectively. PEMEX is in the process of reviewing the methodology for estimates of Mexico's remaining proved reserves in the northern region, which is expected to be completed in the second half of 1998. As the estimate of reserve quantities for the southern region was revised in 1998, and the estimate of the amount of the potential revision, if any, on the currently estimated proved developed reserves for the north region cannot be determined as of this date, no adjustment has been made to the units-of-production amortization for these two regions during 1997.

(c) Pensions, Seniority Premiums and Other Post-retirement Benefits

Bulletin D-3 was issued in 1992 by the Mexican Institute of Public Accountants ("MIPA"). It establishes the procedures for measuring the expenses and liabilities for pension plans and seniority premiums. The primary differences between PEMEX's application of Bulletin D-3 and Statement of Financial Accounting Standards (SFAS) No. 87 "Employers Accounting for Pensions" relate to actuarial assumptions and implementation dates. PEMEX adopted SFAS No. 87 effective January 1, 1989 and recorded a transition obligation on adoption which is being amortized over 15 years.

Under U.S. GAAP, PEMEX follows the guidelines of SFAS No. 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions," in accounting for health service and other supplemental payments provided to retirees. SFAS No. 106 requires the accrual of the expected cost of providing such benefits to employees during the years that the employees render service. Under Mexican GAAP, PEMEX accounts for supplemental payments under its Bulletin D-3 calculations. PEMEX, however, accounts for other health service benefits on a pay-as-you-go basis under Mexican GAAP.

(d) Accrued Vacation

Under Mexican GAAP, vacation expense is recognized when taken rather than in the period earned by the employee, which is required under U.S. GAAP.

(e) Inflation Accounting

U.S. GAAP does not require the recognition of the effects of inflation on the financial statements. As mentioned in Note 2b, PEMEX's financial statements recognize the effects of inflation according to NIF-06 BIS/A which requires that non-monetary assets, including inventories of materials and supplies and fixed assets, be restated to their net realizable value through appraisals made by independent appraisers or by using the SPI; the difference is recorded as a revaluation surplus.

Since NIF-06 BIS/A is not deemed to be a comprehensive method of accounting for inflation (as discussed in Note 14), PEMEX has eliminated, retroactively to 1992, the effect of revaluation of fixed assets, inventories and costs of sales from the reconciliation of income and equity. PEMEX has not adjusted the depreciation effect of fixed asset revaluations prior to 1992 under NIF-06 BIS/A for the reconciliation of income and equity. For U.S. GAAP purposes, the 1992 balances became the historical basis of the fixed assets under an accommodation granted by the U.S. Securities and Exchange Commission.

(f) Fixed Assets-Depreciation

Under Mexican GAAP, PEMEX depreciates the book value of its fixed assets which includes amounts capitalized for foreign exchange losses and restatements for inflation. For U.S. GAAP purposes PEMEX has reversed the depreciation expense attributable to restatements for inflation and foreign exchange losses which are included in the basis of fixed assets.

(g) Fixed Assets-Foreign Currency Exchange Losses

Under Mexican GAAP, exchange losses arising from debt are capitalized as part of fixed assets; the net amount of the remaining net exchange differences are reflected in the statement of income debited to costs and operating expenses or credited to revenues.

To conform with U.S. GAAP, all exchange gains or losses have been recognized in results of operations for 1997, 1996 and 1995 in the reconciliation of income and equity. In addition, under U.S. GAAP, foreign currency transaction gains or losses would be reported as nonoperating (income) or expenses.

(h) Fixed Assets-Capitalization of Interest

Under Mexican GAAP, interest is capitalized to property, plant and equipment based upon total interest cost incurred on loans identified with construction projects, whether or not amounts borrowed have been spent on such projects.

Under U.S. GAAP, interest is capitalized based upon total interest incurred in proportion to additions to construction in progress. PEMEX has accordingly adjusted income and equity to reflect the U.S. GAAP requirements for capitalizing interest. The adjustment for capitalized interest is presented net of the effects of depreciation related to such assets.

Interest costs for the years ended December 31, 1997, 1996 and 1995, for Mexican GAAP and U.S. GAAP purposes were allocated as follows:

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	1997	1996	1995
Under Mexican GAAP:			
Interest capitalized in fixed assets	Ps. 2,282,605	Ps. 2,285,784	Ps.3,184,997
Interest in the specific reserve for exploration and depletion	752,237	779,928	572,794
Interest expense	4,567,172	3,767,215	2,626,338
Total interest cost	Ps. 7,602,014	Ps. 6,832,927	Ps.6,384,129
Under U.S. GAAP:			
Interest capitalized in fixed assets	Ps. 3,061,280	Ps. 2,013,415	Ps.1,264,196
Interest expense	4,540,734	4,819,512	5,119,933
Total interest cost	Ps. 7,602,014	Ps. 6,832,927	Ps.6,384,129

(i) Environmental Matters

PEMEX has an internal structure to identify and quantify restoration, dismantlement and abandonment costs. Since 1994, under the direction of the Mexican Government, PEMEX contracted with external engineers for the performance of operational audits which included environmental assessments of the sites being audited. These assessments include cost estimates for remedying any shortfall in compliance with Mexican environmental laws. Such remedies can include improving the operating efficiency of plants, cleaning up contaminated land and water, and investing in capital expenditures to minimize the effect of PEMEX's operations on the environment. Through December 31, 1997, 48 operational audits have been completed and have been sent to the Mexican Government for approval. After approval by the Mexican Government, PEMEX reviews the audits and determines which findings can be resolved by changing current plant or drilling operations and implementing the current capital expenditures plan. In addition, PEMEX recalculates the estimated cost of environmental cleanups using national labor rates instead of the higher international labor rates used by the engineers in calculating such costs. Having completed such an analysis, PEMEX adjusts the estimated costs to bring the plant into compliance with Mexican environmental law and then negotiates an agreement with the Mexican Government stipulating the terms, amounts to be expended and the steps to be taken to bring the site into compliance with Mexican environmental laws.

For U.S. GAAP purposes, environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefit are expensed. Liabilities for expenditures of a non-capital nature are recorded on an undiscounted basis when environmental assessment and/or remediation is probable and the costs can be reasonably estimated.

Under U.S. GAAP and Mexican GAAP, PEMEX has established accruals for restoration and removal costs identified in their operational audits. On the basis of its internal evaluation of the environmental findings in the operational audits and ongoing negotiations with the Mexican government regarding the resolution of such findings, PEMEX recorded liabilities because remedial efforts are probable and the amounts can be reasonably estimated. The amount and timing of such expenditures are subject to further negotiations with the Mexican government.

During 1997 and 1996 PEMEX invested Ps.3,042.6 million and Ps.3,311.8 million, respectively, in various environmental projects. PEMEX has budgeted Ps.2,099 million for environmental projects in 1998. The most important of these projects have been directed to the modernization of installations, the implementation of systems and control mechanisms to monitor atmospheric pollution, the acquisition of equipment to clean hydrocarbon spills, the expansion of aquatic effluent systems, the restoration and reforestation of affected areas, studies for environmental investigation and the conduct of environmental audits. In addition, PEMEX has engaged in extensive research and development efforts to develop capacity for increased production of unleaded gasoline, diesel and fuel oil with lower sulfur content and alternative fuels, such as industrial oil gas and natural gas. Currently, PEMEX is developing a procedure to determine the costs and expenses accrued to the activities associated with integral safety and environmental management ("Procedimiento para la Determinación de Gastos Asociados a las Actividades de Seguridad Industrial y Protección Ambiental").

Management of PEMEX believes that its operations are in substantial compliance with current Mexican environmental laws as such laws have been historically interpreted and enforced.

PEMEX has contracted insurance policies to cover the cost of environmental contingencies. The accruals for U.S. and Mexican GAAP purposes are not reflected net of any amounts forthcoming under such policies.

(j) Accounting for Derivatives

Written instruments: Under Mexican GAAP, PEMEX records income on its written options as the premiums are collected. Gains and losses on written options are recognized on a cash basis on each contractual payment date (see also Note 10). Under U.S. GAAP, PEMEX records option premiums as deferred income when received and amortizes the deferred income in relation to the market value of the option with gains and losses recorded currently in income.

Purchased instruments: Under Mexican GAAP, the cost of premiums on purchased options are expensed when paid. Gains and losses on purchased options are recognized on a cash basis on each contractual payment date. Under U.S. GAAP, the premiums paid for interest rate options and cap agreements purchased are amortized to interest expense over the terms of the agreements. In addition, purchased options which are non-hedging instruments are marked to market with gains and losses recorded currently in income. Amounts receivable or payable under purchased instruments are recognized as an adjustment to interest expense.

(k) Sale of Shares of Repsol

Under Mexican GAAP and as discussed in Note 6, PEMEX recorded a Ps.242,408 gain on the transfer of its Repsol S.A. shares to a trust. For U.S. GAAP purposes, the transfer of the shares does not meet the criteria for sale recognition and accordingly, the gain was reversed and the transfer of the shares treated as a financing transaction.

(l) Sale of Air Transport Assets

Under Mexican GAAP, during 1994, PEMEX recorded a gain of Ps.340,969 on the sale of its air transport division to a newly created company, SAEMSA, in exchange for a 49% ownership interest in such company plus other consideration of Ps.291,103. Under Mexican GAAP, the gain was calculated by including the imputed fair value of the 49% interest in SAEMSA which was received by PEMEX as part of the sale proceeds. Under the sale agreement PEMEX will continue to have more than a minor use of the property through a leaseback. For U.S. GAAP purposes, this transaction is treated as a sale-leaseback, accordingly, the realized gain was deferred, and will be amortized into income over the term of the lease. The amortization of the deferred gain during 1997, 1996 and 1995 amounted to Ps.68,194, Ps.110,808 and Ps.41,113 respectively.

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(m) Advance Payments on Minimum Guaranteed Dividend

Under Mexican GAAP, advance payments on the minimum guaranteed dividend, derived from the capitalization of debt as described in Note 13, are recorded as an account receivable which is reserved against retained earnings upon formalization by the Board of Directors.

Under U.S. GAAP, such balances are considered as a reduction in equity. PEMEX has accordingly adjusted equity to reflect such U.S. GAAP reduction in equity.

The effective rate used to calculate the minimum guaranteed dividend is LIBOR plus 0.8125% (which was 6.0245% and 5.932% for 1997 and 1996, respectively).

In connection with the reduction of the "Certificates of Contribution A" (Note 13), Petróleos Mexicanos and the Government agreed to modify the schedule of the minimum guaranteed dividend payments for future years commencing in 1998.

The scheduled maturities on the original principal amount of the capitalized debt over the next five years is as follows:

Year	Amount in US$
1998	—
1999	250,000
2000	250,000
2001	—
2002	873,848
Thereafter	3,495,391
	4,869,239

(n) Fixed Asset Impairment

For U.S. GAAP purposes, effective January 1, 1996, PEMEX adopted SFAS No.121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". SFAS No.121 provides criteria for when and in what circumstances an impairment loss (write-down) should be recorded and the manner in which the write-down should be measured. An evaluation of impairment is undertaken whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Under SFAS No.121, the impairment criteria is met when the carrying value of assets exceeds the sum of expected future cash flows (undiscounted and without interest charges) of related assets. The asset is written down to fair value, if available, or the present value of expected future cash flows. PEMEX measures impairment of its oil and gas producing assets based on the undiscounted estimated future cash flows associated with estimated proved reserves on a field basis.

(In thousands of pesos and thousands of U.S. dollars)

The impact of the adoption of the new standard was to reduce long-term assets with a corresponding charge to income by Ps.348,350 and Ps.7,157,949 in 1997 and 1996, respectively. In 1997, the expense relates primarily to producing fields. In 1996, the expense relates primarily to producing fields, refineries and other plants with capitalized costs. Expected cash flows and fair values were estimated internally using Company methodology and practices for valuing similar properties to be acquired or sold.

(o) Accounting for Investment Securities

In 1996, PEMEX adopted SFAS No.115 "Accounting for Certain Investments in Debt and Equity Securities" for U.S. GAAP purposes, and has recorded the adjustment to equity as the cumulative effect of change in accounting principal. PEMEX has classified its investment securities as "Available-for-Sale", and accordingly, they are recorded at fair value with unrealized gains and losses excluded from income and reported in a separate component of equity. The fair value of the securities is determined by quoted market prices. The cost and fair value of PEMEX's investments at December 31, 1997 and 1996 is as follows:

	1997			1996		
	Cost	Fair value	Unrealized Gain (Loss)	Cost	Fair value	Unrealized Gain (Loss)
Investment securities	Ps.1,354,592	Ps.5,158,962	Ps.3,804,370	Ps.1,354,592	Ps.4,491,178	Ps.3,136,586

Under Mexican GAAP, the held-for-investment securities are carried at cost. The unrealized gain for U.S. GAAP purposes, is largely explained by the foreign exchange effect, due to the fact they are held in foreign currencies.

(p) Special Tax on Production and Services

Under Mexican GAAP, the Special Tax on Production and Services is reflected in revenue when charged to customers and, at the same time, as an operating expense.

Under U.S. GAAP, this tax would have no net effect on revenues or operating expense, as both the amount charged to customers and the amount accrued as payable to the tax authorities would be reflected in revenues.

As a result, under U.S. GAAP, revenues and operating expense would have been less than those reflected under Mexican GAAP by Ps.37,728,329, Ps.19,766,891 and Ps.17,703,170, for the years ended December 31, 1997, 1996 and 1995, respectively.

II. Additional Disclosure Requirements:

a. Cash Flow Information

Under Mexican GAAP, PEMEX presents statements of changes in financial position. In contrast with the statements of cash flows required by U.S. GAAP, PEMEX's statements of changes in financial position do not include certain information relating to the three major categories of sources and uses of funds: funds from operating, financing and investing activities.

Under U.S. GAAP the following information would be disclosed separately in reconciling income for the year to funds provided by operations: changes in hydrocarbon extraction duties, changes in allowances for doubtful accounts and slow-moving inventories, net exchange gains or losses and accrued interest income from affiliates. Additionally, under U.S. GAAP borrowings and repayments of debt would be presented separately in arriving at funds from financing activities, and investments in and the proceeds from the sale of property, wells, plants and transportation equipment would be presented separately in arriving at funds from investment activities. In the statements of changes in financial position, PEMEX has disclosed information within the financing and investment categories on a net basis.

(In thousands of pesos and thousands of U.S. dollars)

The following table details the effects discussed above using Mexican GAAP measurement methods and U.S. GAAP presentation:

Cash flows from operating activities:	1997	1996	1995
Income for the year plus or less charges or credits not requiring the use of cash:			
Following U.S. GAAP presentation	Ps. 38,810,441	Ps. 40,571,929	Ps. 30,460,176
Difference (1), (5)	(14,281)	(797,183)	1,017,197
Under Mexican GAAP	Ps. 38,796,160	Ps. 39,774,746	Ps. 31,477,373
Increase (decrease) in assets and liabilities:			
Following U.S. GAAP presentation	Ps. (12,595,805)	Ps.(13,350,069)	Ps.(11,503,658)
Differences			
Accounts receivable (3)	(954,797)	2,660,127	(2,619,482)
Inventory (1)	(19,599)	(108,135)	(143,003)
Sundry Credits reserve (1)	(54,680)	768,068	43,035
Reserve for retirement, pensions and indemnities (5)	65,781	—	—
Under Mexican GAAP	(13,559,100)	(10,030,009)	(14,223,108)
Following U.S. GAAP presentation	Ps. 26,214,636	Ps.27,221,860	Ps. 18,956,518
Differences	(977,576)	2,522,877	(1,702,253)
Under Mexican GAAP	25,237,060	29,744,737	17,254,265

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	1997	1996	1995
Cash flows from financing activities:			
New long-term financing	Ps. 51,166,429	Ps. 25,074,736	Ps.18,332,100
Interest payable (Interest payments), net	146,680	220,388	155,426
Financing payments	(40,264,529)	(20,253,789)	(16,955,333)
Dividends paid to the Federal Government	(7,759,093)	(6,781,517)	(4,289,362)
Net increase in financing following U.S. GAAP presentation	3,289,487	(1,740,182)	(2,757,169)
Difference:			
Foreign currency exchange loss	1,620,259	736,614	22,028,000
Dividends paid to the Federal Government(4)	977,576	2,492,155	2,628,340
Net increase in financing under Mexican GAAP	Ps. 5,887,322	Ps. 1,488,587	Ps.21,899,171
Cash flows from investing activities:			
Acquisition of fixed assets	Ps. (28,108,525)	Ps. (18,094,915)	Ps.(14,366,084)
Disposal of fixed assets (2)	1,782,899	1,847,081	2,169,913
Net investment at cost in property, wells, plants and transportation equipment under U.S. GAAP	(26,325,626)	(16,247,834)	(12,196,171)
Capitalized exchange loss Difference:	(1,360,150)	(1,043,295)	(20,951,523)
Net investment at cost in property, wells, plants and transportation equipment under Mexican GAAP (including capitalized exchange loss and interest)	Ps.(27,685,776)	Ps.(17,291,129)	Ps.(33,147,694)
<u>Supplemental cash flow information:</u>			
Cash payment for taxes	165,227,666	133,806,872	90,950,767
Cash payments for interest, net of amount capitalized	7,772,716	6,332,827	6,228,703

(1) The items that are excluded from the determination of cash flows under SFAS No. 95 are: the adjustments in hydrocarbon extraction duties, dividends paid to the Federal Government, the offset of accounts receivable from the Federal Government against prior years' retained earnings, equity in earnings of unconsolidated entities, as well as the provision for both doubtful accounts and obsolete inventories.
(2) Disposal of fixed assets did not generate cash flow for the most part.
(3) The difference is due to the effects of the advanced payments on minimum guaranteed dividend and the foreign currency translation gain on accounts receivable.
(4) The difference is because for Mexican GAAP purposes the dividends to the Federal Government are those approved by the Board of Directors in the year whereas for US GAAP purposes it is considered in the cash flow statements.
(5) Non cash activities relate to the reduction of the company's reserve for retirement, pensions and indemnities.

(b) Cash and Cash Equivalents

Cash and cash equivalents include all cash balances and highly liquid instruments purchased with an original maturity of three months or less.

(c) Pensions and Seniority Premiums and Post-retirement Benefits

SFAS No.87 is followed by PEMEX for the calculation of seniority premiums and pension expense under U.S. GAAP.

The calculation of pension cost and benefit obligations under SFAS No.87 requires considerable judgment with respect to choosing actuarial assumptions. Each significant assumption should reflect the best estimate of the plan's future experience solely with respect to that assumption. Assumed discount rates and compensation levels often have the greatest effect on pension cost and benefit obligations and are related because both are affected by some of the same economic factors. The discount rate should be based upon the current prices for settling the pension obligation, referred to as the "settlement rate." Assumed compensation levels should reflect the best estimate of actual future compensation levels for the individuals involved and be consistent with assumed discount rates to the extent that both incorporate expectations of the same future economic conditions, such as inflation.

Applying these provisions of SFAS No.87 in a historically high inflation environment such as Mexico creates unique problems which are complicated by economic events since December 1994. The opportunity for a company to settle a pension obligation at any particular point in time may not exist; long term financial instruments may not exist in Mexico as they do in the United States and volatile inflation rates may make it difficult to predict compensation progression.

SFAS No.87 does not include specific guidance under these conditions. PEMEX believes it is appropriate to use actuarial assumptions which include an estimate of long-term inflation (nominal rates). PEMEX has determined its discount rate and salary progression rate for SFAS No.87 including a long-term inflation rate.

An alternative approach to actuarial assumptions where benefits are indexed to inflation (which is not generally the case in Mexico) would be to eliminate the effect of inflation in the assumptions (i.e., use real rates). PEMEX believes that the effect on the U.S. GAAP reconciliation of net income would not be materially different under this approach. However, the "accumulated benefit obligation" and the related minimum liability for pensions can be affected by the discount rate used. Under SFAS No.87, the accumulated benefit obligation is the present value of expected future benefit payments based upon an employee's service to date without assuming any increase in the employee's compensation. If the accumulated benefit obligation were calculated using an assumed real discount rate of 4.6%, the accumulated benefit obligation calculated under SFAS No.87 would be Ps.66,665,472.

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The components of net seniority premium and pension plan cost, calculated in accordance with SFAS No.87, consist of the following:

	1997	1996	1995
Service cost: benefits earned during the year	Ps.1,854,871	Ps.1,094,970	Ps. 937,690
Interest cost on projected benefit obligation	7,055,484	4,632,643	3,778,963
Expected return on plan assets	(429,956)	(380,596)	(303,733)
Net amortization and deferral	1,322,874	189,337	177,664
Amortization of net transition obligation	1,122,160	1,122,160	1,122,160
Net cost under U.S. GAAP	10,925,433	6,658,514	5,712,744
Net cost under Mexican GAAP	10,693,293	6,644,949	4,591,699
Additional expense that would be recognized under U.S. GAAP	Ps. 232,140	Ps. 13,565	Ps.1,121,045

Actuarial assumptions used in the calculation of net seniority premium and pension plan cost under U.S. GAAP as of December 31 are:

	1997	1996	1995
Discount rate	14.00%	14.00%	14.00%
Rates of increase in compensation levels	10.00%	11.00%	11.00%
Expected long-term rate of return on assets	15.00%	15.00%	15.00%

The combined seniority premium and pension plan liability as of December 31, 1997 and 1996 under SFAS No.87 is as follows:

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	1997	1996
Actuarial present value of benefit obligations:		
Vested benefit obligation	Ps.44,170,152	Ps.31,358,145
Accumulated benefit obligation	Ps.52,521,130	Ps.36,018,219
Projected benefit obligation	Ps.69,425,986	Ps.52,284,180
Plan assets at fair value	5,903,602	2,866,370
Projected benefit obligation in excess of plan assets	63,522,384	49,417,810
Unrecognized net loss	(13,258,120)	(10,218,904)
Unrecognized transition obligation	(7,855,131)	(8,977,290)
Prior service cost	(15,283,246)	(9,072,883)
Accrued liability under U.S. GAAP	27,125,887	21,148,733
Accrued costs recognized in the consolidated balance sheet under Mexican GAAP	24,152,139	18,407,125
Net U.S. GAAP adjustment to seniority premium and pension plan liability	Ps. 2,973,748	Ps. 2,741,608
Additional minimum liability	Ps.19,491,641	Ps.12,003,117

The plan's assets consist primarily of cash, investments, and an interest in a real estate joint venture.

In accordance with the provisions of SFAS No.87, PEMEX has reflected, for U.S. GAAP purposes, an additional minimum liability at the end of each year representing the excess of the accumulated benefit obligations over the fair value of plan assets and accrued pension liabilities. The additional minimum liability is offset by recording an intangible asset and, accordingly, has no impact on income or equity.

PEMEX has implemented SFAS No.106 effective January 1, 1995, using the transitional recognition method. PEMEX's previous practice was to expense these costs on a pay-as-you-go basis.

In addition to pensions, PEMEX makes supplemental payments and provides health care benefits to retired employees. PEMEX regularly determines the level of its supplemental payments considering inflationary conditions. Health care is provided through a regional network of PEMEX hospitals and medical centers, which also provide care to active

(In thousands of pesos and thousands of U.S. dollars)

PEMEX employees. No commitments have been made regarding the level of such contributions in the future.

For Mexican GAAP purposes PEMEX has included the projected costs associated with the supplemental payments in its determination of pension obligation under Bulletin D-3, but has excluded the costs associated with medical care, which is accounted for on a pay-as-you-go basis. There are no plan assets for post-retirement benefits.

The components of other post-retirement benefits expense consist of the following for the years ended December 31, 1997, 1996 and 1995:

	1997			1996			1995		
	Supplemental Payments	Health Services	Total	Supplemental Payments	Health Services	Total	Supplemental Payments	Health Services	Total
Service cost	Ps.413,459	Ps. 336,590	Ps. 750,049	Ps. 144,372	Ps. 199,294	Ps. 343,666	Ps.145,334	Ps.189,968	Ps.335,302
Interest cost	2,163,670	2,262,324	4,425,994	1,064,379	1,507,806	2,572,185	966,252	1,199,843	2,166,095
Amortization of actuarial gains and losses	469,969	220,925	690,894	(33,879)	(3,935)	(37,814)	—	—	—
Amortization of transition obligation	418,020	518,346	936,366	418,020	518,346	936,366	418,019	518,346	936,365
Net expense under U.S. GAAP	3,465,118	3,338,185	6,803,303	1,592,892	2,221,511	3,814,403	1,529,605	1,908,157	3,437,762
Expense under Mexican GAAP	3,492,429	862,162	4,354,591	1,385,492	697,296	2,082,788	2,400,692	462,862	2,863,554
Additional (less) expense under U.S. GAAP	Ps. (27,311)	Ps.2,476,023	Ps.2,448,712	Ps. 207,400	Ps.1,524,215	Ps.1,731,615	Ps.(871,087)	Ps.1,445,295	Ps.574,208

Actuarial assumptions used in the calculation of other post-retirement benefits under U.S. GAAP as of December 31 were:

	1997	1996	1995
Discount rate	14.00%	14.00%	14.00%
Health Care Cost Trend Rate	10.00%	10.00%	10.00%

Since the other post-retirement benefits are not based on levels of compensation, it is not necessary to use salary increase assumptions to determine expenses. The effect of a 1% increase in the health care cost trend rate is to increase net expense for post-retirement benefits by Ps.710,384 and increase the accumulated post-retirement benefit obligation by Ps.4,162,864.

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The other post-retirement benefit liability as of December 31, 1997 and 1996 is as follows:

	1997			1996		
	Supplemental Payments	Health Services	Total	Supplemental Payments	Health Services	Total
Accumulated unfunded post retirement benefit obligation:						
Retirees	Ps.14,620,444	Ps.17,793,552	Ps.32,413,996	Ps.10,171.219	Ps.11,825,611	Ps.21,996,830
Fully eligible active participants	553,539	455,448	1,008,987	416,592	249,975	666,567
Other active plan participants	8,010,691	7,130,038	15,140,729	5,609,006	4,529,564	10,138,570
Total	23,184,674	25,379,038	48,563,712	16,196,817	16,605,150	32,801,967
Unrecognized actuarial losses	(4,532,982)	(9,850,285)	(14,383,267)	(1,768,627)	(5,008,245)	(6,776,872
Prior service cost and plan amendments	(8,284,898)	(2,408,698)	(10,693,596)	(6,020,265)	(434,527)	(6,454,792
Unamortized transition obligation	(6,178,647)	(7,674,522)	(13,853,169)	(6,596,667)	(8,192,868)	(14,789,535
Net post-retirement benefit liability: U.S. GAAP	4,188,147	5,445,533	9,633,680	1,811,258	2,969,510	4,780,768
Mexican GAAP	4,879,145	—	4,879,145	2,474,945	—	2,474,945
Net U.S. GAAP adjustment	Ps. (690,998)	Ps. 5,445,533	Ps. 4,754,535	Ps. (663,687)	Ps. 2,969,510	Ps. 2,305,823

d) Leases

During 1997, 1996 and 1995 PEMEX's rent expense under operating leases amounted to Ps.114,401, Ps.186,902, and Ps.333,944, respectively.

PEMEX enters into noncancelable lease arrangements for equipment used in the normal course of business. The following table shows the future minimum obligations under lease commitments in effect at December 31, 1997:

	Capital Leases (1)	Operating Leases
1998	Ps. 517,614	Ps. 241,957
1999	477,004	60,180
2000	429,264	42,607
2001	372,753	15,366
2002	438,462	3,460
Thereafter (1)	2,967,016	-
	Ps.5,202,113	Ps.363,570

(1) includes Ps.1,718,248 of imputed interest

(e) Interest, net

For Mexican GAAP purposes, interest net is presented as an operating cost in the statement of income. For U.S. GAAP purposes, interest net would be presented as a non-operating item in the statement of income.

(f) Business Segment Information

PEMEX's primary business is the exploration and production of crude oil and natural gas and the refining and marketing of petroleum products conducted through three business segments: Exploration and Production, Refining, and Gas and Petrochemicals.

Income (loss) and identifiable assets for each segment have been determined after intersegment adjustments. Sales between segments are made at internal transfer prices established by PEMEX which reflect international market prices.

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	Exploration and Production	Refining	Gas and Petrochemical (1)	Corporate and Other	Intersegment Eliminations	Total
Year ended December 31, 1997:						
Sales:						
Trade	Ps.81,653,432	Ps.128,168,449	Ps.44,553,786	Ps.9,654,690	Ps. —	Ps.264,030,357
Intersegment	91,377,874	8,669,626	17,922,154	121,085,256	(239,054,910)	—
Total net sales	173,031,306	136,838,075	62,475,940	130,739,946	(239,054,910)	264,030,357
Income (loss)	12,988,322	(6,812,225)	1,909,789	510,969	(650,668)	7,946,187
Depreciation and Amortization	4,708,666	2,130,983	3,386,707	370,267		10,668,623
Acquisition of fixed Assets	16,224,790	6,750,693	4,763,270	369,772		28,108,525
Total assets	162,828,291	93,106,533	60,223,155	291,761,534	(263,439,863)	344,479,650
Year ended December 31, 1996:						
Sales:						
Trade	Ps.81,337,313	Ps.101,168,798	Ps.36,708,077	Ps.12,778,746	Ps. —	Ps.231,992,934
Intersegment	87,249,253	7,951,956	18,945,368	114,326,360	(228,472,937)	—
Total net sales	168,586,566	109,120,754	55,653,445	127,105,106	(228,472,937)	231,992,934
Income (loss)	15,178,449	(1,086,030)	2,977,337	(476,812)	(98,343)	16,494,601
Depreciation and Amortization	4,906,943	2,507,870	2,638,991	344,520		10,398,324
Acquisition of fixed Assets	10,034,512	6,394,723	1,309,182	356,498		18,094,915
Total assets	158,103,775	79,551,894	52,934,491	286,885,844	(265,426,917)	312,049,087
Year ended December 31, 1995:						
Sales:						
Trade	Ps.47,931,305	Ps. 72,098,770	Ps.25,752,012	Ps.11,527,511	Ps. —	Ps.157,309,598
Intersegment	53,965,973	5,986,864	11,173,543	73,007,177	(144,133,557)	—
Total net sales	101,897,278	78,085,634	36,925,555	84,534,688	(144,133,557)	157,309,598
Income (loss)	7,888,113	(2,371,943)	4,436,391	(448,347)	304,424	9,808,638
Depreciation and Amortization	4,567,816	2,254,743	2,388,833	173,990		9,385,382
Acquisition of fixed Assets	7,037,881	5,976,409	1,216,503	135,291		14,366,084
Total assets	121,123,834	62,325,179	51,425,068	238,285,823	(228,721,780)	244,438,124

(1) The Gas and Petrochemicals segment includes the balances and operations of Pemex - Gas y Petroquímica Básica and Pemex-Petroquímica.

(In thousands of pesos and thousands of U.S. dollars)

Geographical segment information:

The majority of PEMEX's operations are in Mexico. PEMEX's export sales by region are as follows for the years ended December 31:

	1997	1996	1995
United States	Ps. 78,920,970	Ps. 75,952,838	Ps.51,273,881
Canada, Central and South	8,714,170	14,019,261	4,693,261
Europe	7,668,075	6,119,519	6,114,277
Far East	3,385,006	5,057,454	3,102,767
TOTAL	Ps. 98,688,221	Ps.101,149,072	Ps.65,184,186

(g) Fair Value of Financial Instruments:

The estimated fair value of financial instruments, for which it is practicable to estimate that value, as of December 31, 1997 and 1996:

	1997		1996	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Cash and cash equivalents	Ps.17,428,855	Ps.17,428,855	Ps.17,999,663	Ps.17,999,663
Accounts receivable	31,675,575	31,675,575	32,945,987	32,945,987
Liabilities:				
Accounts payable	14,574,231	14,574,231	11,116,986	11,116,986
Short-term debt	35,731,604	35,731,604	36,028,775	36,015,404
Long-term debt	56,338,936	56,042,366	42,534,637	42,187,710

The reported amounts of financial instruments such as cash equivalents, accounts receivable/payable and short-term debt approximate fair value because of their short maturities.

The fair value of long-term debt is determined by reference to market quotes, and where quotes are not available, is based on discounted cash flow analyses. Because assumptions significantly affect the derived fair value and they are inherently subjective in nature, the estimated fair values can not be substantiated by comparison to independent market quotes and, in many cases, the estimated fair values would not necessarily be realized in an immediate sale or settlement of the instrument.

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The fair value of bonds issued in currencies other than U.S. dollars includes the fair value of the cross currency swaps used to convert the debt into U.S. dollars.

The accrual method of accounting is permitted for derivative financial instruments that are designated as and effective as a hedge. Such instruments would be accounted for as part of the transactions being hedged when they mature, are sold, are terminated or if the anticipated transactions are no longer expected to occur.

(h) Valuation and Qualifying Accounts

The valuation and qualifying accounts for PEMEX are as follows:

Description	Balance at beginning of period	Additions charged to costs and expenses	Deductions	Balance at end of period
For the year ended December 31, 1995				
Reserves deducted in the balance sheet from the assets to which they apply				
Allowance for uncollectible trade accounts	Ps. 652,647	24,530	15,672	Ps. 661,505
Allowance for slow-moving inventory and obsolescence	Ps.2,288,982	19,775	63,003	Ps.2,245,754
For the year ended December 31, 1996				
Reserves deducted in the balance sheet from the assets to which they apply				
Allowance for uncollectible trade accounts	Ps. 661,505	72,164	168,536	Ps. 565,133
Allowance for slow-moving inventory and obsolescence	Ps.2,245,754	3,980	108,090	Ps.2,141,644
For the year ended December 31, 1997				
Reserves deducted in the balance sheet from the assets to which they apply				
Allowance for uncollectible trade accounts	Ps. 565,133	20,730	39,833	Ps. 546,030
Allowance for slow-moving inventory and obsolescence	Ps.2,141,644	33,901	53,500	Ps.2,122,045

(i) Significant Risks and Uncertainties

Environmental

The ultimate costs to be incurred in relation to PEMEX's environmental contingencies may exceed the total amounts reserved. Additional liabilities may be accrued as the assessment work is completed and formal remedial plans are formulated.

In many cases, investigations are not yet at a stage where PEMEX is able to quantify the liability or estimate a range of possible exposure. In such cases, the amounts of PEMEX's liabilities are indeterminate due to the unknown magnitude of possible contamination, the imprecise and conflicting engineering evaluations and estimates of proper cleanup methods and costs, the unknown timing and extent of the corrective actions that may be required, and the present state of the law.

Government

The operations and earnings of PEMEX have been, and may in the future be, affected from time to time in varying degree by political developments and laws and regulations, such as forced divestiture of assets, restrictions on production, price controls, tax increases, cancellation of contract rights, refined product specifications, environmental, health and safety regulations. Both the likelihood of such occurrences and their overall effect upon PEMEX are not predictable.

Labor

PEMEX employees belonging to the Union of Petroleum Workers of the Mexican Republic represent 77% of the workforce. They have a collective bargaining agreement which is renegotiated every two years and has no firm expiration date.

Product

Since PEMEX's major products are commodities, significant changes in the prices of oil and gas and chemical products could have a significant impact on PEMEX's results of operations in any particular year. Crude oil represents approximately 54% of PEMEX's revenues which makes it reasonably possible that the Company is vulnerable to near-term severe impacts from fluctuations in prices.

General

PEMEX has certain other contingent liabilities with respect to litigation, claims and contractual agreements arising in the ordinary course of business. Although these contingencies could result in expenses or judgments that could be material to the Company's results of operations for a given reporting period, on the basis of management's best assessment of the ultimate amount and timing of these events, such expenses or judgments are not expected to have a material adverse effect on the Company's operations, financial position, condition or liquidity.

(j) Concentration of Credit Risk

PEMEX is subject to credit risk through trade receivables and short-term cash investments and derivative financial instruments. A significant portion of PEMEX's sales are to customers whose activities are related to the oil and gas industry, including some who are located in foreign countries (primarily the United States). PEMEX generally extends credit to these customers and, therefore, collection of receivables is affected by the economy of the oil and gas industry and the country of Mexico (since there is a strong demand for its products in its domestic market). Also, with respect to foreign sales, collection may be more difficult in the event of a default. However, PEMEX closely monitors extensions of credit and has never experienced significant credit losses. Also, most foreign sales are made to large, well-established companies.

PEMEX invests excess cash in low risk, liquid instruments, which are placed with a wide array of institutions. See Note 10 for discussion of credit risks with respect to financial instruments.

(k) Capitalized Software Costs

Direct internal and external costs related to the development of internal use software are deferred and included in other assets. Capitalized software costs as of December 31, 1997, 1996 and 1995 amounted to Ps.163,702, Ps.144,109 and Ps.67,653, respectively.

(l) Recently Issued Accounting Standards

In June 1997, the U.S. Financial Accounting Standards Board ("FASB") issued SFAS No.130, "Reporting Comprehensive Income". SFAS No.130 establishes standards for the reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The statement requires that changes in the amounts of items that are required to be recognized under SFAS No.130 as components of comprehensive income, including foreign currency translation adjustments and gains and losses on certain securities, be reported in a financial statement that is displayed with the same prominence as other financial statements; it does not address the issues of recognition or measurement. This statement is effective for fiscal years beginning after December 15, 1997 and requires reclassification of earlier financial statements for comparative purposes. Management believes that the impact of implementing the requirements of SFAS No.130 will not have a material effect on its consolidated financial statements.

The FASB issued SFAS No.131, "Disclosure about Segments of an Enterprise and Related Information" in June 1997. SFAS No.131 establishes a new framework for the way that public business enterprises report financial and descriptive information about reportable operating segments in financial statements. It requires entity-wide disclosures about the products and services an entity provides, the significant countries in which it holds assets and reports revenue, and its major customers. This statement is effective for periods beginning after December 15, 1997. Management believes the impact of implementing the disclosure requirements of SFAS No.131 will not have a material effect on its consolidated financial statements.

The FASB issued Statement No.132, "Employers' Disclosure about Pensions and Other Postretirement Benefits" in February 1998. SFAS No.132 revises current disclosure requirements for employers' pension and other retiree benefits but does not change the measurement or recognition of pension or other postretirement benefit plans. The statement is effective January 1, 1998. Management believes the impact of implementing the disclosure requirements of SFAS No.132 will not have a material effect on its consolidated financial statements.

The FASB issued SFAS No.133, "Accounting for Derivative Instruments and Hedging Activities" in June 1998. The statement in effective for all quarters of all fiscal years beginning after June 15, 1999. PEMEX is currently reviewing the impact of adopting SFAS No.133.

17. SUPPLEMENTARY INFORMATION ON OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES (UNAUDITED):

The following tables provide supplementary information on the oil and gas exploration, development and producing activities of PEMEX in compliance with SFAS No.69 "Disclosures about Oil and Gas Producing Activities" published by the Financial Accounting Standards Board of the United States. All exploration and production activities of PEMEX are located in Mexico.

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The supplemental data presented herein reflects information for all of the Company's oil and gas producing activities. Capitalized costs and results of operations presented herein have been prepared in accordance with Mexican GAAP.

Capitalized costs for oil and gas producing activities:

	As of December 31,		
	1997	1996	1995
Proved properties	Ps.193,514,454	Ps.156,703,714	Ps.143,129,983
Construction in progress	15,947,578	7,993,900	5,459,372
Accumulated depreciation and amortization	(91,897,900)	(66,618,063)	(64,125,769)
Net capitalized costs	Ps.117,564,132	Ps. 98,079,551	Ps. 84,463,586

Costs incurred for oil and gas property acquisition, exploration and development activities:

	Year Ended December 31,		
	1997	1996	1995
Exploration	Ps. 551,587	Ps. 534,373	Ps. 346,808
Development	9,274,199	7,736,793	4,960,684
Total costs incurred	Ps.9,825,786	Ps.8,271,166	Ps.5,307,492

There are no property acquisition costs because PEMEX exploits oil reserves owned by the Mexican Federal Government.

Development costs include costs of geological and geophysical studies of field development amounting to Ps.1,276,240, Ps.565,379 and Ps.964,190 for 1997, 1996 and 1995, respectively, that are expensed, under successful efforts, as geological and geophysical exploration expense.

(In thousands of pesos and thousands of U.S. dollars)

Results of operations for oil and gas producing activities:

	Year Ended December 31,		
	1997	1996	1995
Revenues from affiliates	Ps.173,031,306	Ps.168,586,566	Ps.101,897,278
Production taxes	116,693,323	114,852,728	71,298,300
Excess-gains taxes	3,780,684	9,559,634	2,898,000
Production costs (excluding taxes)	28,921,080	19,300,807	13,282,441
Exploration expenses	1,276,243	1,135,302	1,048,147
Depreciation, depletion and amortization	4,719,467	4,717,994	4,305,436
	155,390,797	149,566,465	92,832,324
Results of operations for oil and gas producing activities	Ps. 17,640,509	Ps. 19,020,101	Ps. 9,064,954

Crude oil and natural gas reserves :

Under the Mexican Constitution and Mexican statutory law, all oil and other hydrocarbon reserves within Mexico are owned by the Mexican nation and not by PEMEX. Under its Organic Law, PEMEX has the exclusive right to exploit those reserves and owns the extracted production, not the reserves, subject to a federal production tax currently assessed at the rate of 60.8% of revenue from the sale of production. Crude oil exports are subject to an additional "excess gains" tax.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs at the date of estimation.

PEMEX estimates Mexico's proved reserves using standard geological and engineering methods generally accepted by the petroleum industry. The choice of method or combinations of methods employed in the analysis of each reservoir is determined by experience in the area, stage of development, quality and completeness of basic data and production history. The reserve data set forth herein represent only estimates. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate depends on the quality of available data and of engineering and geological interpretation and judgment. As a result, estimates of different engineers often vary. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revision of such estimate.

(In thousands of pesos and thousands of U.S. dollars)

The following two tables of oil and gas reserves set forth the Mexican Government's official published estimates of proved reserves.[1] Such estimates do not reflect recent reserve revisions in the marine and southern regions relating to PEMEX's current review of reserve estimates, as further described after the oil and gas reserves table below.

Crude oil and condensate reserves (including natural gas liquids)[a]
(millions of barrels)

	1997	1996	1995
Proved developed and undeveloped reserves			
At January 1	48,472	48,796	49,775
Revisions	262	702	(129)
Extensions and discoveries[b]	367	176	243
Production	(1,279)	(1,201)	(1,093)
At December 31	47,822	48,473	48,796
Proved developed reserves at December 31[c]	29,154	29,664	30,044

Note: Table amounts may not total due to rounding.
a Crude oil and condensate reserves include the fraction of liquefiable hydrocarbons recoverable in gas processing plants.
b Extensions include only positive changes due to new data gathered through drilling of extension wells. Negative changes are reported as revisions.
c Crude oil proved developed reserves at the beginning of 1995 were estimated to be 30,138 million barrels.

[1] The reserve estimates are published in PEMEX's *1996 Statistical Yearbook* and *Memoria de Labores*.

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Dry natural gas reserves
(billions of cubic feet)

	1997	1996	1995
Proved developed and undeveloped reserves			
At January 1	63,913	67,668	68,413
Revisions	(52)	(2,979)	(363)
Extensions and discoveries[a]	791	353	666
Production[b]	(1,196)	(1,129)	(1,048)
At December 31	63,456	63,913	67,668
Proved developed reserves at December 31[c]	31,095	30,907	34,734

Note: Table amounts may not total due to rounding.
a Extensions include only positive changes due to new data gathered through drilling of extension wells. Negative changes are reported as revisions.
b Natural Gas production reported in item 1-Description of Business, refers to wet, sour gas. There is a shrinkage when natural gas liquids and impurities are extracted to obtain dry natural gas. Therefore, reported natural gas volume is greater than dry natural gas.
c Dry natural gas proved developed reserves at the beginning of 1995 were estimated to be 35,334 billion cubic feet.

PEMEX is in the process of reviewing its estimates of Mexico's proved reserves, which are being audited by Netherland Sewell and Associates, Inc. (NSAI) international experts in the field. Beginning in 1997, PEMEX revised its procedures for estimating reserves to meet the reserve definitions and standards of the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC). For Mexico's reserves, the SPE/WPC proved reserve definition is similar to the proved reserve definition used for U.S. financial reporting. In 1996, PEMEX applied the revised procedures to reserves in its marine regions. The revised reserve estimates as of December 31, 1996 were audited by NSAI whose February 1997 report states that the revised estimates were prepared by PEMEX in accordance with generally accepted petroleum engineering and evaluation principles and that the PEMEX estimated offshore reserves as of December 31, 1996 were reasonable in the aggregate. In 1997, PEMEX applied the revised procedures to reserves in the marine regions and the southern region onshore, and the revised estimates for the southern region were similarly audited by NSAI. PEMEX plans to apply the revised procedures to the northern region and have the revised estimates audited by NSAI and DeGolyer and MacNaughton (D&M). Until reserve estimates using revised methodology are available for all regions, PEMEX will continue to publish concurrently estimates based on its criteria established prior to 1996 in order to provide for more meaningful inter-period comparisons. The estimates of reserves set forth in this disclosure report are based on these previously established criteria.

With the new information gathered on the behavior of the reservoirs, and the more rigorous criteria and standards of the SPE and WPC, proved reserves for the Northeast and Southwest marine regions, as of December 31, 1997, are estimated to be 16,123 million barrels of oil equivalent. Using other criteria and previous information, PEMEX had estimated its proved reserves for these regions at 27,309 million barrels of oil equivalent. Similarly, the December 31, 1997, proved reserves of the southern region are estimated to be 7,669 million barrels of oil equivalent under the revised procedures and 11,374 million barrels of oil equivalent under previous criteria.

Standardized measure of discounted future net cash flows related to proved oil and gas reserves:

The standardized measure tables below relate to proved oil and gas reserves, which are presented: (i) after adjusting for the aforementioned revisions in the marine regions and southern regions (ii) excluding approximately 17 billion boe of proved undeveloped reserves of the northern region[2], and (iii) excluding proved reserves scheduled to be produced more than 25 years after the date of the standardized measure.

Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of the country's proved reserves. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves, assuming continuation of year-end economic conditions.

In addition to being subject to the payment of all taxes and contributions set forth by the Ministry of Finance and Public Credit (except as indicated below), PEMEX is presently subject to the following special duties: a hydrocarbon extraction duty, an extraordinary hydrocarbon extraction duty, an additional hydrocarbon extraction duty, a tax on hydrocarbon income and the *Impuesto Especial Sobre Producción y Servicios* (Special Tax on Production and Services or "IEPS tax"). These taxes and duties are to be credited against the *Derecho Sobre Hidrocarburos* (the "Hydrocarbon Duty"), which is calculated by applying a rate of 60.8% to the sales revenue of PEMEX to third parties (sales and revenues are taken to include the IEPS tax generated by the sale of refined products, but not to include VAT). In addition to the payment of the Hydrocarbon Duty, PEMEX must pay to the Government an excess gains tax, which for 1997 equaled 39.2% of its revenues in respect of crude oil export sales at prices

[2] Current priorities in PEMEX's investments portfolio will not soon allow development of the reserves of this area.

(In thousands of pesos and thousands of U.S. dollars)

in excess of US$14.50 per barrel. For 1998, the excess gains tax applies to prices in excess of US$15.50 per barrel. PEMEX is not subject to the *Ley del Impuesto Sobre la Renta* (Income Tax Law) or the *Ley del Impuesto al Activo* (Asset Tax Law).

The standardized measure provided below represents a comparative benchmark value.

The information provided does not represent expected future cash flows nor fair market value of PEMEX's production rights. Estimates of proved reserves are imprecise and may change over time as new information becomes available and as economic conditions change. Furthermore, probable and possible reserves, which may become proved in the future, are excluded from the calculation. To comply with SFAS No.69, the standardized measure calculation requires assumptions as to the timing of future production from proved reserves and the timing and amount of future development and production costs.

Standardized measure of discounted future net cash flows
(millions of dollars)

	December 31,		
	1997	1996	1995
Future cash inflows	US$287,036	US$414,071	US$384,287
Future production costs (excluding taxes)	(49,058)	(50,866)	(52,606)
Future development costs	(42,649)	(45,619)	(46,745)
Future cash flows before taxes	195,329	317,586	284,936
Future production-and-excess-gains taxes	(154,988)	(267,183)	(242,884)
Future net cash flows	40,341	50,403	42,052
Effect of discounting net cash flows at 10%	(26,844)	(23,607)	(21,388)
Standardized measure of discounted future net cash flows	US$ 13,497	US$ 26,796	US$ 20,664

Note: Table amounts may not total due to rounding.

Oil and gas prices have declined approximately 29% and 10%, respectively, since December 31, 1997 through April 1998. Had the standardized measure at December 31, 1997 been calculated using oil and gas prices at April 30, 1998, that standardized measure would have approximated 9,529 million dollars.

To comply with SFAS No.69, the next table presents the aggregate standardized measure change for each year and significant sources of variance:

(In thousands of pesos and thousands of U.S. dollars)

Change in standardized measure of discounted net cash flows
(millions of dollars)

	1997	1996	1995
Sales of oil and gas produced, net of production costs	US$(19,310)	US$(20,558)	US$(15,423)
Net changes in prices and production costs	(73,755)	87,698	10,473
Extensions and discoveries	2,961	1,850	1,555
Development cost incurred during the year	3,292	2,047	1,228
Changes in estimated development costs	(4,652)	(2,237)	(2,211)
Reserve revisions, and timing changes	8,229	(45,863)	1,183
Accretion of discounted pre-tax cash flows	15,914	12,689	11,891
Net changes in production-and-excess-gains taxes	54,021	(29,494)	(6,874)
Aggregate change in standardized measure	US$(13,300)	US$ 6,132	US$ 1,822
Standardized measure			
As of January 1	US$ 26,796	US$ 20,664	US$18,842
As of December 31	13,496	26,796	20,664
Change	US$(13,300)	US$ 6,132	US$ 1,822

Note: Table amounts may not total due to rounding.

In computing the amounts under each factor of change, the effects of variances in prices and cost are computed before the effects of changes in quantities. Consequently, the effect of changes in reserves is calculated at year-end prices and cost rates. The change in computed taxes included taxes effectively incurred during the year and the change in future tax expenses.

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UNITED MEXICAN STATES

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Area, Population and Society

Mexico, a nation formed by 31 states and the Federal District (comprising Mexico City), is the fifth largest nation in the Americas and the thirteenth largest in the world, occupying a territory of 759,529 square miles (1,967,183 square kilometers). To the north, Mexico shares a border of 1,931 miles (3,107 km) with the United States of America, and to the south it has borders with Guatemala and Belize. Its coastline extends over 6,303 miles (10,143 km) along both the Gulf of Mexico and the Pacific Ocean.

Mexico is the second most populous nation in Latin America, with a population of 91.1 million as reported by the *Instituto Nacional de Estadística, Geografía e Informática* (National Statistical, Geographic and Information Institute, or "INEGI") in its 1995 population and housing count. Approximately 73.5% of Mexico's population is located in urban areas. Mexico's three largest cities are Mexico City, Guadalajara and Monterrey, with estimated populations in 1995 of 16.4 million, 3.3 million and 2.9 million, respectively. The annual rate of population growth averaged 3.3% in the 1960s and 1970s. In the 1980s, Government efforts in the areas of family planning and birth control, together with declining birth rates among women under 35 and those living in urban areas, resulted in a reduction of the population growth rate to an estimated 1.57% in 1998.

Mexico is generally classified as a middle-income developing country and had a per capita GNP (adjusted for purchasing power parity) in 1996 of U.S. $7,660, compared with U.S. $28,020 in the United States, U.S. $8,130 in Venezuela, U.S. $11,700 in Chile and U.S. $6,340 in Brazil. Life expectancy at birth in Mexico was 72 years in 1996, compared with 77 years in the United States, 73 years in Venezuela, 75 years in Chile and 67 years in Brazil. Adult illiteracy was estimated at 8% for men and 13% for women in 1995, compared with less than 5% for both genders in the United States, 8% for men and 10% for women in Venezuela, 5% for both genders in Chile and 17% for both genders in Brazil. Infant mortality in 1996 was 32 deaths per 1,000 live births in Mexico, compared with 7 in the United States, 12 in Chile, 22 in Venezuela and 36 in Brazil.

Form of Government

The present form of government was established by the Political Constitution of Mexico (the "Constitution"), which took effect on May 1, 1917. The Constitution establishes Mexico as a federal republic and provides for a tripartite government, separated into executive, judicial and legislative branches. The President and the members of Congress are elected by popular vote of Mexican citizens who are 18 years of age and older.

The President is the chief of the executive branch of the Mexican Federal Government (the "Government"). The current President of Mexico is Ernesto Zedillo Ponce de León, whose term expires on December 1, 2000. The Constitution limits the President to one six-year term and does not allow re-election for any additional terms. The executive branch of the Government consists of 17 ministries and the office of the Federal Attorney General. The principal officials of all the ministries and the Federal Attorney General are appointed by the President. The appointment of *empleados superiores* (senior employees) of the *Secretaría de Hacienda y Crédito Público* (Ministry of Finance and Public Credit) and the Federal Attorney General is subject to ratification by the Senate.

Federal judicial authority is vested in the Supreme Court of Justice, the Circuit and District Courts and the *Consejo de la Judicatura Federal* (Federal Judicial Board). The Supreme Court is comprised of 11 *Ministros* (Ministers), who serve 15-year terms (except in the case of members appointed after Constitutional amendments which took effect on December 31, 1994 (the "Constitutional Amendments"), whose terms range from eight to 20 years). The Ministers of the Supreme Court are selected by the Senate from a pool of candidates nominated by the President. The President of the Supreme Court is limited to a single term of four years. The Federal Judicial Board, which is composed of seven members, one of whom is the President of the Supreme Court, administers the Federal judicial system and appoints Circuit Court judges and District Court judges (*magistrados*).

Legislative authority is vested in the Congress, which is composed of the Senate and the Chamber of Deputies. Senators serve a six-year term, Deputies serve a three-year term and neither may serve consecutive terms in the same chamber. As a result of the Constitutional Amendments, the Senate is comprised of 128 members (twice its previous size), which consist of four Senators from each state and four Senators from the Federal District. The Chamber of Deputies is comprised of 500 members, 300 of whom are elected directly by national electoral districts and 200 of whom are elected through a proportional representation system that allocates 200 seats in the Chamber of Deputies to political party representatives, based on the proportion of the votes cast for those parties that receive at least 2.0% of the national vote. The Constitution provides that the President may veto bills and that Congress may override such vetoes with a two-thirds majority of each chamber.

The *Partido Revolucionario Institucional* (Institutional Revolutionary Party or "PRI") has been the dominant political party in Mexico. Since 1929, the PRI has won all Presidential elections; and from 1929 until July 1997, the PRI held a majority of the seats in both Chambers of the Federal Congress. Until 1989, the PRI had also won all of the state governorships, however, the *Partido Acción Nacional* (National Action Party, or "PAN"), the oldest opposition party in the country, now holds five state governorships and the *Partido de la Revolución Democrática* (Democratic Revolution Party or "PRD") holds one state governorship.

In June 1994, the political parties participating in the federal elections and 3,000 representatives of various segments of Mexican society signed an agreement named *Veinte Acuerdos por la Democracia* (the "Twenty Democracy Accords") in which commitments were made to achieve fair and open elections in Mexico to further the goal of democracy. Pursuant to the Twenty Democracy Accords, the 1994 federal elections were conducted with certain institutional mechanisms aimed at impartiality and political neutrality, including: (i) a federal census that produced more accurate voter lists, (ii) the establishment of the *Instituto Federal Electoral* (the Federal Electoral Institute), an autonomous state agency empowered by the Constitution to resolve electoral disputes and organize elections; (iii) the introduction of holographic tamper-proof photo voter identification cards, which discouraged voter fraud and aided detection of such fraud, and (iv) the invitation of Mexican and foreign election observers to certify the electoral process. Such measures, as well as the general interest of voters in the elections, resulted in the largest voter turnout in twelve years, with 77.3% of registered voters voting. In the August 1994 Presidential election, Ernesto Zedillo, the PRI candidate, won the Presidential election with 48.77% of the vote; the PAN candidate received 25.94% of the vote and the PRD candidate obtained 16.60% of the vote.

On January 17, 1995, the four principal political parties, the PRI, PAN, PRD and the *Partido del Trabajo* (Labor Party, or "PT"), entered into the *Acuerdo de los Pinos* (the "Los Pinos Accord"), which furthered the electoral and political reforms embodied in the Twenty Democracy Accords. The Los Pinos Accord achieved the following commitments and goals: (i) the creation of an impartial forum to negotiate accords between the Government and the national executive committees of all political parties, as well as between the Congress and the state legislatures; (ii) the promotion of a national dialogue for political reform; (iii) a strengthening of federal electoral reform, and the use of the federal reforms as a framework for electoral reforms in each state; (iv) the solution of electoral issues in a democratic fashion, in order to allow the nation to concentrate on solving its more urgent economic and social challenges; and (v) a commitment to avoiding post-electoral disputes once the reforms were effected and the conditions of fairness and legality of the process were satisfied.

On August 22, 1996, certain constitutional amendments (the "1996 Amendments") aimed at reforming the electoral law were ratified. The amendments excluded the President from participation in the Federal Electoral Institute; eliminated the Electoral Committee of the Chamber of Deputies, which had been responsible for ratifying the results of presidential elections; imposed limits on expenditures on political campaigns and controls on the sources and uses of funds contributed to a political party; granted voting rights to Mexican citizens residing abroad; reduced from 315 to 300 the maximum number of congressional representatives who may belong to a single party and established the current electoral procedure of proportional representation in the Senate. The 1996 Amendments empowered the Supreme Court to review the constitutionality of electoral law; and the Mexican Federal Electoral Court, which had previously been part of the executive branch, was integrated into the judicial branch.

The 1996 Amendments provided for the popular election of the Chief of Government of the Federal District, and granted the Chief of Government of the Federal District the authority to appoint the Attorney General of the Federal District; both positions had previously been presidential appointments. In addition, pursuant to the 1996 Amendments Federal District legislative delegates, who represent the various boroughs of the Federal District, will be popularly elected beginning in 2000. In elections held on July 6, 1997, the voters of the Federal District elected Cuauhtémoc Cárdenas Solórzano, the candidate of the PRD, to the office Chief of Government. Mr. Cárdenas took office on December 5, 1997 for a term of three years. Future Chiefs of Government of the Federal District will serve six-year terms.

In the Congressional election also held on July 6, 1997, one quarter of the seats in the Senate and all of the seats in the Chamber of Deputies were up for election. The election resulted in the following distribution of Congressional seats: The PRI has the largest representation in the Congress, with 239 seats in the Chamber of Deputies (a number short of a majority) and 77 Senate seats; the PAN has the second-largest representation in the Congress, with 121 seats in the Chamber of Deputies and 33 seats in the Senate; and the PRD has the third-largest representation in the Congress, with 125 seats in the Chamber of Deputies and 16 seats in the Senate. The *Partido Verde Ecologista de México* (Ecological Green Party of Mexico or "PVEM") has the fourth-largest representation in the Congress, with eight seats in the Chamber of Deputies and 1 seat in the Senate; and the PT has the fifth-largest representation, with seven seats in the Chamber of Deputies and one seat in the Senate.

Foreign Affairs

Mexico has diplomatic ties with approximately 176 countries. It is a charter member of the United Nations and a founding member of the Organization of American States, the International Monetary Fund (the "IMF"), the International Bank for Reconstruction and Development (the "World Bank"), the International Finance Corporation ("IFC") and the Inter-American Development Bank ("IDB"). Mexico is also a non-borrowing regional member of the Caribbean Development Bank. In 1986, Mexico became a party to the General Agreement on Trade and Tariffs ("GATT"). In 1991, Mexico became a founding member of the European Bank for Reconstruction and Development ("EBRD") and was admitted into the Pacific Basin Economic Co-operation Conference. Mexico is a signatory, along with Canada and the United States, to the North American Free Trade Agreement ("NAFTA"), which went into effect on January 1, 1994. On April 14, 1994, Mexico was admitted as a member of the Organization for Economic Cooperation and Development ("OECD"), making it the first new member to be admitted into the OECD since 1973. Mexico became a member of the World Trade Organization ("WTO") on January 1, 1995, the date on which the WTO superseded the GATT.

THE ECONOMY

Events During 1994 and 1995

While successful in reducing inflation from 159.2% in 1987 to 7.1% in 1994 and achieving real GDP growth averaging 3.9% over the 1990-1994 period, the Mexican economy had certain weaknesses by 1994 that made it unable to withstand the severe internal and external political and economic shocks that occurred in 1994, resulting in the destabilization of the Mexican economy at the end of 1994, a crisis of confidence on the part of foreign portfolio investors and an economic and financial crisis.

Among the weaknesses of the economy apparent in 1994 was a reduced level of domestic savings. Although Mexico, during the decade from 1975-1985, registered levels of domestic savings in excess of 20% of GDP, by 1994 the level of domestic savings had fallen to 15% of GDP, reducing the resources available for the investment necessary for continued economic growth. In contrast, the levels of domestic savings in growing economies in southeast Asia and in certain Latin American countries have been closer to 30% of GDP. From 1990 through 1994, the difference between the savings rate and investment in Mexico was reflected in a substantial current account deficit, which reached U.S. $24.4 billion in 1992, U.S. $23.4 billion in 1993 and U.S. $29.7 billion in 1994. By the end of 1994 Mexico's current account deficit had become unsustainable for the reasons noted below.

A second weakness of the Mexican economic model arose from the Government's exchange rate policy. Over the period from December 1987 through December 1994, representatives of the Government, business and labor entered into a series of accords (each, an "Accord"), which were designed to limit price and wage increases so as to lower the rate of inflation, which had by 1987 reached 159.2%. Among the elements included in the first Accord was a commitment by the Government to maintain a fixed peso/dollar exchange rate from February to December 1988. Thereafter, the Government implemented a policy of gradual devaluation of the peso at rates of 16.7% in 1989, 11.4% in 1990, 4.5% in 1991 and 2.4% in 1992, as compared with annual inflation rates (measured by the increase in the National Consumer Price Index ("NCPI")) of 19.7% in 1989, 29.9% in 1990, 18.8% in 1991 and 11.9% in 1992. From October 1992 through December 20, 1994, the peso/dollar exchange rate was allowed to fluctuate within a band that widened daily. The ceiling of the band, *i.e.*, the maximum selling rate, depreciated at a daily rate of 0.0004 pesos (equal to approximately 4.5% per year), while the floor of the band, *i.e.*, the minimum buying rate, remained fixed. During this period, Banco de México intervened in the foreign exchange market as the peso/dollar exchange rate reached either the floor or the ceiling of the band. While the Government's exchange rate policy contributed to general economic stability, encouraged foreign portfolio investment and helped reduce inflation, over time it led to a progressive overvaluation of the peso. The appreciation of the peso made imported consumer goods and services relatively more accessible in comparison with domestic products, contributing to the growth in the current account deficit, which rose from 3.0% of GDP in 1990 to 7.0% of GDP in 1994.

In order to finance the growing current account deficit, Mexico relied on substantial inflows of foreign direct investment and portfolio investment. From 1990 through 1993, the capital account surplus exceeded the current account deficit, leading to an accumulation of international reserves to the level of U.S. $24.5 billion at the end of 1993. From 1992 through 1994, increasing amounts of capital inflows were made up of foreign portfolio investment, including investments in the Bolsa Mexicana de Valores, S.A. de C.V. (the "Mexican Stock Market") and investments in short-term Government and private-sector debt instruments, such as bank certificates of deposit. The portfolio investors were attracted to Mexico because of its relatively high real interest rates and high returns on equity investments, compared to returns on investments in developed countries, and its relatively stable exchange rate. The portfolio investment flows were, however, by their nature less stable than direct foreign investment (because investors could generally liquidate their portfolio investments at any time) and left Mexico vulnerable to losing large amounts of foreign capital during 1994.

During 1994, internal and external events combined to complicate the management of the Mexican economy and, in particular, adversely affected the capital inflows needed to finance the current account deficit. Externally, a series of successive increases in interest rates in the United States during 1994, as well as the prospect of further increases in those rates, made Mexican investments and investments in other emerging markets relatively less attractive to foreign portfolio investors and led to a reluctance on the part of investors to commit capital at fixed interest rates or for long periods of time in those markets.

The economic background deteriorated further due to a series of internal disruptions and political events that undermined the confidence of investors in Mexico during 1994. At the beginning of the year, armed insurgents attacked (and in some cases temporarily seized control of) several villages in the southern state of Chiapas. While the Government responded by providing support to the local authorities and publicly offering to negotiate a peaceful resolution that would address the underlying concerns of the local population, the conflict remained a source of debate and uncertainty for the remainder of the year.

The Mexican Presidential and Congressional elections held in 1994 furnished additional grounds for investor unease. In March 1994, Luis Donaldo Colosio, the presidential candidate of the PRI, the dominant political party in Mexico, was assassinated. That event, together with the general uncertainty regarding the outcome and fairness of the Presidential and Congressional elections scheduled to occur in August 1994, led to pressures on the foreign exchange market. Although that uncertainty abated after Ernesto Zedillo was elected President in August 1994 in an election that was widely perceived as fair and open, substantial outflows of foreign capital occurred in the weeks preceding the election. Other destabilizing events during the year included the assassination of José Francisco Ruíz Massieu, the former Secretary-General of the PRI, and the kidnapping of several prominent businessmen. Despite the fact that the Chiapas conflict was confined to a relatively small geographic area and that the Government condemned the assassinations and kidnappings as criminal acts, these events caused some investors to believe that the Mexican political system was less stable than they had believed.

At the end of the first quarter of 1994, the Mexican authorities responded to the pressure on the peso/dollar exchange rate by permitting the exchange rate to depreciate, but always within the limit of the Banco de México intervention band established in the most recent Accord. In addition, in order to retain the capital of investors who perceived a risk of further devaluation of the peso, the Government issued increasing amounts of *Bonos de la Tesorería de la Federación* (Bonds of the Treasury of the Federation, or "Tesobonos"), short-term notes denominated in dollars but payable in pesos indexed to the value of the dollar. The Government also increased interest rates on its peso-denominated internal debt in an attempt to maintain capital inflows. The Government's attempts to stabilize the exchange rate and restore capital inflows were not, however, successful and Mexico suffered a substantial loss in international reserves in 1994, from U.S. $24.5 billion at the end of 1993 to U.S. $17.2 billion on October 31, 1994. During the second half of December 1994, capital continued to flee the country as investors grew even more concerned, resulting in a strong demand for dollars. Given the loss in reserves that had occurred throughout the year, it became impossible to maintain the peso within the band established by the then most recent Accord, and on December 20, 1994, the Government increased the ceiling of the intervention band by Ps. 0.53. That action proved insufficient to address the concerns of investors, and the demand for foreign currency continued to place pressure on the peso/dollar exchange rate. On December 22, 1994, the Government eliminated the intervention band and allowed the peso to float freely against the dollar. A sharp and rapid devaluation of the peso ensued, with the peso losing 34.9% of its value relative to the dollar between December 21, 1994 and December 31, 1994. By December 31, 1994, the country's international reserves had dropped to U.S. $6.1 billion, as a result of substantial outflows of foreign currency and the Government's efforts to support the value of the peso during 1994.

The devaluation at the end of 1994 had a number of adverse repercussions on the Mexican economy. First, the weaker value of the peso relative to the dollar increased the cost, in peso terms, of imported goods and services, and thereby increased the rate of inflation in Mexico. To the extent that employers adjusted wages upward to compensate for the decline in purchasing power resulting from the devaluation, and then adjusted prices to reflect increased wage costs, additional inflationary pressures arose. The inflation rate was 52.0% in 1995.

Second, the devaluation caused the peso value of Mexico's external public debt and its dollar-denominated Tesobonos to increase significantly, from 25.6% of GDP at November 30, 1994 to 39.9% of GDP at December 31, 1994.

Third, the devaluation led to a lack of confidence on the part of investors in Mexico's ability to repay its short-term obligations and, consequently, a reluctance of investors to reinvest in Mexico's maturing Tesobonos. As a result, Mexico faced a liquidity crisis linked closely to the U.S. $29.2 billion of short-term Tesobonos outstanding at the end of 1994 and maturing in 1995. The country's international reserves also fell, as many investors chose not to reinvest in Mexico the proceeds of maturing Government debt, including Tesobonos and *Cetes* (Mexican Government Treasury bills). At January 31, 1995, Mexico's international reserves totaled U.S. $3.483 billion.

Fourth, the devaluation created concerns about the stability of the Mexican banking system. The devaluation of the peso, higher domestic interest rates and anticipated contraction in real GDP in 1995 combined to weaken the quality of the assets of Mexican banks.

These concerns led to sharply higher interest rates, both domestically and externally, on Mexican public-and-private-sector debt and sharply reduced opportunities for refinancing or refunding maturing debt issues. During 1995, interest rates on 28-day *Cetes* averaged 48.5%, as compared with an average interest rate of 14.1% during 1994 as a whole. Mexican equity securities were also affected adversely by events since the end of 1994, with the Mexican Stock Market Index (as defined under "Financial System—The Securities Markets") falling 36.3% in nominal peso terms from December 20, 1994 to February 27, 1995.

Lower- and middle-income members of society have been especially affected by the economic developments since the end of 1994, mainly as a consequence of increased unemployment, higher inflation, higher financial payments and unavailability of credit. Increases in crime and poverty have also been reported. The fact that Mexico does not have an unemployment benefits scheme or a fully developed social welfare system contributed to the social impact of the economic crisis (although certain features of Mexican society, such as the support provided by extended families, may have helped to mitigate the effects of the economic crisis to some extent).

The Government's Response

The Government's response to the events of 1994-1995 included a series of social accords, an international assistance plan and various adjustments to the Government's economic policy.

Social Accords. In order to address the adverse economic situation that developed at the end of 1994, in January 1995 the Zedillo Administration announced a new economic program and a new Accord among the Government, business and labor, the *Acuerdo de Unidad Para Superar la Emergencia Económica* (Agreement for Unity in Overcoming Mexico's Economic Emergency, or "AUSEE"). On March 9, 1995, the Government replaced the AUSEE with the *Programa de Acción para Reforzar el AUSEE* (Action Program to Strengthen the AUSEE, or "PARAUSEE"), which strengthened key aspects of the AUSEE. The PARAUSEE, together with the international support package described below, formed the basis of Mexico's 1995 economic plan (the "1995 Economic Plan").

The objectives of the PARAUSEE, together with the international support package, were to stabilize the financial markets, lay the foundation for a return to lower inflation rates over the medium-term, preserve Mexico's international competitiveness, maintain the solvency of the banking system and reassure long-term investors of the strong underlying fundamentals of the Mexican economy.

The central elements of the PARAUSEE were fiscal reform, aimed at increasing public revenues through price and tax adjustments and reducing public-sector expenditures; restrictive monetary policy, characterized by limited credit expansion; stabilization of the exchange rate while maintaining the current floating exchange rate policy; reduction of the current account deficit; introduction of certain financial mechanisms (described below) to enhance the stability of the banking sector; and maintenance and enhancement of certain social programs, to ease the transition for the poorest segments of society. Key points of the PARAUSEE included: (i) maintenance of the floating exchange rate policy announced in December 1994, (ii) an inflation target for 1995 (December 1994 to December 1995) of 42%, a projected 1995 current account deficit of U.S. $2.4 billion and a decline in real GDP during 1995 of 2.0%, (iii) a commitment in principle by business to increase prices only in the proportion that products sold in Mexico are comprised of imported components, (iv) a commitment by the Government to take the steps necessary to increase public revenues and decrease public expenditures with a view to achieving a budget surplus of 0.5% of GDP, sharply lowering the current account deficit and mitigating the inflationary impact of the devaluation; these steps included an increase in the Value-Added Tax ("VAT") from 10% to 15%, increases in prices of goods and services provided by the public sector and a decrease in expenditures by 9.8% in real terms from the 1994 level, and (v) an increase in the minimum wage of

12%, as compared with the 4% increase set in December 1994, with other salaries to be negotiated between employers and workers.

A key element of the Government's strategy to improve the economic and social conditions of less developed sectors of the Mexican society, the Government established on October 31, 1995 a national rural development program known as *Alianza para el Campo* ("Rural Alliance"). The goals of the Rural Alliance are to increase productivity, fight poverty, raise the income of families living in Mexico's rural zones, produce enough basic foods for the population and promote exports of agricultural products.

On October 26, 1996, the Zedillo Administration announced the establishment of another Accord among the Government and the business, labor and agricultural sectors of the economy, the *Alianza para el Crecimiento Económico* (Alliance for Economic Growth or "ACE"). The ACE replaced the *Alianza para la Recuperación Económica* (Alliance for Economic Recovery or "ARE"), a similar program which was in force from October 1995. The ACE aims to foster sustainable economic growth by emphasizing (i) the export sector, particularly through domestic and foreign investment, (ii) public investment, particularly in the hydrocarbon, electricity, transportation and water sectors, and private consumption and (iii) fiscal and monetary discipline in order to achieve greater price stability and lower interest rates. As part of the ACE, the retail price of gasoline and diesel fuel increased by 8% on December 1, 1996 and the prices of gasoline and diesel fuel increased at monthly rates of 1.03% and 1.2%, respectively, in 1997. The price of electricity for domestic use and agricultural irrigation increased at a monthly rate of 1.2% in 1997. The price of electricity for industrial use increased by 10% and 9%, respectively, with monthly adjustments, starting on January 1, 1997. Furthermore, pursuant to the ACE, the minimum wage increased by 17% on December 3, 1996.

On December 31, 1997, the ACE expired. On February 24, 1998, the Government and representatives of the labor, agriculture and business sectors signed the Acuerdo de Cooperación y Consulta (Cooperation and Consultation Accord or "ACC"). In the ACC, the Government and the three economic sectors agreed to increase productivity and competitiveness to prepare Mexico for the globalization of the world economy. The accord is based on the following commitments: (i) a pledge by the Government and the three economic sectors to periodically examine the development of the Mexican economy and to create subcommissions or working groups to analyze specific economic problems; (ii) to allow the unimpeded negotiation of collective bargaining agreements and to foster a cooperative environment to achieve productivity and competitiveness goals, as well as the equitable distribution of any resulting benefits, (iii) to set as a priority workforce education and job training to increase productivity and to facilitate worker transition to changing production technology and (iv) to catalyze capital investment, infrastructure development and labor retraining in rural areas, in order to increase productivity, competitiveness and the standards of living in such areas. The ACC did not, unlike other Accords, set forth price and wage increases. However, on January 1, 1998, the minimum wage was increased by 15.2%. In addition, the Government announced that electricity prices will increase at a rate of 1.2% per month and that gasoline and diesel prices will increase at a rate of 0.7% per month during 1998.

On June 3, 1997, the Government announced the *Programa Nacional de Financiamiento del Desarrollo 1997-2000* (National Development Financing Program 1997-2000, or "PRONAFIDE"). The PRONAFIDE's goals are to: (i) achieve, on average, real GDP growth of 5% per year during the years 1997-2000, (ii) generate more than one million jobs per year, (iii) increase real wages and salaries, (iv) strengthen the capacity of the Government to respond to social needs, (v) avoid an economic crisis of the type suffered by Mexico during the past 20 years, (vi) continue to decrease gradually the rate of inflation to an estimated 7.5% in the year 2000, and (vii) achieve a public sector balance that is close to equilibrium by the year 2000.

In order to achieve a sustainable real GDP growth of 5%, the Government believes an investment rate of 25% of GDP is required. Thus, the PRONAFIDE sets forth four different courses of action to stimulate investment: first, the Government will promote private-sector savings through the new pension system and through a fiscal policy aimed at stimulating internal savings of individuals, families and businesses; second, the Government will consolidate public savings through the rationalization of public expenditures, keeping such expenditures within the level of tax revenues, although investment and social programs will continue to be a priority; third, the Government will make use of external savings only as a complement to internal savings; and fourth, the Government aims to strengthen and modernize the financial system through adequate supervision and controls, as well as to stimulate and reorient development banks by increasing their level of investment efficiency.

Foreign Exchange Policy. The Government has maintained, and intends to continue to maintain, a floating exchange rate policy. In November and December 1995, in response to increased volatility and pressure on the peso/dollar exchange rate, Banco de México intervened in the foreign exchange market to minimize volatility and maintain order in the market. Since that time, Banco de México has not intervened in the foreign exchange market and has instead promoted and utilized market-based mechanisms for stabilizing the peso/dollar exchange rate. See "External Sector of the Economy—Balance of Payments" and "—Exchange Controls and Foreign Exchange Rates".

Fiscal Reform. Fiscal measures have been undertaken to increase the Government's primary balance and promote private-sector savings. Among the measures adopted was an increase in the VAT and an increase in the depreciation deduction for 1995, the latter of which was designed to provide an enhanced incentive for investment. In addition, on July 3, 1996, the Government announced a restructuring program for the benefit of taxpayers owing past-due taxes to the Government. See "Public Finance—Revenues, Taxation and Expenditures".

Monetary Policy; Prices and Wages. The objective of monetary policy under the 1995 Economic Plan was to stabilize the exchange rate in order to induce capital inflows. Domestic credit was tightened when the exchange rate depreciated, capital outflows took place or inflation was higher than projected. Net domestic credit decreased by Ps. 77.7 billion from December 31, 1994 to December 31, 1995, well within the target of an increase by Ps. 10 billion set by Banco de México for 1995. In addition, new reserve requirements were introduced by Banco de México to facilitate the regulation of liquidity. Pursuant to these requirements, which took effect on March 11, 1995, a bank that overdraws its account with Banco de México must subsequently deposit funds, and maintain amounts on deposit, at least equal to the amount of the overdraft. Substantial fines may be imposed if a bank fails to make and maintain such deposits. The new reserve requirements were intended to reduce Banco de México's daily net extension of credit.

On December 11, 1995, the Government announced certain changes in monetary policy that took effect in 1996. The Government established quarterly targets for the expansion of net domestic credit in 1996 and 1997, as compared with the annual target established for 1995. See "Financial System—Central Bank and Monetary Policy".

Mechanisms to Strengthen the Stability of the Banking Sector. A primary objective of the 1995 Economic Plan was to stabilize and strengthen the banking sector and ensure depositor safety. To that end, the Government took a number of interrelated steps, including:

- The establishment of PROCAPTE, a voluntary program designed to assist banks with capitalization levels below 8% of risk-weighted assets, and intended for use by viable banks experiencing or expected to be facing short-term capital needs. Under this program, the *Fondo Bancario de Protección al Ahorro* (Banking Fund for the Protection of Savings, or "FOBAPROA") advanced funds to participating banks in exchange for five-year mandatorily convertible subordinated bonds.
- Through FOBAPROA, the Government made foreign exchange available through a foreign exchange credit window to help banks meet dollar liquidity needs.
- Mexican law was amended to broaden the scope for investment by foreign and Mexican investors in the equity of Mexican financial institutions by increasing the percentage of the capital stock of most existing Mexican financial institutions that can be owned by non-Mexicans, increasing the percentage of the capital stock of such institutions that can be owned by Mexican corporations (as opposed to Mexican individuals) and increasing, subject

to regulatory approval, the percentage of the capital stock of each such institution that can be owned by any single investor.

- The *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission, or "CNBV") was, through amendment of the banking laws, granted enhanced powers of administrative and management intervention in financial holding companies. In addition, the CNBV increased the amount of required loan-loss reserves, changed the accounting treatment of past-due loans and made other revisions to the accounting principles applicable to Mexican banks to bring Mexican financial accounting standards closer to international standards. The CNBV also increased its supervisory activities through closer and more frequent inspections and heightened reporting requirements.
- Beginning in March 1995, the Government announced a series of debtor support programs designed to help financial institutions and their debtors restructure the large number of past-due loans caused by the financial crisis and the ensuing increase in domestic interest rates and economic recession.

See "Financial System—Banking Supervision and Support".

Structural Reform. The Government took steps to increase the productivity and competitiveness of the economy through deregulation, privatization and increased private-sector investment. These measures included Constitutional amendments and related legislation that have allowed the Government to privatize railways and satellite communications, new legislation permitting Mexican private-sector companies (which may be owned by non-Mexican companies or individuals) to take part in the storage, distribution and transportation of natural gas, plans to privatize power-generating plants and secondary petrochemical plants, airports, ports and highways, and new legislation on civil aviation which provides for the granting of 30-year concessions allowing private companies to operate commercial air transportation services within Mexico. After various adjustments to the policies relating to the privatization of secondary petrochemicals, the Congress has approved an amendment to the relevant law that will permit foreign and Mexican private-sector investors to purchase up to 49% of existing operations. See "—The Role of the Government in the Economy; Privatization" below.

In addition, in September 1995, the Government created the *Fondo de Inversión en Infraestructura* (Infrastructure Investment Fund or "FINFRA"), with the objective of encouraging a greater private-sector participation in the construction of basic infrastructure, such as toll roads, ports, water-treatment plants, drainage and sanitation facilities. FINFRA has participated with private investors in over 40 such infrastructure development projects in several states, including Guanajuato, México, Sonora, Tamaulipas and Veracruz. FINFRA had an initial capitalization of Ps. 1.7 billion, deriving from the proceeds of the privatization of certain state-owned assets, and has been managed by *Banco Nacional de Obras y Servicios Públicos, S.N.C.* ("Banobras").

International Support. In the beginning of 1995, the Government engaged in a series of discussions with the IMF, the World Bank, the IDB and the U.S. and Canadian governments in order to obtain the international financial support necessary to relieve Mexico's liquidity crisis and aid in restoring financial stability to Mexico's economy. The proceeds of the loans and other financial support were used to refinance public-sector short-term debt, primarily Tesobonos, to restore the country's international reserves and to support the banking sector.

The largest component of the international support package was up to U.S. $20 billion in support from the United States pursuant to four related agreements entered into on February 21, 1995: the U.S.-Mexico Framework Agreement for Mexican Economic Stabilization, the Oil Proceeds Facility Agreement (the "Oil Agreement"), the Medium-Term Exchange Stabilization Agreement and the Guarantee Agreement, collectively, the "February 21 Agreements"). The February 21 Agreements contemplated that these resources were to be made available to Mexico in the form of (i) medium-term (*i.e.*, up to five-year) peso/dollar swap transactions entered into between the U.S. Treasury Department, acting through the Exchange Stabilization Fund ("ESF"), and Mexico, (ii) guarantees by the U.S. Treasury Department, acting through the ESF, of debt securities with a tenor of up to ten years issued by Mexico and (iii) short-term swap transactions entered into by Banco de México with the U.S. Government pursuant to the North American Framework Agreement of April 26, 1994 (the "NAFA").

During 1995, the U.S. and Canadian Governments disbursed U.S. $13.7 billion of proceeds to Mexico under the February 21 Agreements and the NAFA, the proceeds of which were used by Mexico to refinance maturing short-term debt, including Tesobonos and U.S. $1 billion of short-term swaps under the NAFA. In a series of repayments and prepayments beginning in October 1995 and ending on January 16, 1997, Mexico extinguished all of its obligations under the February 21 Agreements.

On February 1, 1995, the IMF approved a stand-by program for Mexico in an amount of Special Drawing Rights ("SDR") approximately equivalent to U.S. $17.64 billion, based upon its review and approval of Mexico's economic program. During 1995, Mexico received the equivalent of U.S. $12.8 billion in disbursements under its IMF stand-by program (in the form of purchases of SDR by Banco de México), based upon meeting an agreed-upon set of quarterly economic, monetary and fiscal targets under the program during 1995. During 1995, Mexico repaid SDR 0.75 billion (approximately U.S. $1.12 billion) of its repurchase obligations to the IMF, leaving an outstanding amount of repurchase obligations to the IMF of SDR 10.65 billion (approximately U.S. $15.8 billion) at December 31, 1995. The improvement in Mexico's access to the international capital markets and the relative strengthening of its international reserves enabled the Government to prepay to the IMF U.S. $1 billion in 1996 and U.S. $2.7 billion in 1997.

On June 23, 1995, the Government entered into agreements with the World Bank and the IDB providing for up to U.S. $2.75 billion in adjustment loans, of which U.S. $1.75 billion is being used to support the Mexican financial system and U.S. $1.00 billion is being used to support the Government's provision of essential social services. As of March 31, 1998, the Government had borrowed U.S. $1.48 billion of the amounts committed by the World Bank and U.S. $1.25 billion of the amounts committed by the IDB, with an aggregate of U.S. $18 million remaining available to be disbursed.

Modified Debt Profile. Using resources made available through the international support package as well as operations by Banco de México, in 1995 Mexico altered its debt profile significantly. The outstanding Tesobono balance was reduced from U.S. $29.2 billion at December 31, 1994 to U.S. $246 million at December 31, 1995. By February 16, 1996, Mexico had no Tesobonos outstanding, and has not issued Tesobonos since that date. As of December 31, 1996, 100% of Mexico's net internal debt was denominated and payable in pesos, as compared with only 44.3% of such debt at the end of 1994. By the end of 1997, 95.4% of Mexico's external public-sector debt consisted of long-term (*i.e.*, one year or more) maturities, as compared with 69.0% of such debt, including Tesobonos, at the end of 1994.

Political Reform. In the domestic political arena, the Government has renewed its efforts to resolve its differences with the insurgents in the Chiapas region, by facilitating their participation in the political process. On March 9, 1995, Congress approved a law granting temporary amnesty to insurgents who participate in peace talks with the Government, and on March 13, 1995, the law establishing the framework for these peace talks took effect. On September 11, 1995, the Government and the insurgents reached an agreement pursuant to which both sides accepted a common political agenda and procedural rules, and agreed to the creation of a working committee regarding the rights of indigenous peoples. This agreement was expected to represent a first step toward a comprehensive peace agreement between the parties. The working committee began negotiations on October 17, 1995 and concluded a second round of meetings on November 19, 1995 having made significant progress in laying out the framework for a plenary session that took place from January 10 through January 19, 1996. The attendees at the plenary session drafted an agreement on a series of measures aimed at enhancing and guaranteeing the rights of the indigenous population. The agreement was signed on February 16, 1996. Talks with the insurgents continued following such agreement, but are currently on hold.

On August 28, 1996, a newly formed group calling itself the Popular Revolutionary Army ("PRA") attacked military and police targets in small cities of some southern states of Mexico. In May 1997, the PRA and Government troops were involved in two skirmishes in the southern state of Guerrero. It is generally believed that this group does not enjoy popular support, and its terrorist attacks have been condemned by both Government and non-government representatives. A consensus has emerged to take decisive action and apply the force of law against the PRA, and in this connection the Government has arrested several alleged members of the group.

In December 1997, a violent incident occurred in the municipality of Chenalhó, Chiapas, which resulted in a number of fatalities. The Chenalhó incident has fortified the Government's determination to negotiate peace in Chiapas. The Government's new peace plan includes the following basic goals: (a) to reinitiate an intense dialogue and negotiation among the federal and state governments, political parties, the *Ejército Zapatista de Liberación Nacional* (National Liberation Zapatista Army or "EZLN"), the *Comisión de Concordia y Pacificación* ("COCOPA") and the *Comisión Nacional de Intermediación* ("CONAI"), (b) to formulate a legal framework, consistent with the accords of San Andrés Larraínzar, that satisfies all sides, that respects Mexico's multicultural heritage, that encourages the development of lesser developed regions and that seeks the inclusion of the indigenous population in the economic and social development of Mexico, (c) to achieve, through the application of the rule of law, the disarmament of all non-governmental groups, (d) to continue with the investigation of the Chenalhó incident and rigorously prosecute those responsible, and (e) to restructure thoroughly the Chiapas state police.

The above-mentioned reforms, together with the changes in the Mexican economy since 1982, helped restore order to the foreign exchange markets and has enabled the Mexican economy to recover, in large measure, from the economic crisis experienced since the end of 1994. In the short-term, however, higher inflation and interest rates than those that were experienced before 1995 have prevailed and will continue. In addition, significant new investment in infrastructure, industrial and agricultural modernization, training and environmental protection will be required for continued growth and development. The Mexican economy is likely to continue to be subject to the effects of adverse domestic and external factors such as declines in foreign direct and portfolio investment, high interest rates and low oil prices, which may lead to volatility in the foreign exchange and financial markets and may affect Mexico's ability to service its foreign debt.

The Role of the Government in the Economy; Privatization

Overview. Since 1983, the Government has set as a priority the sale to the private sector of its interest in all non-strategic commercial enterprises. In 1982, the Government owned or controlled 1,155 public-sector enterprises. By December 31, 1997, the number of Government-owned businesses had been reduced to 189. Between 1982 and December 31, 1997, the Government divested itself of 1,054 Government enterprises, through sales to the private sector, mergers or liquidations. In part as a result of these privatizations, the share of Government expenditures in GDP fell from 41.8% in 1982 to 23.6% in 1997. The importance of subsidies also diminished significantly.

In January 1995, the Government announced a comprehensive privatization program intended to give new impetus to the Government's privatization efforts, which the Government views as a key element of Mexico's structural economic reforms. Under the program, the Government successfully privatized railroads and satellite communications. The privatization program also contemplates the privatization of ports, airports and highways and the sale of the Government's remaining ownership interest in previously privatized commercial banks. In addition, the program contemplates that the level of private investment in power-generating facilities will increase significantly.

Considerable progress has been made in developing a broad range of mechanisms to allow investors a choice of how to finance acquisitions of Government assets subject to privatization.

Under the current privatization program the Government has achieved more effective regulatory reform as well as improved coordination among the relevant agencies than in previous privatizations. To this end, the Government is modernizing the legal and regulatory framework applicable to certain sectors (such as telecommunications) in advance of privatization, rather than following privatization. Congress has enacted a series of laws which increase the scope for private and foreign participation in key sectors of the Mexican economy.

Telecommunications. In June 1995, Congress enacted legislation to liberalize telecommunications in Mexico upon the expiration in August 1996 of the exclusive concession granted to Telmex to render domestic and international telephone services in Mexico. Pursuant to the legislation, the *Secretaría de Comunicaciones y Transportes* (Ministry of Communications and Transportation, or "SCT") has granted 30-year concessions (which may be extended for an additional 30 years) for the establishment and operation of public telecommunications networks. No license fees have been charged in connection with the granting of such concessions. In addition, the Government conducted auctions for 20-year concessions (which may be extended for an additional 20 years) to use portions of the radio spectrum to operate cellular telephone networks and for concessions to operate satellite telecommunications systems. Although the various concessions may only be granted to Mexican individuals and companies, foreigners may own up to 49% of the capital stock of such companies (except in the case of concessions to operate cellular telephone systems, where foreigners may increase their ownership beyond 49% with the approval of the National Foreign Investment Commission ("NFIC")). Concessionaires are free to establish rates for the services they provide. From October 1, 1995 through December 31, 1997, 12 concessions were granted for the operation of a wide range of public telecommunications services. Such concessions, which include long-distance telephone services, have been granted to the following companies, among others: Avantel, Iusatel, Alestra, Unicom, Investcom, Cableados y Sistemas and Miditel.

In mid-1997, the Government published rules describing the restructuring of the Mexican satellite system and setting for the guidelines for permitting private investment in satellite communications. On October 24, 1997, the Autrey group and Loral Space were awarded the bid to acquire 75% of the shares of Satélites Mexicanos, the Mexican satellite company, with the Government keeping the remaining 25% of the shares for the present.

On August 9, 1996, the Ministry of Communications and Transportation announced the creation of the Federal Telecommunications Commission as a decentralized administrative entity. This commission is responsible for the regulation and supervision of telecommunications services in Mexico, with the goals of promoting competition, expanding the available services and improving efficiency in this sector. The commission has been involved in the design and supervision of administrative policies and technical plans, the issuance of technical provisions and the undertaking of specialized analysis relating to telecommunications issues. In addition, the commission is coordinating processes to use and operate geo-stationary orbital positions and satellite orbits assigned to Mexico, including their frequency bands and rights to broadcast and receive signals. The commission has four members, including a chairman, appointed by the President of Mexico.

Natural Gas Industry. Effective May 12, 1995, Congress enacted amendments to the law regarding the natural gas industry. The amendments provide that Mexican private-sector companies (which may be owned by non-Mexican companies or individuals) may take part in the storage, distribution and transportation of natural gas and to that end may construct, own and operate natural gas pipelines, installations and equipment. By the end of 1997, the Government had granted nine 12-year concessions for the construction, ownership and/or operation of natural gas distribution centers in Chihuahua, Mexicali, Hermosillo, Toluca, Río Pánuco, Saltillo, Monterrey, Nuevo Laredo and Piedras Negras. Additional concessions, including for the Mexico City metropolitan area, will be awarded in 1998.

Railways. In 1995, Congress enacted a new law on railways, pursuant to which 50-year concessions may be granted (which may be extended for up to an additional 50 years) to operate sections of Mexico's railway system. Although only Mexican individuals or companies may hold railway concessions, foreigners may own up to 49% of the capital stock of such companies and may increase their ownership share beyond this limit with the approval of the NFIC. On November 13, 1995, the SCT announced its plans to, in addition to granting concessions, privatize Mexico's railways by establishing four new companies, each of which owns one of Mexico's principal rail networks. In December 1996, SCT granted the concession of *Ferrocarril del Noreste* (the Northeast rail line) to *Transportación Ferroviaria Mexicana, S.A. de C.V.* a joint venture with Mexican and foreign participants. In June 1997, SCT granted the concession of *Ferrocarril del Pacífico Norte* (the North-Pacific rail line) to *Grupo Ferroviario Mexicano* a joint venture with Mexican and foreign participants. In October 1997, SCT granted the concession of two short lines, the Tijuana-Tecate short line to Medios de Comunicación y Transporte de Tijuana, S.A. de C.V., and the Coahuila-Durango short-line to Grupo Aceros del Norte, S.A. de C.V. and Industrial Peñoles, S.A. de C.V. In June 1998, SCT granted the concession of *Ferrocarril del Sureste* (the Southeast rail line) to *Triturados Basálticos y Derivados, S.A. de C.V.*

Aviation. Legislation regarding civil aviation has been enacted which provides for 30-year concessions (which may be extended for an additional 30 years) to operate regularly scheduled commercial air transportation services within Mexico. Concessions may only be granted to Mexican companies, but foreigners may own up to 25% of the capital stock of such companies.

The *Ley de Aeropuertos* (Airports Law) became effective in December 1995. It is intended to promote the development of airport infrastructure in an efficient and equitable manner, so as to make Mexican airports more competitive. The Airports Law allows for up to 49% foreign investment although higher participation percentages may be obtained with the approval of the NFIC.

Secondary Petrochemicals. On December 13, 1996, Petróleos Mexicanos authorized its subsidiary entity, Pemex—Petroquímica ("Pemex-Petrochemicals"), to form several new petrochemical companies, which will own the non-basic petrochemical assets of the petrochemical complexes of Cosoleacaque, La Cangrejera, Morelos, Pajaritos, Independencia, Camargo, Escolín, Reynosa and Tula. The Government, through Petróleos Mexicanos, will maintain a majority interest of 51% in each new company and intends to sell the remaining 49% interest in each of the new companies to private investors.

By July 1, 1997, Pemex-Petrochemicals established the first seven of the eight companies that were to be formed. Pemex-Petrochemicals intends to establish the remaining petrochemical company in the second half of 1998.

Electricity. The Government continues to promote private sector participation in various forms of electricity generation. In mid-1996 the first large co-generation project started in the state of Tamaulipas, thus opening the field for similar endeavors. With an estimated cost of over U.S. $650 million, the Samalayuca II power plant is being constructed in the state of Chihuahua by a consortium of domestic and foreign investors.

Gross Domestic Product

In 1992, 1993 and 1994 real GDP grew at the rates of 3.6%, 2.0% and 4.5%, respectively.

The drastic reduction and, in some instances, reversal of net capital inflows from abroad that occurred at the end of 1994 and in the first months of 1995, along with the significant devaluation of the peso, caused a 6.2% contraction in economic activity in real terms in 1995 as compared with 1994. The economic contraction in 1995 affected production in all sectors, although not all segments within such sectors reported declines. In the primary sector (agriculture), production in agriculture, livestock and forestry grew. The secondary sector (industry) posted production cutbacks in manufacturing, mining and construction, while activity in the electricity, natural gas and water division rose, albeit to a lesser degree than in previous years. The decline in the activity of the tertiary sector (services) fundamentally reflected the severe setback recorded in the commerce, restaurant and hotel division.

Real GDP increased by 5.2% in 1996 as compared with 1995. Manufacturing; construction; mining, petroleum and gas; and transportation, storage and communications were the most dynamic sectors of the economy during 1996, growing by 10.9%, 9.8%, 8.1% and 8.0%, respectively, followed by the electricity, gas and water and the commerce, hotels and restaurants sectors, which each expanded by 4.8%. The agriculture, livestock, fishing and forestry sector grew by 3.6% and the financial services, insurance, real estate and community, social and personal services sector showed a lower growth rate of 0.8% as compared with 1995.

According to preliminary figures, in 1997, real GDP increased by 7.0% as compared with 1996. Construction; commerce, hotels and restaurants; manufacturing; and transportation, storage and communications were the most dynamic sectors of the economy, growing by 10.2%, 9.9%, 9.8% and 9.5% in real terms, respectively, followed by the electricity, gas and water sector, which grew by 5.8%, financial services, insurance, real estate and community, social and personal services sector, which grew by 4.4%, and mining, petroleum and gas, which grew by 4.3%. Agriculture, livestock, fishing and forestry showed a lower growth rate, growing by 1.4% as compared with 1996.

In 1997, industrial production (*i.e.*, the manufacturing; mining, petroleum and gas; construction; and electricity, gas and water sectors) in Mexico, in constant 1993 prices, accounted for 26.0% of GDP, with manufacturing output alone representing 19.1% of total domestic output. Although petroleum and natural gas production remain important industrial activities in Mexico, the aggregate contribution of the mining, petroleum and gas sectors was only 1.3% in 1997. In 1997, primary activities, which include agriculture, livestock, fishing and forestry, accounted for 5.6% of GDP, and the service sector (*i.e.*, transportation, storage and communications; commerce, hotels and restaurants; and financial services, insurance, real estate and community, social and personal services) represented 62.8% of GDP.

According to preliminary figures, in the first quarter of 1998, real GDP increased by 6.6% as compared with the same period of 1997. Manufacturing; construction; commerce, hotels and restaurants; and transportation, storage and communications were the most dynamic sector of the economy, growing by 10.6%, 10.2%, 9.5% and 8.7% in real terms, respectively, followed by mining, petroleum and gas; electricity, gas and water; and financial services, insurance, real estate and community, social and personal services, which grew by 5.1%, 4.8% and 4.5%, respectively, while agriculture, livestock, fishing and forestry contracted by 6.0%, in each case as compared with the first quarter of 1997.

The Government currently projects a 5.0% increase in GDP (in real terms) for 1998.

Prices and Wages

From 1987 to 1997, the Government reached a series of Accords with labor and business representatives, each of which stressed the moderation of inflation, fiscal discipline and (in the case of Accords entered into before 1995) a gradual devaluation of the peso. There was a gradual reduction in the number of goods and services whose prices were covered by the Accords. These policies contributed to lower consumer inflation rates from 51.7% in 1988 to 7.1% in 1994. The effect of the devaluation of the peso and the Government's response to that event and related developments caused a significant increase in inflation in 1995, as well as a decline in real wages for much of the population during 1995. Inflation during 1995 (as measured by the increase in the NCPI) was 52.0%, as compared with 7.1% during 1994.

Over the medium-term, the Government is committed to reversing the decline in real wages experienced in the last decade through control of inflation, a controlled gradual upward adjustment of wages and a reduction in income taxes for the lower income brackets. The Government's restrictive monetary policy is designed to help control inflation. In addition, the PARAUSEE included a commitment by business to increase prices only in the proportion that products sold in Mexico were comprised of imported components.

The fiscal and monetary policies implemented by the Government in response to the 1995 crisis succeeded in lowering inflation (as measured by the increase in the NCPI) to 27.7% in 1996 and 15.7% in 1997. Inflation during the first seven months of 1998 was 9.3%, as compared with 9.6% during the same period of 1997.

The following table shows in percentage terms the changes in price indices and the annual increase in the minimum wage for the periods indicated.

Changes in Price Indices

	National Producer Price Index(1)	National Consumer Price Index	Increase in Minimum Wage
1993	4.6%	8.0%	8.1%
1994	9.1	7.1	7.0
1995	59.5	52.0	30.8
1996	25.3	27.7	31.8
1997	10.5	15.7	—
1998			
January	2.0	2.2	15.2
February	1.6	1.8	—
March	0.7	1.2	—
April	0.9	0.9	—
May	0.5	0.8	—
June	0.9	1.2	—
July	1.0	1.0	—

(1) Index includes oil prices.
Source: Banco de México.

Interest Rates

Interest rates generally increased and became more volatile in 1994 in response to a number of political and economic factors, including investor reactions to the increase in U.S. interest rates, increased volatility of the peso/dollar foreign exchange rate, uncertainty concerning the Mexican Presidential elections in August 1994 and certain related developments. Interest rates increased sharply during the first four months of 1995 in response to the economic and financial events of that period and the Government's 1995 Economic Plan. See "—Events during 1994 and 1995" above. From May through September 1995, interest rates declined gradually, but increased in October and November 1995, partially in response to increased volatility of the peso/dollar exchange rate. In 1996, interest rates declined gradually during most of the year, except for increases caused by seasonal liquidity pressures and external factors. The favorable performance of interest rates reflected the Government's success in reducing inflation and decreasing the volatility of the peso/dollar exchange rate, as well as the positive results of the banking system support program. During 1997, interest rates have declined steadily. This trend is attributable to lower inflation expectations, greater stability in the foreign exchange market, the Government's fiscal and monetary discipline and the favorable perception of foreign and domestic investors. Nonetheless, at the end of October 1997, certain external events translated into an increase in volatility in the international scenario, leading to temporary fluctuations in domestic interest rates. During 1997, interest rates on 28-day *Cetes* averaged 19.8% and interest rates on 91-day *Cetes* averaged 21.2%, as compared with average rates on 28-day and 91-day *Cetes* of 31.4% and 32.9%, respectively, during 1996. On March 11, 1998, Banco de México adopted a temporary "short" position, decreasing liquidity to the financial system, to reduce volatility in the foreign exchange market caused by the Asian economic crises and the fall in crude oil prices and to control inflationary expectations. As of August 12, 1998, the "short" position was still in place, and has resulted in higher than expected interest rates in 1998. On August 11, 1998, the 28-day *Cetes* rate was 21.49% and the 91-day *Cetes* rate was 24.25%.

In January 1993, Banco de México began to publish a new interest rate, the *tasa de interés interbancaria promedio* (average interbank interest rate or "TIIP"). The purpose of the TIIP is to provide an additional reference rate that more accurately reflects the current conditions in the domestic financial market. The TIIP is determined by credit operations between banks at any given time. By contrast, the *costo porcentual promedio* (the average weighted cost of term deposits for commercial banks, or "CPP"), an alternative measure of interest rates, lags somewhat behind current market conditions.

In March 1995, Banco de México introduced a new interest rate, the *tasa de interés interbancaria de equilibrio* (the equilibrium interest rate, or "TIIE"). The difference between the TIIE and the TIIP is that the TIIE is calculated as the interest rate at which the supply and demand for funds in the domestic financial market reach equilibrium, while the TIIP is calculated as an average interest rate. Banco de México has begun to replace the TIIP with the TIIE with a view to eliminating the TIIP entirely by the year 2001.

The following table sets forth the average interest rates per annum on 28-day and 91-day *Cetes*, the CPP, the TIIP and the TIIE for the periods indicated.

Average *Cetes*, CPP, TIIP and TIIE Rates

	28-Day *Cetes*	91-Day *Cetes*	CPP	TIIP	TIIE
1993:					
January-June	16.4%	17.3%	20.9%	20.4%(1)	—
July-December	13.5	13.6	16.2	16.1	—
1994:					
January-June	13.0	13.5	14.2	15.3	—
July-December	15.2	15.7	16.8	20.4	—
1995:					
January-June	55.0	54.3	49.6	63.6	71.2%(2)
July-December	41.9	42.2	40.7	44.5	44.6
1996:					
January-June	35.4	37.2	34.5	37.3	37.1
July-December	27.4	28.6	26.9	30.1	30.1
1997:					
January-June	20.8	22.2	20.8	23.2	23.2
July-December	18.8	20.3	17.4	20.5	20.6
1998:					
January	18.0	19.4	17.0	19.5	19.7
February	18.7	19.6	17.0	20.6	20.5
March	19.9	20.8	17.4	21.7	21.7
April	19.0	19.5	17.7	20.4	20.6
May	17.9	18.9	16.9	20.2	19.9
June	19.5	21.0	17.2	21.1	21.5
July	20.1	21.8	17.8	21.7	21.9

(1) February-June average.
(2) Average for the last two weeks of March.
Source: Banco de México.

Employment and Labor

Although there are no reliable statistics on unemployment and underemployment, both are widespread in Mexico and increased significantly in 1995. With the recovery of the economy in 1996 and 1997, employment has begun to improve noticeably. The number of permanent employees registered with the IMSS, which is an indicator of employment in the "formal" sector of the economy, increased by 673,897 during 1997. Also according to this indicator, almost one million jobs were created from the end of 1994 to the end of 1997.

Notwithstanding this progress, unemployment has been and continues to be particularly widespread in rural areas, where approximately 26.5% of the population resides. Mexico's trade liberalization policies and, more recently, the implementation of the NAFTA have also produced structural changes in the economy that have generated unemployment. Mexico does not have an unemployment benefits scheme or a fully developed social welfare system. The Government is committed to fostering an economic environment that will generate employment opportunities for the large numbers of persons expected to enter the labor force in the medium-term. However, the Government recognizes that addressing Mexico's significant unemployment and underemployment problem is likely to be an important challenge in the balance of the 1990s.

In some regions of Mexico, especially where industrial growth has been rapid, industry has experienced a shortage of skilled labor and management personnel, as well as high turnover rates. Since 1978, the Government has sought to address these problems through legislation requiring in-house training programs, the costs of which are tax deductible. The Government recognizes that further significant investment in worker training will be required.

A significant portion of the Mexican work force is unionized. Mexican labor legislation requires that collective bargaining agreements be renewed at least every two years (with wages subject to renegotiation annually) and contains certain legal limitations on strikes. Approximately 0.006% and 0.004% of total working days were lost due to strikes during 1996 and 1997, respectively.

Mexico's minimum wage is set by a commission (the "National Wage Commission") consisting of representatives of business, labor and the Government. Mexican law requires industry to provide substantial worker benefits, including mandatory profit-sharing through a distribution of 10% of pre-tax profits to workers. Other benefits include mandatory participation in the pension fund and worker housing fund systems administered by the Government. The minimum wage increased by 10% in December 1995, 12% in April 1996, 17% in December 1996 and 15.2% in January 1998.

The *Ley del Seguro Social* (Social Security Law) and *Ley del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado* (the Law of the Institute for Social Security and Social Services of Government Workers, together with the Social Security Law, the "Social Security Laws"), as amended in May 1992, required an employer (including any government entity) to deposit with a credit institution selected by the employer an amount equal to 2% of each worker's base salary. The amount contributed on behalf of each worker forms a retirement sub-account which, together with the housing sub-account described in the following paragraph, constitute a single account for each worker. Sums contributed to a worker's retirement sub-account may be withdrawn only when the worker retires or becomes permanently disabled. This compulsory retirement savings system was designed both to improve the economic condition of Mexican workers and to promote long-term savings in the economy. These savings are expected to provide financing for investment projects in both the public and private sectors.

A new Social Security Law became effective on July 1, 1997. As in the case of the Social Security Laws, the new law continues to specify the terms pursuant to which economic and other services and compensation are to be provided to members of the social security system. The new law also provides that each worker may maintain an independent retirement account, which is to be managed by an approved *Administradora de Fondos para el Retiro* (Manager of Retirement Funds, "AFORES" or each, an "AFORE"). AFORES, which were authorized pursuant to the *Ley del Sistema de Ahorro para el Retiro* (Retirement Savings System Act), adopted by the Mexican Congress on April 25, 1996, are financial institutions established, subject to Government approval, to administer individual pension accounts and manage mutual funds known as *Sociedades de Inversión Especializadas de Fondos para el Retiro* (Specialized Retirement Mutual Investment Funds or "SIEFORES"). A majority of the outstanding shares of each AFORE must be owned by Mexican persons, and no single person may acquire control over more than 10% of any class of shares.

On January 27, 1997, the Board of the *Comisión Nacional del Sistema de Ahorro para el Retiro* (National Commission for Retirement Savings System or the "Retirement Savings Commission") approved several AFORES, and their corresponding SIEFORES. Such fund managers have the right to solicit individual Mexican workers to deposit savings in their licensed funds but could not collect money until July 1997, when the new Social Security law took effect. Beginning on July 1, 1997, the AFORES began operations and now invest contributions in SIEFORES. Voluntary contributions were invested through the AFORES beginning July 1, 1997, and mandatory contributions have been invested through the AFORES since September 17, 1997.

The *Instituto del Fondo Nacional de la Vivienda para los Trabajadores* (the National Workers' Housing Fund Institute, or the "Institute") was created by law in 1972 (the "Housing Law") in order to administer housing programs for workers and address the shortage of housing, estimated as of December 31, 1993 at 4.6 million housing units. The Institute's principal objectives are the financing, construction and allocation of housing for workers. The Housing Law was amended in 1992. Under the amended law, employers are required to contribute an amount equal to 5% of each worker's base salary to a housing sub-account with a banking institution. As with the retirement sub-accounts, the funds contributed are deductible from the employer's current income for tax purposes. These funds are in turn required to be deposited to an account of the Institute at Banco de México. Upon a worker's receipt of a loan from the Institute for the purchase or construction of a home, any amounts in the worker's housing sub-account are available for financing the down payment on the home. Unused amounts may be withdrawn by the worker upon retirement or permanent disability. The amendments also changed the role of the Institute in the housing market. The Institute has ceased its involvement in the construction of housing units and now limits its activities to those of a financial intermediary, extending credit to workers for the construction and purchase of homes.

At June 30, 1998, funds totaling approximately Ps. 90.3 billion had been deposited in the new pension and housing funds, with Ps. 38.2 billion of such amount corresponding to deposits in workers' retirement sub-accounts and Ps. 52.1 billion corresponding to deposits in workers' housing sub-accounts.

FINANCIAL SYSTEM

Mexico's financial system is comprised of commercial banks, national development banks, securities-brokerage houses, development trust funds and other non-bank institutions, such as insurance companies, bonding companies, foreign exchange houses, factoring companies, bonded warehouses, financial leasing companies and limited-scope financial institutions. In 1990, Mexico adopted legislation aimed at achieving the benefits of universal banking, the *Ley Para Regular las Agrupaciones Financieras* (Law to Regulate Financial Groups), which permits three or more different types of financial services companies to operate under a single financial services holding company (or two or more different types, if each of the two institutions is any of a commercial bank, a securities firm or an insurance company).

The financial authorities are the Ministry of Finance and Public Credit, Banco de México, the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission, or "CNBV"), the Retirement Savings Commission and the *Comisión Nacional de Seguros y Fianzas* (National Insurance and Bonding Commission).

Under the Organic Law of the Federal Public Administration, the Ministry of Finance and Public Credit is responsible for the coordination and supervision of Mexico's financial system and for the formulation of Mexico's fiscal policy.

Central Bank and Monetary Policy

Banco de México, chartered in 1925, is the central bank of Mexico and, at December 31, 1997, had assets of Ps. 368,998 million (U.S. $45.65 billion).

Banco de México is Mexico's primary authority for the execution of monetary policy and the regulation of currency and credit. It is authorized by law to regulate interest rates payable on time deposits, to establish minimum reserve requirements for credit institutions and to provide discount facilities for certain types of bank loans.

Effective August 23, 1993, a constitutional amendment relating to Banco de México's activities and role within the Mexican economy was passed. The amendment's purpose was to reinforce the independence of Banco de México to enable it to act as a counterbalance to the executive and legislative branches in monetary policy matters. The amendment significantly strengthened Banco de México's authority with respect to monetary policy, foreign exchange and related activities and the regulation of the financial services industry. On April 1, 1994, a new law governing the activities of Banco de México became effective. The new law put into effect the greater degree of autonomy granted to Banco de México under the constitutional amendment described above and established a Foreign Exchange Commission charged with determining the nation's exchange rate policies.

The following table shows Mexico's M1 and M4 money supply aggregates at each of the dates indicated.

Money Supply

	December 31,					April 30,
	1993	1994	1995	1996	1997(1)	1998(1)
	(in millions of nominal pesos)					
M1						
Notes and coins	Ps. 43,228	Ps. 51,870	Ps. 60,655	Ps. 74,091	Ps. 94, 530	Ps. 88,579
Checking deposits						
in domestic currency	101,214	94,163	88,951	134,731	180,686	177,008
in foreign currency	4,469	8,486	15,762	23,856	30,902	36,135
Total M1	Ps. 148,911	Ps. 154,519	Ps. 165,367	Ps. 232,678	Ps. 306,118	Ps. 301,722
M4	Ps. 587,735	Ps. 729,091	Ps. 880,053	Ps.1,166,200	Ps. 1,506,680	Ps. 1,616,340

Note: Totals may differ due to rounding.
(1) Preliminary.
Source: Banco de México.

1995 and 1996. As a result of the strict control over the money supply, the monetary aggregate M1 registered a real annual contraction of 29.7% from the end of 1994 to the end of 1995. This decrease followed from a real annual decrease of 38.0% in checking accounts held in domestic currency, as well as a real annual decrease of 23.0% in the balance of notes and coins in public circulation. The decrease in the demand of notes and coins by the public resulted from the low level of economic activity, higher levels of inflation and higher domestic interest rates in 1995 characterizing the economic crisis in that year. The M4 monetary aggregate (which includes M1 plus financial savings in the form of time deposits, treasury bills, bonds, promissory notes and other money and capital market financial instruments) contracted by 20.6% in real terms in 1995, falling from 58.2% of GDP in 1994 to 55.7% of GDP in 1995. The reduction in the M4 aggregate was caused primarily by a lower investment in government securities by non-residents, which dropped from 8.7% of GDP in 1994 to 1.6% in 1995.

The aggregate amount of the M1 money supply at December 31, 1996 was Ps. 232,678 million, a 10.2% increase in real terms over the 1995 level, reflecting the recovery of the economy in 1996. As of the same date, the aggregate amount of the M4 money supply was Ps. 1,166 billion, a 3.8% increase in real terms over the 1995 level. At December 31, 1996, the monetary base (currency in circulation plus bank deposits at the central bank) was Ps. 83,991 million, an increase of Ps. 17,182 million, or 25.7%, over the monetary base at December 31, 1995.

1997 Monetary Program. During 1997, Banco de México formulated its market credit operations with the goal that the daily average of the net total balance of the current accounts of banks accumulated during a given reporting period would result in a predetermined amount. If that amount was zero, monetary policy would achieve neutrality. If that amount was negative, it could be said that Banco de México had left the monetary system "short". By leaving the system in a "short" monetary position, the central bank would exert an upward influence on interest rates. If the average net balance was positive, it could be said that Banco de México had left the monetary system "long", which would promote a decline in interest rates. The central bank could adopt a "short" or "long" stance in order to combat disorderly conditions in the money and foreign exchange markets, or to help ensure that the changes in the monetary base would follow a path consistent with the assumed inflation rate. Banco de México operated with a daily balance of zero on the accumulated balances of the accounts held for the banking system throughout 1997. In other words, throughout 1997, the Banco de México did not generate either short or long positions; instead, it maintained a neutral monetary position.

The evolution of the monetary base over the course of 1997 differed, to some extent, from that expected at January 1997. During 1997, the monetary base grew by 29.6% in real terms over the amount registered at the end of 1996. Banco de México believes that this variation resulted not from a relaxation of its monetary policy, but from an increased demand for bank notes and coins, a greater than expected economic growth rate, lower interests rates and an increased demand for cash from banks to satisfy their cash needs. At December 31, 1997, the deviation between the actual and the forecasted monetary base reached Ps. 4.320 billion.

During 1997, net international assets increased by U.S. $13.511 billion, a substantially greater increase than the U.S. $2.5 billion anticipated by Banco de México's 1997 monetary program. This significant accumulation resulted from the application of the Foreign Exchange Commission's program of monthly auctions of rights that entitle banking institutions to sell U.S. dollars to Banco de México when certain conditions are met. See "External Sector of the Economy—Balance of Payments".

Net domestic credit during 1997 remained below the limits established by the 1997 Monetary Program. Because the combination of the net domestic credit and the net inflow of international assets resulted in an adequate monetary base level, the decrease of the net domestic credit did not lead to a liquidity shortage.

At December 31, 1997 the monetary base totaled Ps. 108.891 billion, representing a real increase of 12.0% as compared to the level at December 31, 1996. As a result of the improvement in economic activity and the decrease in inflationary expectations, the monetary aggregate M1 grew by 13.7% in real terms in 1997. At December 31, 1997, the aggregate amount of the M4 money supply was Ps. 1,507 billion, an increase in real terms of 11.7% over the 1996 level.

1998 Monetary Program. Banco de México's 1998 monetary program was formulated in the context of two important domestic and global phenomena: the continuing gradual recovery of the Mexican economy and the high volatility of international financial markets due to the crises experienced by certain East Asian economies.

The 1998 monetary program contemplates that Banco de México will adjust the primary money supply on a daily basis, so that this supply satisfies the demand for monetary base and in accordance with Banco de México's commitment to maintain a neutral monetary policy. To avoid fueling a level of demand for money which might result in a higher than desirable inflation pattern, Banco de México will, under ordinary circumstances, engage in open market operations to reduce the monetary base in order to achieve the annual inflation rate target. At December 31, 1998, the monetary base is expected to reach Ps. 133.4 billion, which represents a 22.5% increase as compared to the level at December 31, 1997. Furthermore, the 1998 monetary program will, as in 1997, include quarterly limits on the variation in net domestic credit, based on the expected increase in the monetary base and an expected accumulation of international reserves of U.S. $1.0 billion.

Banco de México will retain the right to adjust the profile of its monetary policy, relaxing or restricting it when unexpected circumstances require. Therefore, Banco de México may adopt short positions whenever future inflationary pressures are anticipated which threaten a sustainable decrease in inflation rates or at any time when such measures are required to reduce volatility in the currency and foreign exchange markets. Similarly, Banco de México may adopt long positions whenever (i) movements in short-term interest rates are inconsistent with exchange rate movements, in particular when an appreciation in the value of the peso occurs and there are no additional inflationary pressures; (ii) an estimated sustainable appreciation (both real and nominal) in the value of the peso occurs due to an introduction of large amounts of short-term capital to the monetary system; or (iii) increases in interest rates occur due to volatility in the money markets. On March 11, 1998, Banco de México adopted a temporary short position in an attempt to reduce volatility in the foreign exchange market caused by the Asian economic crisis and a drop in crude oil prices. As of July 31, 1998, this short position was still in place.

Banking System

In September 1982, President José López Portillo decreed the nationalization of the private Mexican commercial banks. Effective November 18, 1982, a constitutional amendment was adopted to implement the nationalization, which granted to the Government a monopoly on the rendering of the banking and credit services. The number of banking institutions was reduced from 68 to 29 in the first two years of nationalized banking, and to 18 by 1988. Of the 18 remaining banks, six were nationwide banks, five were regional banks and seven were multi-regional banks.

Effective June 28, 1990, the Constitution was amended to permit Mexican individuals and financial holding companies to own controlling interests in Mexican commercial banks. Subsequently, the *Ley de Instituciones de Crédito* (Law of Credit Institutions, or "Banking Law") was enacted to regulate the ownership and operation of Mexican commercial banks. Pursuant to the Banking Law, Mexico began the process of privatizing the commercial banks. By July 6, 1992, the Government had privatized all 18 state-owned commercial banks, with the proceeds from the sale of the banks exceeding U.S. $12 billion.

Upon privatization, the capital stock of banking institutions, other than development banks, was transformed into three classes of common stock, Series "A", "B" and "C", representing at least 51%, up to 49% and up to 30% of its capital, respectively. In February 1995, existing legislation was amended to permit, among other things, greater foreign investment in Mexican-owned banks as part of the package of reforms adopted in connection with Mexico's economic stabilization program put forward in response to the financial crisis of late 1994 and early 1995 (the "1995 Reform"). Under the 1995 Reform, the shareholding structure of banks was changed from three series of common stock to two: Series "A" (representing at least 51% of capital) and "B" (representing up to 49% of capital). The new legislation also relaxed the limitations on eligibility for share ownership. Prior to the 1995 Reform, Series "A" shares could be owned only by Mexican individuals, financial group holding companies, Mexican development banks and the Government, whereas they now generally may also be owned by Mexican *personas morales* (legal persons, such as corporations, partnerships and trusts, that are not individuals) and certain institutional investors established under Mexican law and controlled by Mexicans. (Prior to the 1995 Reform, such entities could not own Series "A" shares but were permitted to own Series "B" shares.) As was the case before the 1995 Reform, persons eligible to own Series "A" shares are also eligible to own Series "B" shares. Foreign persons, who prior to the 1995 Reform could own only Series "C" shares, are now eligible to own Series "B" shares. Thus, the limitation on aggregate foreign shareholdings of Mexican-controlled banks has effectively been increased from 30% to 49%. As was also the case before the 1995 Reform, foreign governmental entities exercising functions of authority are not permitted to own shares in Mexican banks.

Generally, no shareholder is authorized to own, directly or indirectly, more than 5% of the shares representing the capital stock of a banking institution. However, under the 1995 Reform this percentage may be increased to 20% if the Ministry of Finance and Public Credit so authorizes. Prior to the 1995 Reform, the Ministry of Finance and Public Credit could waive the per-shareholder limit up to a maximum of 10%. The 1995 Reform also provided that the per-shareholder limits will not apply to any foreign financial institution that, in accordance with a program approved by the Ministry of Finance and Public Credit to acquire a Mexican-owned bank, acquires ultimate control (*i.e.*, 51% or more of the shares of common stock of such bank) of that bank. Under the 1995 Reform, however, the Ministry of Finance and Public Credit may not approve any program whereby foreign investors acquire a bank the net capital of which exceeds 6% of the total amount of net capital of all Mexican banks. In addition, the aggregate net capital of Mexican banks controlled by foreign financial institutions established pursuant to trade treaties, such as the NAFTA (excluding acquisitions of control of existing Mexican banks) will, until January 1, 2000, not be permitted to exceed 25% of the total net capitalization of all Mexican banks.

The capital stock of Mexican banks is divided into ordinary capital, evidenced by the series of common stock referred to above, and additional capital evidenced by Series "L" shares. Under the 1995 Reform, the limitation on the volume of Series "L" shares that a bank is permitted to issue was increased from 30% to 40% of its total ordinary capital. Series "L" shares may be issued only with the approval of the CNBV, are not considered ordinary capital and confer on their holders only limited voting rights (*e.g.*, the right to vote on extraordinary events such as mergers, spin-offs and delisting). Series "L" shares may include the right to receive preferred dividends and may be held by any person, including foreign investors other than foreign entities exercising governmental functions.

The capital structure rules for financial group holding companies parallel those for commercial banks. Each of the amendments relating to capital structure and acquisition of Mexican-owned commercial banks referred to above has been coupled with identical reforms applicable to financial group holding companies.

The 1994-1995 peso devaluation and ensuing financial crisis created concerns about the stability of the Mexican banking system. The devaluation, higher domestic interest rates and contraction in real GDP combined to weaken the quality of the assets of Mexican banks, caused the capitalization of several banks to fall below the minimum required levels and created funding difficulties for many banks.

At December 31, 1994, 1995 and 1996, past-due loans represented approximately 7.3%, 7.1% and 6.4%, respectively of total commercial bank loans, and, on average, Mexican banks had provisions covering 48.6%, 72.5% and 103.3%, respectively, of past-due loans. (Until January 1, 1997, only the portion of the principal and interest of a loan that was 90 days or more in arrears was considered "past-due"; this rule was modified effective January 1, 1997, as discussed below.)

The weakening of the banking system prompted the Government to enact policies aimed at increasing the capitalization of Mexican banks. New reserve requirements were introduced by Banco de México to facilitate the regulation of liquidity. Pursuant to these requirements, which took effect on March 11, 1995, a bank that overdraws its account with Banco de México must subsequently deposit funds, and maintain amounts on deposit, at least equal to the amount of the overdraft. Substantial fines may be imposed if a bank fails to make and maintain such deposits. The new reserve requirements were intended to reduce Banco de México's daily net extension of credit.

In addition, in 1995 and 1996, the Ministry of Finance and Public Credit approved recapitalization plans for the following financial institutions, many of which involved strategic investments by foreign financial institutions:

- *Grupo Financiero Probursa, S.A. de C.V.*, which included, among other transactions, an investment by *Banco Bilbao Vizcaya, S.A.* in *Multibanco Mercantil Probursa, S.A.* ("MMP") and the purchase by FOBAPROA of approximately Ps. 8.3 billion (in market value) of MMP's loan portfolio.

- *Grupo Financiero Serfin, S.A.* ("GFS"), which included, among other transactions, the acquisition by HSBC Holdings, N.V. of a minority interest in GFS and FOBAPROA's purchase of approximately Ps. 24.9 billion (in market value) of *Banca Serfin's* loan portfolio.

- *Grupo Financiero GBM-Atlantico, S.A. de C.V.*, which included the purchase by FOBAPROA of approximately Ps. 6.1 billion (in market value) of *Banco del Atlántico, S.A.'s* loan portfolio.

- *Grupo Financiero Promex-Finamex, S.A. de C.V.*, which included, among other capital raising transactions, the purchase by FOBAPROA of approximately Ps. 3.0 billion (in market value) of Banca Promex, S.A.'s loan portfolio.

- *Grupo Financiero Bancrecer, S.A. de C.V.*, which included, among other capital raising transactions, the acquisition by FOBAPROA of approximately Ps. 15.7 billion (in market value) of *Bancrecer, S.A.'s* loan portfolio.

- *Grupo Financiero Bital, S.A. de C.V.*, which included, among other capital raising transactions, the acquisition by FOBAPROA of Ps. 7.6 billion (in market value) of *Bital's* loan portfolio.

- *Banco Mercantil del Norte, S.A.* ("Banorte"), which included, among other capital raising transactions, the acquisition by FOBAPROA of Ps. 4.1 billion (in market value) of Banorte's loan portfolio.

- *Grupo Financiero Banamex Accival, S.A. de C.V.*, which included, among other capital raising transactions, the purchase by FOBAPROA of approximately Ps. 23.0 billion (in market value) of Banamex's loan portfolio.

- *Grupo Financiero Invermèxico, S.A. de C.V.*, which included an agreement in principle for Banco Santander to purchase a controlling interest in Invermèxico and the recapitalization by *Invermèxico* by Banco Santander, as well as the purchase of certain existing assets by FOBAPROA.

- *Banca Confia, S.A.*, which included, among other capital raising transactions, the purchase by FOBAPROA of approximately Ps. 6.0 billion (in market value) of *Banca Confia's* loan portfolio.

- *Bancomer, S.A. de C.V.*, which included, among other capital raising transactions, strategic alliance with Bank of Montreal pursuant to which Bank of Montreal acquired a 16% equity interest (and 20% voting interest) in Bancomer and FOBAPROA purchased approximately Ps. 23.6 billion (in market value) of Bancomer's loan portfolio.

- *Grupo Financiero Inverlat, S.A. de C.V.* ("Inverlat"), which included the acquisition by Bank of Nova Scotia of up to 55% of the capital stock of Inverlat.

Amendments to the Banking Law intended to broaden the range of activities conducted by banks and improve the safety and soundness of the banking system became effective on July 24, 1993. The amendments permit banks (including development banks, discussed below) to engage in financial leasing activities and liberalize the conditions under which banks may engage in repurchase transactions with securities. In addition, each bank is required to create a capital reserve fund, through annual charges of at least 10% of its net income, until the reserve fund reaches a level equal to the bank's paid-in capital. Banks are also now required to have their annual financial statements audited by external auditors. Finally, the Banking Law now regulates investment advisors.

In connection with the implementation of the NAFTA, amendments to several laws relating to financial services (including the Banking Law and the *Ley del Mercado de Valores* ("Securities Market Law")) were approved by the Congress in December 1993 and became effective on January 1, 1994. These measures permit non-Mexican financial groups and financial intermediaries, through Mexican subsidiaries, to engage in various activities in the Mexican financial system, including banking and securities activities. On April 20, 1994, the Ministry of Finance and Public Credit issued new regulations which implement amendments to several financial services laws approved by the Mexican Congress in December 1993, as well as provisions of the NAFTA dealing with financial services and any future trade agreements incorporating similar provisions. The new regulations set forth rules under which Canadian and U.S. financial institutions (and other foreign financial institutions acting through Canadian or U.S. affiliates) are permitted to establish or acquire Mexican financial institutions and financial holding companies.

In October 1994, the Ministry of Finance and Public Credit began granting approvals for such Canadian and U.S. institutions and their affiliates to establish financial institutions in Mexico. As of December 31, 1997, (a) the Ministry of Finance and Public Credit had authorized applications for the establishment or acquisition by such Canadian and U.S. institutions of 10 financial group holding companies, 20 commercial banking institutions, 16 securities firms, 22 insurance companies, 8 limited-scope financial institutions, 13 financial leasing companies, 6 factoring companies, 3 bonding companies and 1 foreign exchange house; (b) the CNBV had authorized applications for the establishment or acquisition by such Canadian and U.S. institutions of six investment companies and one investment adviser; (c) the Ministry of Finance and Public Credit had granted a "favorable opinion" with respect to the establishment of two limited-scope financial institutions.

Again in the case of these "NAFTA affiliates", the 1995 Reform introduced important changes to the rules governing their establishment and shareholding structure. Pursuant to the 1995 Reform, the minimum shareholding required for a foreign financial institution to establish a Mexican affiliate bank, financial group holding company, securities firm or limited-purpose "securities specialist" has been reduced from 99% to 51%. The stated purpose of this liberalization is to increase the possibilities for forming joint ventures between foreign financial institutions and Mexican investors. In addition, the 1995 Reform introduced a significant change to the previously existing limits on the capitalization of Mexican affiliates of foreign financial institutions. Prior to the 1995 Reform, such affiliated institutions were subject to individual and aggregate size limitations based on capital during a transition period that expires on January 1, 2000, regardless of whether they were newly established or existing entities acquired by the foreign financial institution. The 1995 Reform lifts this restriction with respect to acquired entities, provided that the acquisition is approved by the Ministry of Finance and Public Credit, and subject to an exception in the case of banks. As noted above, until the expiration of the transition period on January 1, 2000, the net capital of an acquired bank may not exceed 6% of the aggregate net capital of all Mexican banks, and the net capital of all banks affiliated with foreign financial institutions may not exceed 25% of the aggregate net capital of all Mexican banks.

In an effort to increase competition and encourage efficiency, through December 31, 1997, the Ministry of Finance and Public Credit had approved applications for the establishment of 16 new banks, in addition to the authorizations granted to U.S. and Canadian institutions to establish commercial bank affiliates mentioned above. Furthermore, the Banking Law contemplates the creation of limited-purpose financial institutions that are permitted to obtain financing in the securities markets and lend to certain business sectors only. Through December 31, 1997, 24 such limited-purpose financial institutions had been approved.

In addition to commercial banks, the Mexican banking system includes various development banks, the substantial majority of the capital of which is owned by the Government. The most important development banks are *Nacional Financiera, S.N.C.* ("NAFIN"), Bancomext and Banobras. Among NAFIN's principal activities are the granting of credits to small- and medium-sized businesses, promoting the development of the securities market and serving as financial agent of the Government in certain international transactions. Bancomext's principal activities are granting export- and import-related credits and issuing guaranties to private- and public-sector entities. Banobras' principal activities consist of providing short-, medium-and long-term financing to public enterprises and federal, state and municipal governments and granting credits for low-income housing.

Under the laws establishing NAFIN, Bancomext and Banobras, the Government is responsible, at all times, for the transactions entered into by such development banks with foreign private, governmental and inter-governmental institutions, among others. In May 1998, the Government announced that a fourth development bank, *Banco Nacional de Comercio Interior, S.N.C.* ("Banci") would be liquidated as part of the Government's goal of improving the efficiency of the Mexican development banks.

Banking Supervision and Support

In 1991, the Government promulgated rules setting forth the procedures to be followed in classifying loans as "non-performing" and the reserves required therefor, and the implementation of capital adequacy requirements conforming to those recommended under the Basle Accord. These rules were intended to improve the Mexican banking system and to make standards applicable to Mexican commercial banks consistent with those applicable to banks in other countries. A new series of rules to be followed by Mexican development banks to determine and classify the risk of non-payment of loans made by these banks and requiring development banks to establish loan loss reserves became effective on June 1, 1993. New rules establishing capital adequacy standards for Mexican development banks became effective on October 1, 1994, pursuant to which such banks are required to maintain capitalization levels at least equal to 10% of their risk-weighted assets.

Under the Banking Law, the CNBV (as the successor, effective May 1, 1995, to the National Banking Commission) is the entity responsible for the supervision of commercial and development banks. It is empowered to impose sanctions for failure to comply with existing banking regulations. The CNBV is administered by a Board of Directors comprised of ten members in addition to its President and two of its Vice Presidents. Five of the members are appointed by the Ministry of Finance and Public Credit, three members are appointed by Banco de México, one member is appointed by the National Commission for the Retirement Savings System and one member is appointed by the National Insurance and Bonding Commission.

The 1995 Reform granted the CNBV powers of administrative and management intervention in financial holding companies similar to the CNBV's existing powers with respect to banks and securities dealers. Mexican financial groups are organized in a holding company structure, and the new powers of intervention give the CNBV the option of intervening and carrying out such interventions at either the holding company or operating company level.

Beginning in 1994, the CNBV has exercised its authority to intervene in the management of a number of Mexican financial institutions, including the following:

- In September 1994, the CNBV seized operating control of the Cremi/Union financial group due to alleged irregularities by management. FOBAPROA has injected approximately Ps. 7 billion in Cremi/Union since the intervention. In August 1996, *Banco Bilbao Viscaya* acquired *Banca Cremi's* branch network, and in October 1996, *Banca Promex* acquired *Banco Union's* branch network.

- In March 1995, the CNBV seized control of *Grupo Financiero Asemex-Banpaís, S.A. de C.V.* ("GFAB"), GFAB's banking subsidiary, *Banpaís, S.A.* ("Banpais") and insurance subsidiaries, *Aseguradora Mexicana, S.A.* ("Asemex") and *Seguros Banpaís, S.A.* ("Seguros"), as a result of alleged irregularities in the operation of Banpais, Asemex and Seguros. In May 1996, *Seguros Comercial América, S.A.*, a Pulsar subsidiary, acquired 70% of the shares of Asemex. In December 1997, Banorte acquired 81% of the shares of Banpaís and agreed to purchase Banpais' loan portfolio.

- In May 1996, the CNBV seized operating control of *Banco Capital, S.A.* ("Capital") and *Banco del Sureste, S.A.* ("Sureste"). The intervention in Sureste stemmed from a capital impairment caused by transactions undertaken by its affiliated brokerage firm, while the intervention in Capital was made in response to a lack of required capital caused by problematic transactions undertaken by its affiliated leasing company.

In 1995 and 1996, the Government announced a number of programs designed to stabilize and strengthen the banking sector. In February 1995, Banco de México adopted the *Programa de Capitalización Temporal* (Temporary Capitalization Program, or "PROCAPTE"), which was administered by FOBAPROA. PROCAPTE was a voluntary program designed to assist viable banks that, by virtue of conditions prevailing in the financial markets, were unable to comply with regulatory capitalization requirements. Under PROCAPTE, FOBAPROA advanced funds to participating banks in exchange for subordinated bonds maturing on March 31, 2000, which were mandatorily convertible at the option of FOBAPROA into Series "A" or Series "B" shares of the issuing institution in the circumstances described below. If a participating bank's basic net capital (excluding the subordinated bonds) were to fall below 2% of risk-weighted assets while the bonds are outstanding, or if the bonds were not repaid prior to their five-year maturity, the bonds would be converted to equity at a rate based on the book value of the bank at the time of conversion. Because of the possibility of conversion at book value, banks had an incentive to repay the bonds prior to maturity. In the event that FOBAPROA exercised its conversion right, FOBAPROA would sell the shares it receives to the public. During the term of PROCAPTE, each participating bank was required to maintain a capitalization coefficient of 9%, which could decline to 8.5% if the decrease was caused by the creation of general reserves. The issuing bank could at any time during the term of the subordinated debt instruments repurchase all or any portion of them from FOBAPROA, as long as it did so by raising capital to effect the repurchase, through the issuance either of new shares or other mandatorily convertible subordinated obligations, such that the bank maintained a capitalization level not lower than that required under PROCAPTE.

In March 1995, five commercial banks obtained support through PROCAPTE. By May 1995, the value of bonds issued through PROCAPTE reached Ps. 7,008 million. In February of 1997, *Banco del*

Centro S.A., the last bank participating in PROCAPTE, liquidated its total participation of Ps. 810.1 million, thus concluding the PROCAPTE program.

In addition, through FOBAPROA, the Government made foreign exchange available through a foreign exchange credit window to help banks meet dollar liquidity needs. Outstanding drawings under this program reached their highest point of U.S. $3.8 billion in April 1995, and were completely repaid as of August 31, 1995. No such drawings were made after that date.

On March 30, 1995, the Government announced a debt restructuring program covering five types of past-due loans: small- and medium-size business loans, mortgage loans, certain debt of states and municipalities, foreign-currency denominated loans and four categories of debt owed to development banks. Restructured loans were converted into new financial units known as *Unidades de Inversión* (inflation-indexed units of account or "UDIs"). UDIs are units of account whose value in pesos is indexed to inflation on a daily basis, as measured by the change in the NCPI. UDI loans were designed to mitigate the short-term effect of inflation on borrowers and improve the asset quality of banks, although banks retained the asset quality risk associated with restructured loans. Under an UDI-based loan, the borrower's nominal peso principal balance is converted to an UDI principal balance and interest on the loan is calculated on the outstanding UDI balance of the loan. Principal and interest payments are made by the borrower in an amount of pesos equivalent to the amount due in UDIs at the stated value of UDIs on the day of payment.

UDI loans have been made by special trusts set up by commercial banks for this purpose and were funded through long-term UDI bonds purchased by the Government through Banco de México. The outflow of money to commercial banks was in turn neutralized by the purchase by such banks of Government bonds. The maximum size of the restructuring program was estimated as of April 10, 1998 to be approximately Ps. 273 billion. The Government currently estimates that the cost to it of the UDI program (in present value terms) will be Ps. 96.3 billion (3.0% of 1997 GDP).

On August 23, 1995, the Government announced the *Acuerdo de Apoyo Inmediato a los Deudores de la Banca* (Accord for the Immediate Support of Bank Debtors, or "ADE"), a debt restructuring program designed to help borrowers restructure their payment obligations under certain loans at subsidized interest rates. The ADE program covered four types of peso- or UDI-denominated bank loans: credit card loans, personal and consumer loans, business loans (particularly loans to small- and medium-sized businesses) and mortgage loans. Pursuant to the ADE program, most borrowers with existing loans in good standing could benefit from the subsidized interest rates for a period of 13 months beginning in September 1995. To take advantage of the subsidized interest rates, holders of existing mortgage loans were required to convert their loans into UDIs. In addition, holders of past-due loans were required to sign special agreements to restructure their debts. Under the ADE program, borrowers in the agriculture sector with existing business loans could benefit from subsidized interest rates for a period of 18 months beginning in September 1995. The Government currently estimates that the cost to it of the ADE program (in present value terms) will be approximately Ps. 5.0 billion (0.2% of 1997 GDP).

On May 16, 1996, the Government announced an additional debt restructuring program for the benefit of mortgage loan debtors, having four aspects. First, the size of the ADE program for mortgage loans was increased from UDI 43 billion to UDI 100 billion and covered loans restructured through September 30, 1996. Second, payments by mortgage debtors over a 10-year period were subject to a discount (starting at 30% and decreasing to 5% by the end of the period) on the amount otherwise payable. During the first three years of the program, debtors are allowed to prepay their loans free of penalties and with a 10% discount on the outstanding balance. These discounts will apply to a maximum UDI 500,000 of UDI-denominated credits per debtor per bank outstanding as of April 30, 1996. Third, borrowers could transfer their mortgaged properties to a trust fund and pay monthly rent to such trust fund with a repurchase option during a six-year period. Fourth, loans for the construction or purchase of public housing granted by banks or by the Housing Fund ("FOVI") were covered during a five-year period, with discounts on the amounts otherwise payable starting at 30% and ending at 6% during that period, provided that borrowers have been in good standing since their loans were granted. In addition, borrowers who have had arrears but pay all past-due amounts on loans for the construction or purchase of public housing could benefit from this program during a four-year period, with discounts on the amounts otherwise payable starting at 24% and ending at 6% during that period. The net present value of the fiscal cost of this program is estimated at approximately Ps. 39.2 billion (1.2% of 1997 GDP).

On July 23, 1996, the Government announced the *Programa de Apoyo Financiero al Sector Agropecuario y Pesquero* (Financial Support Program for the Agriculture and Fishing Sector, "FINAPE"), a debt restructuring program for borrowers in the agriculture and fishing sector. The FINAPE program, which took effect on September 1, 1996 and covered loans restructured through December 30, 1996, had three principal features. First, the program covered the total portfolio of loans granted by Mexican banks for agriculture and fishing purposes outstanding as of June 30, 1996, including dollar-denominated credits. Second, holders of agricultural and fishing loans could elect to convert their loans into UDIs or restructure their debts under terms agreed with the respective banks and, in any case, banks would waive their rights to collect interest on late payments. Loans converted into UDIs are payable in periods of five, eight and ten years with initial interest rates of 7.00%, 7.25% and 7.50%, respectively, during the first two years of the restructured credits, which will be increased after the second year of the restructured credits by 0.5% each year. Third, debtors are allowed to prepay their loans without penalty and, in addition, may reduce the outstanding principal amount of their loans by 40% to 16%, depending on the amount outstanding. Borrowers who were current on their payments received discounts on the outstanding principal amount of their loans, retroactive to July 1, 1996 (or the date of restructuring if such date was after July 1, 1996). The costs of such reductions in outstanding principal amounts will be absorbed principally by the banks unless they grant new credits to the agriculture and fishing sector, in which case the Government will absorb a larger share of such costs. The Government currently estimates that the net present value of the cost of the FINAPE program will be approximately Ps. 15.8 billion (0.5% of 1997 GDP).

On August 16, 1996, the Government announced the *Acuerdo de Apoyo Financiero y Fomento a la Micro, Pequeña y Mediana Empresa* (Agreement of Financial Support and Development for Micro-, Small- and Medium-Size Firms, or "FOPYME"), which became effective on October 1, 1996. FOPYME was intended to benefit 97.8% of the businesses with indebtedness of up to Ps. 6 million. Borrowers from commercial or development banks whose loans were made before July 31, 1996 could benefit from this program, as could borrowers of loans granted by commercial banks and non-bank financial intermediaries with resources obtained from development banks and Government trusts. Debtors that were past due in their credits were entitled to restructure their debt from October 1, 1996 until January 31, 1997 and could take advantage of the FOPYME benefits from the date of restructuring. Under FOPYME, debtors with non-revolving credit lines that were current in their payments received a 30% discount on the first Ps. 500,000 of indebtedness, and a 17% discount on indebtedness higher than Ps. 500,000 but lower than Ps. 2 million, as well as certain reductions in the interest payable on their loans. The Government currently estimates that the net present value of the fiscal cost of the FOPYME program will be approximately Ps. 7.8 billion (0.2% of 1997 GDP). The banking system will absorb a similar amount.

Effective January 1, 1997, Banking Circular 1343 ("Circular 1343") issued by the CNBV adopts significant changes in the accounting practices applicable to Mexican commercial banks and development banks, with the intent of making those practices more consistent with international accounting standards, including U.S. generally accepted accounting principles. The new rules require that the entire principal amount of a loan (rather than the overdue portion only) be treated as past due after a default continues for more than a specified period (generally 90 days), and that the loan be placed on non-accrual status after that period. In addition, Circular 1343 requires that banks' securities portfolios be marked-to-market, and that variations in the valuation of marketable securities be fully disclosed in the financial statements. Circular 1343 also requires the full recognition of the effects of inflation in the financial statements, including the revaluation of all fixed assets and the recognition of the inflation-related profit or loss derived from monetary positions.

At the end of 1997, and calculated in accordance with the new accounting criteria applicable to credit institutions as of the beginning of this year, the past-due loans of commercial banks (excluding banks under Government intervention and those in special situations) totaled Ps. 84,582 million. The past-due loans of several banks decreased during the last quarter of the year primarily due to loan write-offs, the progress made in restructurings and continued efforts to recover past-due loans. The ratio of past-due loans to total loans of commercial banks was 11.7% at December 31, 1997, as compared with 12.8% at September 30, 1997.

The amount of loan loss reserves created by commercial banks (excluding intervened banks and those in special situations) reached a total of Ps. 53,116 million at December 31, 1997, equivalent to 62.8% of their past-due loans, exceeding the minimum level of 45% required by the new accounting criteria.

Credit Allocation by Sector

The following table shows the allocation by sector of credit extended by commercial and development banks on the last date for the periods indicated.

Credit Allocation by Sector(1)

	1993		1994		1995		1996		1997(1)	
	(% of total)		(% of total)		(% of total) (in billions of pesos)		(% of total)		(% of total)	
Agriculture, mining, forestry and fishing....	Ps. 44.1	8%	Ps. 56.5	6%	Ps. 59.9	5%	Ps. 71.0	6%	Ps. 76.7	6%
Energy........................	3.5	1	5.9	1	7.0	1	7.4	1	10.5	1
Industry......................	84.3	14	122.1	14	146.3	13	162.9	13	173.3	14
Services and other activities..................	182.9	31	274.4	32	292.0	26	246.3	20	244.5	19
Commerce..................	86.7	15	128.9	15	140.2	12	145.2	12	152.3	12
Government................	72.5	12	127.8	15	212.0	19	239.7	19	231.5	18
Total, including others....	Ps.583.5	100%	Ps.872.3	100%	Ps.1,129.2	100%	Ps.1,231.2	100%	Ps.1,280.6	100%

(1) Includes commercial and development banks.
(2) Preliminary.
Source: Banco de México.

As the table above indicates, the percentage of total credit allocated to the Government increased significantly from 12% of total credit to 18% of total credit from 1993 to 1997.

Insurance Companies and Auxiliary Credit Institutions

Effective July 15, 1993, the *Ley General de Instituciones y Sociedades Mutualistas de Seguros* (Insurance Company Law) was amended in order to encourage the expansion of the insurance market in Mexico. The main objectives of the amendment were to strengthen the insurance business in Mexico, consolidate the presence of insurance institutions in the economy and flexibly regulate insurance activity so that insurance institutions will be better able to provide services to consumers through expanded operations. Furthermore, the amendment permitted insurance companies, subject to certain limitations, to engage in foreign currency-denominated funding activities.

To achieve these objectives, the law permitted insurance companies to use the services of intermediaries located in Mexico or abroad for their re-insurance transactions and to issue non-voting or limited voting shares, as well as subordinated obligations. Insurance companies may now act as trustees for the administration of properties which involve the payment of insurance premiums. In addition, foreign insurance companies are now permitted, with the prior approval of the Ministry of Finance and Public Credit, to establish representative offices in Mexico.

Pursuant to amendments to the Insurance Company Law, effective November 18, 1995, foreign investors may purchase up to 49% of the capital stock of Mexican insurance companies; in addition, foreign financial institutions domiciled in countries with which Mexico has entered into trade agreements may, with the approval of the Ministry of Finance and Public Credit, acquire the majority of the shares representing capital stock of a Mexican insurance company.

Effective July 16, 1993, the *Ley General de Organizaciones y Actividades Auxiliares del Crédito* (Auxiliary Credit Organizations Law) was amended in order to promote the growth of financial intermediaries and increase customer protection. Pursuant to the amended law, no individual or entity is permitted to hold directly or indirectly more than 10% of the paid-in capital of such financial intermediaries without the prior authorization of the Ministry of Finance and Public Credit; auxiliary credit institutions and foreign exchange brokers are required to allocate 10% of their profits to a capital reserve fund until such fund equals their paid-in capital; financial leasing companies are able to enforce judicially the repossession of goods leased in case of default by the lessee of its obligations; and the CNBV is entitled to prevent auxiliary credit institutions from using misleading documentation.

Pursuant to amendments to the Auxiliary Credit Organizations Law, effective November 18, 1995, foreign investors may purchase up to 49% of the capital stock of auxiliary credit institutions; in addition, foreign financial institutions domiciled in countries with which Mexico has entered into trade agreements may, with the approval of the Ministry of Finance and Public Credit, acquire the majority of the shares representing capital stock of an auxiliary credit institution.

In connection with the implementation of the NAFTA, amendments to several laws relating to financial services became effective on January 1, 1994, and implementing regulations were issued by the Ministry of Finance and Public Credit on April 20, 1994. Under the new measures, non-Mexican financial groups and financial intermediaries are permitted, through Mexican subsidiaries, to engage in various activities, including the provision of insurance, in Mexico. See "—Banking System" above.

The Securities Markets

The Mexican Stock Exchange is Mexico's only stock exchange and is located in Mexico City. The Mexican Stock Exchange is organized as a corporation with shares owned by 32 brokerage firms, each of which is authorized to trade on the exchange floor. Both debt and equity securities are traded on the Mexican Stock Exchange, including stocks and bonds of private-sector corporations, equity certificates or shares issued by banks, commercial paper, bankers' acceptances, certificates of deposit, Government debt and special hedging instruments linked to the dollar. Effective in January 1990, important reforms were introduced to the Securities Market Law and the *Ley de Sociedades de Inversión* (Investment Company Law) to modernize Mexican securities regulation and to permit a broader range of securities to be offered and of transactions to be undertaken. Currently, institutional investors are the most active participants in the Mexican Stock Exchange, although retail investors also play a role in the market. The Mexican equity market is one of Latin America's largest in terms of market capitalization, but it remains relatively small and illiquid compared to major world markets.

On July 24, 1993, amendments to the Securities Market Law became effective, which amendments include more flexible rules for the repurchase by Mexican companies of their own shares and a new definition of (and rules relating to) privileged information. In addition, under the new amendments, brokerage houses are authorized to act as trustees in transactions related to their trading activities, and the listing of foreign securities on the Mexican Stock Exchange is permitted upon the authorization of the Ministry of Finance and Public Credit, the CNBV and Banco de México. The amendments also include the creation of an international quotation system. In addition, beginning in July 1994 foreign securities firms were permitted to establish representative offices in Mexico with the prior approval of the Ministry of Finance and Public Credit. As of February 9, 1998, the Ministry of Finance and Public Credit had authorized nine foreign securities firms to establish representative offices.

As part of the 1995 Reform (see "—Banking System" above), restrictions on the shareholding structure of securities firms were also relaxed. Prior to the 1995 Reform, the capital of securities firms was required to be represented by at least 70% Series "A" shares (which may be owned only by Mexican persons) and up to 30% Series "B" shares (which may be owned by foreigners other than foreign governmental entities exercising functions of authority). Pursuant to the 1995 Reform, the level of permissible foreign shareholding was increased by permitting securities firms to have 51% of their capital represented by Series "A" shares, with the remainder to be represented by Series "B" shares. In addition, whereas formerly Series "A" shares generally could be owned only by Mexican individuals and financial group holding companies, they now may also be owned by Mexican *personas morales* and certain institutional investors established under Mexican law and controlled by Mexicans. Per-shareholder ownership limits (with authorization from the Ministry of Finance and Public Credit) were raised by the new legislation from 15% to 20% of capital. As was the case prior to the 1995 Reform, the per-shareholder ownership limit without Ministry of Finance and Public Credit authorization is 10% of capital. These limits can be waived by the Ministry of Finance and Public Credit in connection with an approved plan for the acquisition of Mexican-owned securities firm by a foreign financial institution.

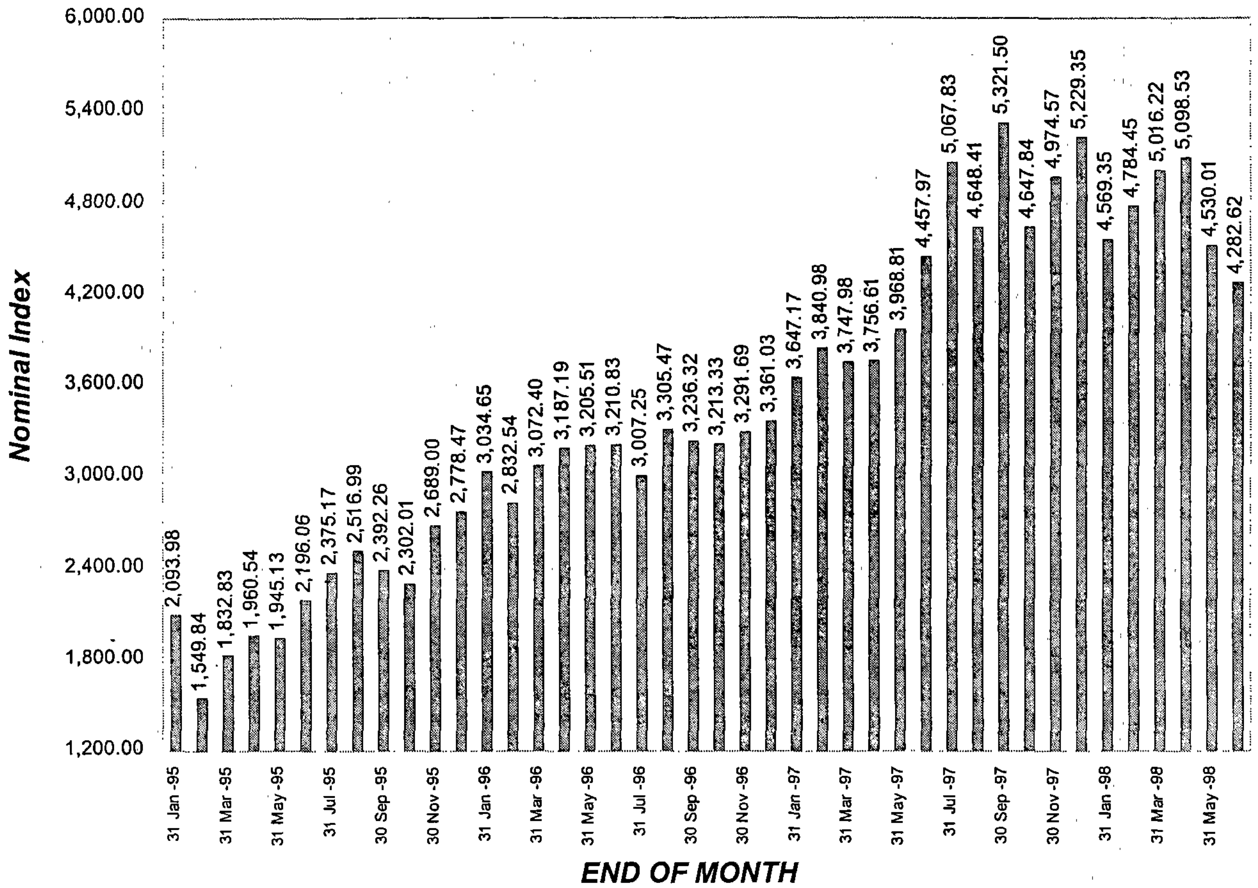
The market capitalization of the Mexican Stock Exchange was U.S. $156.2 billion at the end of 1997, representing an increase of 46.3% from its year-end 1996 level. The value of transactions on the Mexican Stock Exchange reached U.S. $56.5 billion in 1997, representing a 21.3% increase over the 1996 level. Fixed income securities (*i.e.*, commercial paper, notes, bonds and ordinary participation certificates) accounted for 1.7% and equity securities (*i.e.*, shares and certificates of patrimonial contribution or CAPs) accounted for the remaining 98.3% of transactions.

The Mexican Stock Exchange publishes a market index (the "Stock Market Index") based on a group of the 35 most actively traded shares.

During 1995, the stock market was affected by several factors, including the fall in the value of the Mexican peso, fluctuating interest rates, the contraction of economic activity, problems faced by the banking sector and uncertainty as to the time it would take to overcome the crisis. The Stock Market Index increased by 17% in nominal peso terms and decreased by 23% in real terms from year-end 1994 to year-end 1995. The Stock Market Index was 3,361.03 points at the end of 1996, representing a 21.0% increase in nominal peso terms and a 5.3% decrease in real terms over year-end 1995.

The Stock Market Index stood at 5,229.35 points at the end of 1997, representing a 55.6% increase in nominal peso terms and a 34.4% increase in real terms over year-end 1996. The Stock Market Index decreased by 18.1% in nominal peso terms and 24.4% in real terms from the end of 1997 to the end of June 1998.

The following graph charts the Stock Market index for the periods indicated.



Source: Mexican Stock Exchange.

EXTERNAL SECTOR OF THE ECONOMY

Foreign Trade

The import substitution economic development model that Mexico adopted in the 1940s to promote industrialization through protection of local industries, and which in its latter stages was financed by the expansion of oil exports and debt accumulation, gave way in the late 1980s to a more outward-looking approach concentrating on export-led growth.

To foster non-oil exports, the Government has promoted a comprehensive set of trade, fiscal, financial and promotional measures designed to create a macroeconomic environment in which exports will be more competitive. The Government's decision to join GATT in 1986 resulted in, among other things, an important reduction in the protection traditionally given to domestic producers. A five-tier tariff structure was established at the end of 1987 with a maximum rate of 20%. Average tariff rates declined from 22.6% in 1986 to 13.1% in 1992. By 1997, approximately 99.3% of tariff items and 91.8% of imports by value were exempt from import permits and other non-tariff barriers.

The following table provides information about the value of Mexico's merchandise imports and exports (excluding tourism) for the periods indicated.

Exports and Imports(1)

	1993	1994	1995	1996	1997(2)	Jan-June 1998(2)
	(in millions of dollars, except average price of Mexican oil mix)					
Merchandise exports (f.o.b.)						
Oil and oil products	$ 7,418	$ 7,445	$ 8,423	$ 11,654	$ 11,323	$ 3,875
Crude oil	6,485	6,624	7,420	10,705	10,334	3,451
Other	933	821	1,003	949	989	424
Non-oil products	44,468	53,438	71,119	84,346	99,108	54,238
Agricultural	2,505	2,678	4,016	3,592	3,828	2,649
Mining	278	357	545	449	478	220
Manufactured goods	41,685	50,402	66,558	80,305	94,802	51,370
In-bond industry	21,853	26,269	31,103	36,920	45,166	25,072
Other	19,832	24,132	35,455	43,385	49,637	26,298
Total merchandise exports	51,886	60,882	79,542	96,000	110,432	58,112
Merchandise imports (f.o.b.)						
Consumer goods	7,842	9,510	5,335	6,657	9,326	5,288
Intermediate goods	46,468	56,514	58,421	71,890	85,366	47,155
In-bond industry	16,443	20,466	26,179	30,505	36,332	20,096
Other	30,025	36,048	32,242	41,385	49,034	27,059
Capital goods	11,056	13,322	8,697	10,922	15,116	8,560
Total merchandise imports	65,367	79,345	72,453	89,469	109,808	61,003
Trade balance	$ (13,481)	$ (18,464)	$ 7,089	$ 6,531	$ 624	$ (2,891)
Average price of Mexican oil mix(3)	$ 13.20	$ 13.88	$ 15.70	$ 18.94	$ 16.46	$ 10.63

Note: *Totals may differ due to rounding.*

(1) Total external trade figures are calculated according to a methodology developed to conform to international standards under which merchandise exports and imports include in-bond industry.

(2) Preliminary.

(3) Weighted average price (in dollars per barrel) of the Mexican oil mix.

Source: Banco de México.

As a result of the export promotion strategy referred to above, non-oil exports have nearly quintupled since 1982, reaching U.S. $99.1 billion (or 89.7% of total merchandise exports including in-bond industries) in 1997. During the period from 1993 through 1997, non-oil exports, including in-bond industries, grew at a compound annual rate of 22.2%.

In recent years, the composition of Mexico's non-oil exports has also changed. In 1997, U.S. $94.8 billion (or 95.7%) of Mexico's non-oil exports were represented by manufactured goods, compared with U.S. $5.8 billion (or 77.1%) in 1982. Exports of transport vehicles, equipment, machinery and metallic goods increased from approximately 27% of total manufactured exports (excluding in-bond industry) in 1982 to approximately 60.2% in 1997.

From 1988 through 1994, imports increased dramatically from their levels during the period from 1983 to 1987, reflecting increased demand resulting from a resumption of growth in the Mexican economy, the modernization of Mexico's industrial facilities and the decrease in tariffs that accompanied Mexico's entry into GATT. Mexico reported a deficit in its trade balance (inclusive of in-bond industry) of approximately U.S. $13.48 billion in 1993 and U.S. $18.46 billion in 1994. The 1994 trade deficit reflected continued growth in imports in large part due to the overvaluation of the peso during such period. See "The Economy—Events During 1994 and 1995".

Mexico's 1995 economic crisis led to a rapid turnaround in its trade balance in 1995 as the dollar value of exports grew by 30.6% and imports decreased by 8.7%, resulting in a U.S. $7.1 billion trade surplus, the first trade surplus on an annual basis since 1989.

During 1996, overall Mexican exports continued to grow at a healthy pace, as the dollar value of exports grew by 20.7%, while during the same period the imports increased by 23.5% as a result of the recovery of economic activity and of domestic demand. As a result, Mexico registered a trade surplus of U.S. $6.5 billion in 1996.

In 1997, the trade balance registered a surplus of U.S. $624 million, U.S. $5,907 million less than the surplus observed in 1996. Merchandise exports during 1997 increased by 15.0% over their level in 1996. Merchandise imports grew by 22.7% in 1997, due to increased purchases of goods used to expand the productive capacity of the country, a recovery in private consumption and an increase in the demand for intermediate goods used in the production of exports. During 1997, 77.7% of total merchandise imports consisted of intermediate goods, 13.8% consisted of capital goods and 8.5% consisted of consumer goods.

Mexico registered a deficit in its trade balance of U.S. $2,891 million during the first six months of 1998, as compared with a trade surplus of approximately U.S. $2,210 million during the same period of 1997. Merchandise imports during the first six months of 1998 increased at an annual rate of 21.2%, as compared with an increase of 21.7% during the same period of 1997. Of the three categories of merchandise imports, imports of intermediate goods increased by 19.4%, while imports of capital goods increased by 24.3% and imports of consumer goods increased by 34.3%. Merchandise exports totaled U.S. $58.1 billion in the first six months of 1998, as compared with U.S. $52.5 billion in the first six months of 1997. Petroleum exports decreased by 31.4% in the first six months of 1998, while non-petroleum exports increased by 15.7%. Exports of manufactured goods, which represented 88.4% of total merchandise exports, increased by 16.1% during the first six months of 1998, as compared with an increase of 17.7% during the same period of 1997.

Geographic Distribution of Trade

The United States is Mexico's most important trading partner. In 1997, trade with the United States accounted for approximately 85.6% of total exports and 74.8% of total imports.

During 1997, the most important markets for Mexican exports were as follows: the United States, representing 85.6% of exports, Canada, representing 2.0% of exports, Japan, representing 1.0% of exports, Spain, representing 0.9% of exports, Germany, representing 0.7% of exports, the United Kingdom, representing 0.6% of exports, and France, representing 0.4% of exports. The majority of Mexican imports originated in the United States (74.8% of imports), followed by Japan (3.9% of imports), Germany (3.6% of imports), Canada (1.8% of imports), France (1.1% of imports) and Spain (0.9% of imports).

On December 17, 1992, the NAFTA was signed by the Presidents of Mexico and the United States and by the Prime Minister of Canada. On January 1, 1994, following approval by the legislative branches of all three countries, the NAFTA entered into force. Mexico, the United States and Canada also negotiated and entered into supplemental accords to the NAFTA (which are not included in the formal text of the NAFTA) on labor and environmental issues, as well as separate understandings on emergency actions in response to import surges and the funding of environmental infrastructure projects in the Mexico-U.S. border region. In addition, different combinations of the three countries have also reached understandings, or have agreed to pursue further discussions, on various specific issues.

The NAFTA removes most customs duties imposed on goods traded among Mexico, the United States and Canada; removes or relaxes many investment restrictions, including restrictions on foreign investment in banking, insurance and other financial service activities; liberalizes trade in services; provides for protection of intellectual property rights; provides a specialized means for resolution of trade disputes arising under the NAFTA; and promotes trilateral, regional and multilateral cooperation. Mexico has enacted certain laws and promulgated certain regulations to implement the NAFTA and intends to continue this process. Certain provisions of the NAFTA are being phased in over a period of years. The Government expects that the NAFTA will provide improved and more predictable access of Mexican exports to U.S. and Canadian markets. It is anticipated over the long term that the NAFTA will have a favorable effect on employment, wages and economic growth in Mexico. On the other hand, Mexican producers and service providers will be subject to increased foreign competition as tariffs and other restrictions which provided a measure of protection for certain industries from foreign competition are reduced. This increased competition, the effects of which have already been felt in many segments of the Mexican economy after Mexico's entry into GATT in 1986, contributed to increased unemployment in Mexico in the short-term, but has led to favorable changes in the composition of Mexican economic activity.

A free trade agreement between Mexico and Chile went into effect on January 1, 1992. A free trade agreement with Colombia and Venezuela and a similar agreement with Bolivia entered into effect on January 1, 1995. In 1992, Mexico signed a framework free trade agreement with Costa Rica, El Salvador, Honduras, Guatemala and Nicaragua as a step towards establishing a free-trade area by the end of 1997, and in April 1994, Mexico and Costa Rica entered into a definitive free trade agreement. Mexico has also taken important steps to increase its trade relations with Europe and the Pacific Rim countries. For example, on November 18, 1993, Mexico was admitted as a member of the Asian Pacific Economic Cooperation Association, and in July 1998, Mexico began negotiations of a free trade agreement with the European Union. Mexico became a member of the WTO on January 1, 1995, the date the WTO superseded the GATT.

The *Ley de Comercio Exterior* (Foreign Trade Law) was approved by the Mexican Congress on July 13, 1993 to replace and consolidate certain earlier statutes addressing the same topics and to clarify the division of responsibilities between the customs authorities and the foreign trade authorities. The Foreign Trade Law grants broad powers to the President to establish import and export duties and other restrictions. It also empowers the Ministry of Commerce and Industrial Development to resolve trade-related disputes and establish procedures for the imposition of countervailing duties. It creates a new agency, the Foreign Trade Commission, within the Ministry of Commerce and Industrial Development to administer such procedures. In addition, the Foreign Trade Law specifically defines and regulates unfair trade practices, bringing Mexico's regulatory framework more into line with current international practices and standards. The Foreign Trade Law was drafted in response to the increasing importance of international trade in the Mexican economy and the increasing number of international trade agreements to which Mexico has become a party. See "—Foreign Trade" above. The *Ley de Inversión Extranjera* (Foreign Investment Law) was enacted in December 1993 to facilitate the acquisition by non-Mexican investors of interests in Mexican companies. See "—Direct Foreign Investment in Mexico" below.

In-bond Industry

Mexico's *maquiladora* or in-bond industry imports components and raw materials without duty and exports finished products with the manufacturer paying tariffs only on the value added in Mexico. Initially established along the border with the United States, in-bond plants are now being established in other regions of the country where they have access to a larger and more diverse labor pool and are able to take greater advantage of inputs available from Mexican suppliers. Although in 1982 only 71 in-bond plants were in non-border regions, by 1997 that number had increased to 678. More than half of the value added by in-bond industry is in the production of auto parts, transportation equipment and electronic products.

At December 31, 1997, the number of in-bond plants totaled 2,867, which together employed approximately 938,438 workers. Net revenues from maquiladora operations in 1997 totaled U.S. $8,834 million, an increase of 37.7% as compared with 1996.

Balance of International Payments

Since 1988, Mexico has registered deficits in its current account, due primarily to the increase in private sector imports and the Government's trade liberalization policies. The current account deficit totaled U.S. $14.6 billion in 1991, U.S. $24.4 billion in 1992 and U.S. $23.4 billion in 1993, again due to a surge in imports resulting from the country's economic recovery and lower tariffs. Notwithstanding the current account deficits from 1989 to 1993, international reserves continued to grow during this period due to a sustained inflow of capital from abroad resulting from direct foreign investment and investment in the Mexican securities market.

During 1994, the current account deficit widened to U.S. $29.7 billion, U.S. $6.2 billion higher than in 1993. The increase in the current account deficit was due primarily to the overvaluation of the Mexican peso during much of the year, leading to increases in imports at a rate faster than increases in exports. See "The Economy—Events During 1994 and 1995". The current account deficit was U.S. $1,577 million in 1995, 94.7% lower than the current account deficit in 1994. The current account deficit decreased during 1995 due to a sharp adjustment in the peso/dollar exchange rate (which resulted in increased merchandise exports and decreased merchandise imports).

The capital account registered a surplus of U.S. $14.6 billion during 1994, as compared with a surplus of U.S. $32.5 billion during 1993. Domestic events, including the disturbances in the southern part of the country and the uncertainty regarding the Presidential elections in August 1994, as well as external factors, such as the increases in U.S. interest rates, led to large fluctuations in foreign portfolio investment during 1994 and to a net decline in capital inflows from the level registered in 1993. See "The Economy—Events During 1994 and 1995". The capital account surplus during 1995 was U.S. $15.4 billion, 5.6% higher than the capital account surplus during 1994, in large part due to the international financial support granted to Mexico. See "The Economy—The Government's Response—International Support". Direct foreign investment during 1995 totaled U.S. $9.5 billion.

During 1996, Mexico's current account registered a negative balance of U.S. $2,330 million, as compared with a deficit of U.S. $1,577 million in 1995. The capital account surplus for 1996 totaled U.S. $4,069 million. Net direct foreign investment during 1996 totaled U.S. $9,186 million.

Changes registered in the current account during 1997 were primarily attributable to a U.S. $5,908 million decrease in the trade surplus. In 1997, the current account registered a deficit of U.S. $7,448 million, equivalent to 1.8% of GDP, as compared with the U.S. $2,330 million deficit registered in 1996. The capital account surplus for 1997 was U.S. $15,411 million, up from the U.S. $4,069 million surplus in 1996. Direct foreign investment during 1997 totaled U.S. $12,478 million.

During the first quarter of 1998, Mexico's current account registered a deficit of U.S. $3,449 million, as compared with a deficit of U.S. $150.3 million in the same period of 1997. The capital account surplus for the first quarter of 1998 totaled U.S. $4,602 million, as compared with a surplus of U.S. $1,767 million during the same period of 1997. Direct foreign investment during the first quarter of 1998 totaled U.S. $2,041 million.

At December 31, 1997, Mexico's international reserves totaled U.S. $28,003 million, as compared to U.S. $17,509 million, U.S. $15,741 million and U.S. $6,148 million, respectively, at December 31, 1996, 1995 and 1994. At December 31, 1997, the net international assets of Banco de México totaled U.S. $19,824 million, as compared to U.S. $6,313 million and U.S. $(35) million, respectively, at December 31, 1996 and 1995. At July 31, 1998, Mexico's international reserves totaled U.S. $30,724 million, and the net international assets of Banco de México totaled U.S. $22,855 million.

The following table sets forth Mexico's balance of payments for the periods indicated:

Balance of Payments

	1993	1994	1995	1996	1997(1)	First Quarter of 1998(1)
			(in millions of dollars)			
I. Current Account(2)	$ (23,399)	$ (29,662)	$ (1,577)	$ (2,330)	$ (7,448)	$ (3,449)
Credits	67,752	78,372	97,029	115,494	131,535	33,722
Merchandise exports (f.o.b.)	51,886	60,882	79,542	96,000	110,431	28,214
Non-factor services	9,419	10,301	9,665	10,779	11,270	3,159
Tourism	6,167	6,364	6,179	6,934	7,593	2,233
Others	3,252	3,938	3,486	3,845	3,678	926
Factor Services	2,790	3,367	3,828	4,154	4,560	1,192
Interest	2,048	2,700	3,018	3,307	3,750	992
Others	742	667	810	847	811	200
Transfers	3,657	3,822	3,995	4,561	5,273	1,156
Debits	91,152	108,034	98,606	117,824	138,983	37,171
Merchandise imports (f.o.b.)	65,367	79,346	72,453	89,469	109,808	29,972
Non-factor services	11,550	12,270	9,001	10,231	11,800	2,866
Insurance and freight	2,181	2,640	1,975	2,510	3,312	905
Tourism	5,562	5,338	3,171	3,387	3,892	874
Others	3,807	4,292	3,856	4,334	4,596	1,088
Factor services	14,219	16,378	17,117	18,094	17,350	4,330
Interest	10,934	11,807	13,575	13,361	12,436	3,014
Others	3,285	4,571	3,542	4,733	4,914	1,316
Transfers	16	40	35	30	26	3
II. Capital Account	32,482	14,584	15,406	4,069	15,411	4,602
Liabilities	36,085	20,254	22,763	10,410	8,695	5,862
Loans and deposits	2,777	1,100	22,952	(12,194)	(8,820)	791
Development banks	194	1,329	959	(1,246)	(1,021)	(321)
Commercial banks	3,328	1,471	(4,982)	(1,720)	(1,978)	428
Banco de México	(1,175)	(1,203)	13,333	(3,524)	(3,487)	0
Non-financial public sector	(2,402)	(1,690)	10,493	(7,672)	(5,036)	(115)
Non-financial private sector	2,832	1,193	3,149	1,968	2,702	799
Foreign investment	33,308	19,155	(188)	22,604	17,515	5,071
Direct	4,389	10,973	9,526	9,186	12,478	2,041
Portfolio	28,919	8,182	(9,715)	13,419	5,037	3,030
Equity Securities	10,717	4,084	519	2,801	3,215	243
Debt securities in pesos	7,406	(2,225)	(13,860)	908	585	793
Public sector	7,013	(1,942)	(13,791)	949	490	860
Private sector	393	(283)	(69)	(41)	95	(67)
Debt securities in foreign currency	10,797	6,324	3,626	9,710	1,237	1,995
Public sector	4,872	3,980	2,994	8,909	(1,659)	983
Private sector	5,925	2,344	632	801	2,896	1,012
Assets	(3,603)	(5,670)	(7,358)	(6,341)	6,716	(1,261)
III. Errors and Omissions	(3,142)	(3,314)	(4,238)	(35)	2,549	246
IV. Change in net international reserves(3)	5,983	(18,389)	9,593	1,768	10,494	1,400

Note: Totals may differ due to rounding.

(1) Preliminary.

(2) Current account figures are calculated according to a methodology developed to conform to new international standards under which merchandise exports and merchandise imports include in-bond industry.

(3) The sum of items I, II and III does not equal item IV since purchases and sales of gold and silver as well as adjustments in their value are not reflected in items I, II and III.

Source: Banco de México.

On December 11, 1995, the Government announced certain changes in monetary policy that took effect in 1996. The Government established quarterly targets for the expansion of net domestic credit in 1996 and 1997, as compared with the annual target established for 1995. In addition, the definition of "net domestic credit" was changed to be more consistent with international standards. Previously, net domestic credit was defined as the difference between the monetary base (currency in circulation plus bank deposits at the central bank) and net international reserves; the change in "net domestic credit" is now defined as the variation of the monetary base less the variation of Banco de México's "net international assets". "Net international assets" is defined as (a) international reserves; plus (b) assets with a maturity longer than six months derived from credit agreements with central banks, less (x) liabilities outstanding to the IMF, less (y) liabilities with a maturity shorter than six months derived from credit agreements with central banks.

Mexico's Foreign Exchange Commission, consisting of representatives of the Ministry of Finance and Public Credit and Banco de México, announced on August 1, 1996 Mexico's plan to increase its international reserves each month by auctioning rights to sell U.S. dollars to Banco de México. Under the program, Banco de México currently auctions at the end of each month a total of U.S. $250 million in options to sell U.S. dollars (the plan originally envisioned a total of U.S. $130 million per month, which was increased twice in 1996 and once in August 1997, and then decreased in October 1997), although the amount auctioned can be lowered in the event that the flow of foreign currency to México decreases significantly. The auctions take place among commercial banks (which may assign rights arising therefrom) and the winners have the right to sell U.S. dollars to Banco de México during the following month at the peso/dollar exchange rate announced by Banco de México on the day immediately preceding the relevant auction. That exchange rate, however, may not be higher than the average exchange rate during the 20-day period immediately preceding the moment an auction winner exercises its option.

In February 1997, Mexico's Foreign Exchange Commission modified the auction mechanism to provide that if before the 16th day of a certain month, more than 80% of the options sold at the end of the preceding month have been exercised, an additional auction of rights to sell dollars to the central bank for U.S. $300 million will take place, which amount was decreased to U.S. $250 million in October 1997.

In February 1997, the Foreign Exchange Commission announced a plan to auction dollars among commercial banks. If on any day the exchange rate (*i.e.*, the number of pesos equal to one dollar) exceeds by more than 2% the exchange rate on the preceding business day, Banco de México will auction U.S. $200 million at a minimum price in pesos equal to 2% above the exchange rate on the preceding business day. If the exchange rate on the following day again exceeds by more than 2% the exchange rate on the date of the first auction, Banco de México will again auction U.S. $200 million, at a minimum price equal to 2% above the average price resulting from the auction on the preceding day. This mechanism was adopted with the aim of moderating the volatility of the peso/dollar exchange rate, maintaining the Government's freely floating exchange rate regime. For the first time on October 27, 1997, and subsequently on October 30, 1997, November 6, 1997, January 12, 1998 and May 27, 1998, Banco de México applied the auction mechanism referred to above, because the necessary preconditions for doing so were present at such times.

The following table sets forth the international reserves and net international assets of Banco de México at the end of each period indicated.

International Reserves

Year	End-of-Period(1) International Reserves(2)(3)	End-of-Period(1) Net International Assets(4)
	(in millions of dollars)	
1993	$24,538	—
1994	6,148	—
1995	15,741	$ (35)
1996	17,509	6,313
1997	28,003	19,824
1998		
January	28,633	20,237
February	28,597	20,063
March	29,403	21,230
April	30,499	22,213
May	30,202	22,112
June	29,778	21,812
July	30,724	22,855

(1) Periods ending December 31, except as indicated.
(2) International reserves of Banco de México include gold, Special Drawing Rights and foreign exchange holdings.
(3) International reserves are equivalent to gross international reserves minus international liabilities of the central bank with maturities under six months.
(4) In 1995, Banco de México began publishing, on a weekly basis, its net international assets in accordance with the definition provided under "The Economy—The Government's Response".
Source: Banco de México.

Direct Foreign Investment in Mexico

On December 28, 1993, the Foreign Investment Law became effective. The Foreign Investment Law establishes a set of rules to provide legal certainty to foreign investors and promote the country's competitiveness. The law liberalizes certain restrictions on foreign investment in Mexico, permitting, if certain conditions are satisfied, the ownership by foreign investors of 100% of the capital stock of a Mexican company. The law also sets forth which activities of the economy continue to be reserved to the Government or to Mexican investors and lists the different activities in which foreign investment may not exceed 10%, 25%, 30% and 49% of the total investment. The Government recognizes that Mexico is competing for capital with many other countries, including China and the newly independent nations in Eastern and Central Europe, but believes that, because of the increased competitiveness and productivity of its economy, Mexico will be able to maintain access to sources of investment capital.

If certain requirements are met, the Foreign Investment Law allows foreign investors to purchase equity securities traded on the Mexican Stock Exchange that would otherwise be restricted to Mexican investors. Thus, with the authorization of the Ministry of Commerce and Industrial Development, investment trusts may be established by Mexican banks acting as trustees. These trusts issue ordinary participation certificates that may be acquired by foreign investors; the certificates grant only economic rights to their holders and do not confer voting rights in the companies whose stock is held by the trusts (such voting rights being exercisable only by the trustee).

During 1997, direct foreign investment in Mexico notified to the National Foreign Investment Commission ("NFIC") and National Foreign Investment Register ("NFIR") totaled U.S. $7.98 billion (including temporary net imports of machinery and equipment of the in-bond industry). Total accumulated direct foreign investment in Mexico for the period 1994-1997, including new foreign investment projects authorized by the NFIC and the NFIR, amounted to approximately U.S. $32.5 billion. Of the total direct foreign investment accumulated for the 1994-1997 period, excluding that in securities, 59.8% has been channeled to industry, 39.2% to services, 0.9% to mining and 0.2% to agriculture and fishing.

During 1997, *net foreign investment in* Mexico, *as recorded in the balance of payments, totaled* U.S. $17.5 billion, which was comprised of direct foreign investment of U.S. $12.5 billion and portfolio investment of U.S. $5.0 billion.

The following table shows, by country of origin, direct foreign investment in Mexico notified in 1997 and the cumulative totals from 1994 through December 31, 1997.

Direct Foreign Investment(1)(2)

	Direct Foreign Investment Notified in 1997		Cumulative Total	
	(in millions of dollars)			
United States	$4,673.0	58.6%	$18,475.3	56.8%
United Kingdom	1,741.3	21.8	2,595.9	8.0
Germany	273.1	3.4	1,305.5	4.0
Japan	305.9	3.8	1,194.7	3.7
Switzerland	7.9	0.1	336.5	1.0
France	8.2	0.1	330.2	1.0
Netherlands	62.5	0.8	1,928.9	5.9
Spain	231.5	2.9	469.8	1.4
Canada	102.0	1.3	1,501.8	4.6
Sweden	6.7	0.1	167.3	0.5
Italy	3.2	0.0	33.7	0.1
Others	564.8	7.1	4,168.2	12.8
Total	$7,980.1	100.0%	$32,507.8	100.0%

Note: Totals may differ due to rounding.
(1) Excluding portfolio investment. The direct foreign investment corresponds to investments notified to the NFIC and the NFIR (including temporary net imports of machinery and equipment of the in-bond industry).
(2) The direct foreign investment does not include reinvestment and inter-company accounts.
Source: NFCI

Exchange Controls and Foreign Exchange Rates

From late 1982 until November 10, 1991, Mexico maintained a dual foreign exchange rate system, with a "controlled" rate and a "free market" rate. The controlled exchange rate applied to certain imports and exports of goods, advances and payments of registered foreign debt, funds used in connection with the in-bond industry and payments of royalties and technical assistance under registered agreements. The free market rate was applicable to all other transactions. The dual system assisted in controlling the value of the peso, especially in 1983 and 1985. In later years, the difference between the two rates was not significant. Mexico repealed its exchange control rules effective November 11, 1991 and now maintains only a free, or market, exchange rate.

Under the Accords that preceded the AUSEE, the Government implemented a schedule of gradual devaluation of the peso. A fixed exchange rate was maintained from February to December 1988. Thereafter, the intended annual rate of devaluation was gradually lowered from 16.7% in 1989 to 11.4% in 1990, 4.5% in 1991 and 2.4% in 1992. From October 1992 through December 20, 1994, the peso/dollar exchange rate was allowed to fluctuate within a band that widened daily. The ceiling of the band, which was the maximum selling rate, depreciated at a daily rate of 0.0004 pesos (equal to approximately 4.5% per year), while the floor of the band, *i.e.*, the minimum buying rate, remained fixed. Banco de México agreed to intervene in the foreign exchange market to the extent that the peso/dollar exchange rate reached either the floor or the ceiling of the band.

Beginning on January 1, 1994, volatility in the foreign exchange market began to increase, with the value of the peso relative to the dollar declining at one point to an exchange rate of Ps. 3.375 to U.S. $1.00, a decline of approximately 8.69% from the high of Ps. 3.1050 reached in early February.

This increased volatility was attributable to a number of political and economic factors, including a growing current account deficit, the relative overvaluation of the peso, investor reactions to the increase in U.S. interest rates, lower than expected economic growth in Mexico in 1993, uncertainty concerning the Mexican Presidential elections in August 1994 and certain related developments. See "The Economy—Events During 1994 and 1995".

On December 20, 1994, increased pressure on the peso/dollar exchange rate led Mexico to increase the ceiling of the Banco de México intervention band by Ps. 0.53. That action proved insufficient to address the concerns of foreign investors, and the demand for foreign currency continued. On December 22, the Government adopted a free exchange rate policy, eliminating the intervention band and allowing the peso to float freely against the dollar. The value of the peso continued to weaken relative to the dollar in the following days, at one point to Ps. 5.762 = U.S. $1.00, a decline in dollar terms in the value of the peso of approximately 39.88% from the exchange rate of Ps. 3.464 = U.S. $1.00 on December 20, 1994 prior to Mexico's decision to widen the intervention band. See "The Economy—Events During 1994 and 1995".

There was substantial volatility in the peso/dollar exchange rate during the first quarter of 1995, with the peso/dollar exchange rate falling to a low point of Ps. 7.588=U.S. $1.00 on March 13, 1995. By the end of April and through September 1995, the exchange rate began to stabilize; however, the exchange rate began to show signs of renewed volatility in October and November 1995. In November 1995, in response to increased volatility and pressure on the peso/dollar exchange rate (which resulted, at times, in the peso/dollar exchange rate exceeding 8.0), Banco de México intervened twice to support the peso, employing an aggregate amount of U.S. $300 million. In December 1995, Banco de México intervened twice in order to support the peso, employing an aggregate amount of U.S. $205 million; since then, Banco de México has not intervened in the foreign currency market. Rather, the Government has promoted market-based mechanisms for stabilizing the exchange rate. On March 19, 1995, Banco de México approved the establishment of over-the-counter forward and options contracts on the peso in Mexico between banks and their clients. Trading of peso futures contracts on the Chicago Mercantile Exchange ("CME") began on April 25, 1995. The Mexican Stock Exchange intends to trade futures on the peso/dollar exchange rate, and permit spot peso-dollar trading. In addition, since the beginning of October 1996, Banco de México has permitted foreign financial institutions to open peso-denominated accounts and to borrow and lend pesos (subject to general restrictions on conducting banking activities in Mexico). During 1996, exchange rate volatility was reduced. The relative stability in the peso/dollar exchange rate was due to sound fiscal and monetary policies and improved economic expectations. In October 1996, strong pressures were registered in the exchange rate market, which led to a depreciation in the nominal exchange rate. However, the peso stabilized once the basic guidelines for economic policy in 1997 were announced. The peso/dollar exchange rate was relatively stable during much of 1997, although volatility increased during October and November 1997, and has been present at times in 1998, largely due to the effects of the financial crisis in Asia.

The average exchange rate for the full year 1997 was Ps. 7.918 = U.S. $1.00. The peso/dollar exchange rate announced by Banco de México on August 4, 1998 (to take effect on the second business day thereafter) for the payment of obligations denominated in dollars and payable in pesos was Ps. 8.9648 = U.S. $1.00.

See "—Balance of Payments" above for a description of the mechanisms adopted by Mexico's Foreign Exchange Commission to reduce the volatility of the exchange rate and strengthen Mexico's international reserves.

The following table sets forth, for the periods indicated, the daily exchange rates announced by Banco de México for the payment of obligations denominated in currencies other than pesos and payable within Mexico.

Exchange Rates

	Representative Market Rate	
Year	End-of-Period	Average
1993	3.106	3.115
1994	5.325	3.375
1995	7.643	6.419
1996	7.851	7.599
1997	8.083	7.918
1998		
January	8.360	8.179
February	8.583	8.493
March	8.517	8.569
April	8.482	8.500
May	8.880	8.561
June	9.041	8.895
July	8.918	8.904

Source: Banco de México.

PUBLIC FINANCE

General

Budget Process. The Government's fiscal year is the calendar year. The budget process involves the participation and coordination on both an overall and a sectoral basis of all the federal ministries and agencies. The Ministry of Finance and Public Credit prepares the revenue bill which sets forth the revenues to be received by the Government and budget-controlled agencies (as defined below) during the succeeding fiscal year. The various ministries prepare expenditure estimates for their own operations and all of the budget-controlled agencies under their jurisdiction, within the policy orientation and program guidelines established by the Ministry of Finance and Public Credit. These expenditure requests are then reviewed by the Ministry of Finance and Public Credit which prepares the expenditure bill for the Government and the budget-controlled agencies.

Upon passage by both houses of Congress, the revenue bill becomes the Federal Annual Revenue Law, which provides the necessary authority for collecting taxes and other revenues and for contracting loans. Upon passage by the Chamber of Deputies, which under the Constitution is the only chamber required to approve it, the expenditure bill becomes the Federal Expenditure Budget, which provides the authority for incurring expenses during the relevant fiscal year. In addition, the Chamber of Deputies is obligated to review, on a yearly basis, the Public Account, which sets forth the expenditures actually made by the ministries and the budget-controlled agencies.

Under the Constitution, no payment may be made by any ministry or budget-controlled agency unless it is included in the Federal Expenditure Budget or approved under a law subsequently passed by Congress. However, under the Federal Expenditure Budget for 1998 and the Federal Annual Revenue Law for 1998, approved by the Congress in December 1997 (collectively, the "1998 Budget"), the President is authorized to approve additional expenditures for investment in projects having a social benefit or in programs considered to have priority or to be strategically important to the Government, such as rural development, marketing of agricultural products, education, health, housing, transportation and communications, infrastructure and the environment, if there are excess revenues with respect to certain items specified in the Federal Expenditure Budget. At the time the Public Account is submitted for review, the President must inform the Chamber of Deputies of any expenditures made pursuant to this authority.

Treatment of Public Sector Agencies and Enterprises. The federal budget includes the revenues and expenditures of the Government and of certain agencies and enterprises, including for example, Petróleos Mexicanos, whose budgets require specific legislative approval ("budget-controlled agencies"). The overall public sector budget and the revenues and expenditures information included herein are prepared on a consolidated basis, including not only the revenues and expenditures of the Government and budget-controlled agencies, but also of other public sector agencies and enterprises whose budgets are not subject to legislative approval ("administratively controlled agencies"), such as NAFIN, Bancomext and the Mexico City subway system. The budgets of administratively controlled agencies are subject to Governmental review and, as with the budget-controlled agencies, approval of the Ministry of Finance and Public Credit is required for their borrowings. In some instances, borrowings of budget- and administratively controlled agencies are guaranteed by Mexico whether by law or pursuant to contractual arrangements.

Measures of Fiscal Balance. Mexico reports its fiscal balance using four principal measures:

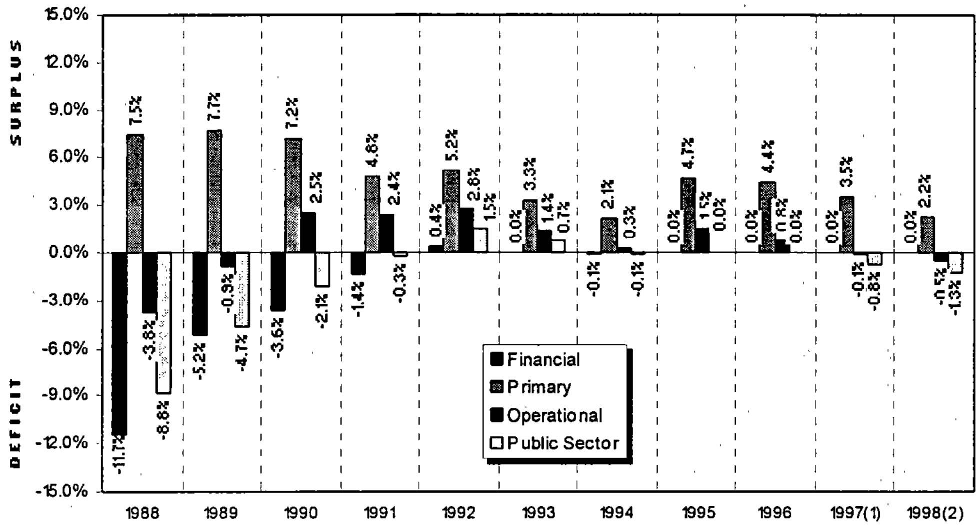
- *Financial balance*, which when in deficit is referred to as the Public Sector Borrowing Requirement ("PSBR"), is calculated as consolidated public sector revenues minus expenditures, including public sector interest expense, but excluding proceeds of privatization. Prior to 1993, this was the principal measure of fiscal balance. Beginning with 1993, however, in connection with the exclusion of the effects of financial intermediation from the calculation of Mexico's fiscal balance, the Government no longer calculates financial balance and has replaced this measure with public sector balance.

- *Public sector balance*, which prior to 1993 was referred to as "economic balance", is calculated in the same manner as financial balance, except that it does not take into account the effects of financial intermediation. Public sector balance has, since 1993, superseded financial balance as the principal measure of fiscal balance.

- *Primary balance*, which is the economic balance or, from 1993 onwards, public sector balance, less net borrowing costs of the Government, that is, the balance of revenues and expenditures of the non-financial public sector, excluding interest payments. The primary balance is also reported without giving effect to proceeds of privatizations. This balance is used to measure the effect of discretionary actions taken to control expenditures and increase revenues.

- *Operational balance*, which is similar to the primary balance but excludes only the inflationary component of interest payments on domestic debt of the non-financial public sector. This balance is used to correct the distortions that affect the measurement of public finances in an inflationary environment.

Public Finance Indicators 1988-1998
(percentage of GDP)



(1) Preliminary.
(2) Budget estimates as set forth in the Criterios Generales de Política Económica 1998 (General Economic Policy Guidelines for 1998).
Source: Ministry of Finance and Public Credit.

Fiscal Policy

The rationalization of public expenditure and the augmentation of revenue have been important components of the Government's economic stabilization strategy. The Government's fiscal policy has had two fundamental objectives: to establish the macroeconomic foundation for sustained growth and to focus the Government's resources on those sectors in which the Government can have the greatest impact in supporting social development and the competitiveness of the Mexican economy.

At present, the Government's principal short-term fiscal policy objectives, in addition to countering inflation, are:

- strengthening economic activity and exports;
- maintaining an adequate surplus in the Government's primary balance and incurring only a moderate public sector deficit;
- continuing the promotion of fiscal federalism; and
- increasing the efficiency and competitiveness of the economy and the effectiveness of the tax collection system.

The Government's principal fiscal policy objectives over the medium-term are:

- a significant reduction of the inflation rate to levels approximating those of Mexico's major trading partners.
- consolidating the process of sustainable economic growth;
- promoting private sector savings;
- the continued modernization of the economy; and

- strengthening social policy through increased real spending on social development.

1998 Budget

The principal objectives of the 1998 Budget are to strengthen the conditions for sustainable economic growth, with a particular emphasis on job creation through private investment in productive activities, taking advantage of the dynamism of the exporting sector and public investment. The 1998 Budget stresses careful management of public finance, macroeconomic stability, structural adjustment and modernization of the economy. The 1998 budget projects a public sector deficit of 1.25% of GDP. If the total social security system reform expenditures of 1.47% of GDP are not taken into consideration, the Government expects the public sector balance for 1998 to result in a surplus of 0.22% of GDP.

Under the 1998 Budget, the Government estimates that it will devote Ps. 146.711 billion (23.1% of total budgetary programmable expenditures) to education and Ps. 155.446 billion (25.8% of total budgetary programmable expenditures) to health and social security. The Government also estimates that it will devote Ps. 33.909 billion to regional and urban development and Ps. 10.833 billion to social spending and nutrition. In addition, the 1998 Budget contemplates that Ps. 113.398 billion will be used for the debt service of the Government and Ps. 20.480 billion for debt service of public sector agencies included in the 1998 Budget. Under the 1998 Budget, the Government is authorized to incur up to the equivalent of U.S. $5 billion of net external debt in 1998.

In January 1998, the Ministry of Finance and Public Credit announced a reduction in public expenditures in the amount of Ps. 15,273 million, equivalent to 0.4% of the projected GDP. The reduction was made in response to the expected decrease in revenues due to the decline in international oil prices, and was intended to prevent any increase in the public sector deficit for 1998. The reduction has been reflected in the Government's ordinary and investment expenditures. The decrease in ordinary expenditures will likely limit the creation of new jobs in governmental agencies and reduce administrative overhead in governmental agencies. The decrease in investment expenditures will result in the postponement of pending projects, but will not affect the continuation of infrastructure projects oriented to attract private investment.

In order to stabilize world crude oil prices, on March 22, 1998, the Government and the governments of Venezuela and Saudi Arabia announced that their three countries had agreed, beginning on April 1, 1998, to reduce their exports of crude oil by 100,000 bpd, 200,000 bpd and 300,000 bpd, respectively. On June 4, 1998, the same countries announced that they would cut their collective crude output by an additional 450,000 bpd beginning July 1, 1998. Pursuant to the June 4, 1998 agreement, Saudi Arabia will reduce its output by an additional 225,000 bpd, Venezuela by an additional 125,000 bpd and Mexico by an additional 100,000 bpd. Although certain other petroleum-exporting nations have reduced their crude oil exports, neither the Government nor Pemex can predict whether such actions will stabilize world oil prices. Both agreements will be effective until the end of 1998.

Despite the agreement described above, and in response to continuing drops in world crude oil prices, on March 24, 1998, the Ministry of Finance and Public Credit announced a downward revision to the 1998 Budget assumption of a weighted average export price per barrel of Mexican crude oil, from U.S. $13.50 to U.S. $12.50. In light of this downward revision and in order to adhere to its original goal of a budget deficit equal to 1.25% of GDP, the Government also announced a second reduction in public expenditures of Ps. 9,000 million, equivalent to 0.2% of projected GDP for 1998.

During the first quarter of 1998, the public sector primary surplus (revenues minus non-interest expenditures) was approximately Ps. 27.0 billion in nominal terms, a decrease of approximately 46.7% in real terms from the surplus for the same period of 1997. The overall public sector balance during the first quarter of 1998 was a surplus of approximately Ps. 1.7 billion in nominal terms, a decrease of approximately 92.1% from the public sector surplus in the same period of 1997. During the first quarter of 1998, the Government implemented two budget cuts totaling 0.64% of GDP to compensate for the downward revision in the expected weighted average price of crude oil exported by Pemex in 1998 (from U.S. $15.50 to U.S. $12.50 barrel). Although tax revenues increased by 18.4% in real terms in the first quarter, total public revenues fell by 6.0%, largely due to the decline in oil-related revenues. Oil revenues represented 32% total revenues during the first quarter of 1998 as compared with 38% during the first quarter of 1997.

In response to continued low crude oil prices, on July 8, 1998, the Government announced a third downward revision to its 1998 Budget assumption of a weighted average export price per barrel of Mexican crude oil, from U.S. $12.50 to U.S. $11.50, which corresponds to an approximately Ps. 9,800 million shortfall in oil revenues. To compensate for this shortfall and to adhere to its original goal of a budget deficit equal to 1.25% of GDP, the Government announced a Ps. 5,500 million reduction in public sector expenditures, equivalent to 0.15% of the Government's projected GDP for 1998, including a Ps. 2,550 million reduction in Pemex's budget. The Government expects that the remainder of the shortfall will be compensated by (i) a reduction of Ps. 1,000 million in the resources of certain public funds and trusts, (ii) Ps. 1,800 million of higher than expected privatization revenues and (iii) Ps. 1,500 million of higher than expected tax revenues in the first five months of 1998. The third budget reduction, when added to those implemented in January and March, brings the total reductions in 1998 public sector expenditures to Ps. 36,247 million, equivalent to 0.96% of projected GDP for 1998. No changes in the 1998 Budget with respect to the Government's welfare programs and the federal contributions to states and municipalities are expected to result from the three budget adjustments announced in 1998.

The assumptions and targets underlying the 1998 Budget embodied in the *Criterios Generales de Política Económica* ("General Economic Policy Guidelines for 1998"), results for 1996 and preliminary results for 1997 and the first quarter of 1998 are set forth below:

1996 and Preliminary 1997 and 1998 First Quarter Results;
1998 Budget Assumptions and Targets

	1996 Results	Preliminary 1997 Results	First three months of 1998	1998 Budget
Real GDP growth	5.2%	7.0%	6.6%	5.0%
Increase in NCPI	27.7%	15.7%	5.2%	12.0%
Average export price of Mexican oil mix	$18.94/barrel	$16.46/barrel	$10.75/barrel	$11.50/barrel
Current account deficit as % of GDP	(0.7%)	(1.8%)	(0.8%)	(2.49%)
Average exchange rate	Ps.7.598/$1.00	Ps.7.918/$1.00	Ps. 8.413	Ps. 8.74/$1.00
Average rate on 28-day *Cetes*	31.4%	19.8%	18.8%	18.71%
Public sector balance as % of GDP	0.0%	(0.8%)	0.2%	(1.3%)
Primary balance as % of GDP	4.4%	3.5%	3.0%	2.2%

Source: Ministry of Finance and Public Credit.

Revenues and Expenditures

The following table sets forth for the consolidated public sector revenues and expenditures and total public sector borrowing requirements for the five fiscal years ended December 31, 1997 and budgetary estimates for 1998.

Selected Public Finance Indicators

	1993	As a % of GDP	1994	As a % of GDP	1995	As a % of GDP	1996	As a % of GDP	1997[1]	As a % of GDP	Budget 1998[3]	As a % of GDP
					(in billions of pesos)(2)							
1. Budgetary revenues...........	Ps.290.7	23.1%	Ps. 298.9	22.8%	Ps. 280.6	22.8%	Ps. 300.3	23.2%	Ps. 317.3	22.9%	Ps. 309.2	21.2%
Federal Government...........	160.0	12.7	198.8	15.2	187.6	15.2	203.0	15.7	218.6	15.8	217.3	14.9
Public enterprises and agencies...........................	130.7	10.4	100.1	7.6	92.9	7.6	97.3	7.5	98.7	7.1	91.9	6.3
2. Budgetary public sector outlays..............................	282.2	22.5	303.0	23.1	282.7	23.0	302.0	23.3	326.7	23.6	327.7	22.5
(a) Budgetary primary expenditures (excluding interest payments)..............	248.8	19.8	272.6	20.8	225.9	18.4	244.8	18.9	270.4	19.5	278.6	19.1
Programmable.................	207.4	16.5	229.6	17.5	189.3	15.4	204.8	15.8	223.8	16.2	228.5	15.7
Non-programmable...........	41.4	3.3	43.0	3.3	36.6	3.0	40.0	3.1	46.6	3.4	50.2	3.4
(b) Interest payments (budgetary sector)..............	33.3	2.7	30.4	2.3	56.8	4.6	57.1	4.4	56.3	4.1	49.1	3.4
3. Budgetary primary surplus (1-2(a))..............................	41.9	3.3	26.3	2.0	54.7	4.4	55.4	4.3	46.9	3.4	30.6	2.2
4. Off-budgetary primary surplus..............................	0.1	0.0	0.9	0.1	2.8	0.2	1.2	0.1	0.9	0.1	0.7	0.1
5. Total primary surplus (3+4).	42.0	3.3	27.2	2.1	57.5	4.7	56.7	4.4	47.8	3.5	31.3	2.2
6. Total interest payments (budgetary and off-budgetary).........................	33.6	2.7	30.6	2.3	57.0	4.6	57.3	4.4	56.5	4.1	49.5	2.1
7. Statistical discrepancy.........	0.2	0.0	1.8	0.1	(0.6)	(0.0)	0.8	0.1	(2.1)	(0.1)	–	–
8. Public sector balance (economic surplus (deficit)) (on a cash basis) (5-6+7)....	8.2	0.7	(1.6)	(0.1)	(0.1)	(0.0)	0.1	0.0	(10.7)	(0.8)	(18.2)	(1.3)

Note: Totals may differ due to rounding.
(1) Preliminary.
(2) Constant pesos with purchasing power at December 31, 1993.
(3) Budgetary estimates.
Source: Ministry of Finance and Public Credit.

In 1997, Mexico registered a public sector deficit of Ps. 24,555 million in nominal terms, or approximately Ps. 10.7 billion in constant 1993 pesos. The larger deficit, which equaled 0.8% of 1997 GDP, is explained by the increase in expenditures to pay the costs related to the programs to support debtors and strengthen the banks, which represented 1.23% of GDP in 1997. Excluding such expenditures would result in a public sector surplus equal to 0.47% of GDP. The primary surplus for 1997 was Ps. 110,114 million in nominal terms, or approximately Ps. 47.8 billion in constant pesos, or 3.5% of GDP. This figure attests to the Federal Government's success in maintaining healthy public finances, surpassing the 1997 goal for a primary surplus equal to 3.37% of GDP. The commitment to maintain sound public finances has helped to stabilize the principal macroeconomic indicators, a necessary step towards achieving sustained growth in production and increasing and stimulating internal savings and investment.

Revenues, Taxation and Expenditures

Revenues. Fiscal measures have been taken to increase the Government's primary balance and promote private-sector savings. Under the 1995, 1996 and 1997 Accords, the Government increased the prices of goods and services (including natural gas, gasoline, electricity and transportation prices) provided by the public sector to reflect international prices and eliminate subsidies. See "—The Government's Response—Social Accords".

During 1997, budgetary public revenues increased by 5.7% in real terms in comparison with 1996. Of the total budgetary revenues, non-oil revenues represented 63.4% of all revenues, representing an increase of 8.1% in real terms, while oil revenues represented 36.6% of all revenues, representing an increase of 1.7% in real terms. The increase in the non-oil revenues is due primarily to a corresponding increase in Federal Government tax revenues, which grew by 13.8% in real terms. The most notable increases in tax revenues came from the income tax and the VAT. Revenues from these taxes increased primarily as a result of the economic growth, fiscal reforms improving tax collection and other fiscal measures adopted by the Federal Government. Moreover, revenues from entities under direct budgetary control increased by 3.4% in real terms. Non-tax revenues decreased by 1.8% in real terms from 1996 to 1997 principally due to a reduction in the profits generated from the operations of Banco de México, which fell from Ps. 20 billion in 1996 to Ps. 4 billion in 1997.

Public sector budgetary revenues decreased as a percentage of real GDP, from 23.1% in 1993 to 22.9% of GDP in 1997.

Taxation. Mexico's federal tax structure includes both direct taxation through income taxes and indirect taxation through VAT. Income taxes consist of the corporate tax and the individual tax. The corporate tax is levied at a flat rate and the individual tax is levied at progressive rates. At present, the income tax rate for corporations and certain self-employed individuals is 34%. Withholding taxes related to interest payments made by Mexican companies to non-residents of Mexico is imposed at a rate of 15% (or, in certain circumstances at the rate of 4.9%) for securities registered with the Special Section of the registry maintained by the CNBV, and at rates ranging form 4.9% to 35% for other obligations.

The VAT is imposed at a fixed rate which is passed through the manufacturing and distribution chain until it becomes part of the purchase price to the consumer. Certain goods and services qualify for an exemption from or a reduced rate of VAT, such as exports, which are exempt from VAT. In 1995, as part of the fiscal reforms implemented by the Government following the devaluation of the peso, the general VAT rate was increased from 10% to 15% (except in the border region with the United States and in duty-free zones, where the VAT rate remained at 10%, and except with respect to pharmaceutical products and food, which continued to be subject to a VAT rate of 0%).

In 1989, Mexico introduced the *Ley del Impuesto al Activo* (the Asset Tax Law), an alternative form of minimum income tax on corporations and individuals engaged in business activities, aimed at reducing tax evasion. The tax (the "Asset Tax") is assessed at a rate of 2% on the aggregate book value of the assets owned by a company in each fiscal year. Income tax payments may be credited against the Asset Tax. The Government believes that the Asset Tax has been helpful in increasing tax collections.

In July 1996, the Government announced a support program for the benefit of taxpayers owing past-due taxes to the Government. Under this program, taxpayers who owe Ps. 5,000 or less in past-due taxes imposed before May 31, 1996 were granted a 50% reduction in the past-due taxes owed, provided they paid the remaining balance (after such reduction) before the end of 1996. Taxpayers owing past-due taxes greater than Ps. 5,000 but less than Ps. 500,000 are allowed to restructure such past-due taxes over six years, provided that they joined the support program by October 31, 1996. In addition, with respect to restructured payments made from August to December 1996, taxpayers would be entitled to a discount in connection with each such payment, ranging from 25% in August to 15% in December, provided that the discounted amount could not exceed the amount of Ps. 125,000. Taxpayers owing past-due taxes greater than Ps. 500,000 were entitled to the benefits of the program similar to those of taxpayers who owe between Ps. 5,000 and Ps. 500,000, but only with respect to the first Ps. 500,000 of back taxes. Taxpayers who are in arrears may participate in the support program until December 31, 1998. For taxpayers who are in arrears for amounts in excess of Ps. 5,000, all restructured amounts paid during 1998 will reflect a 30% discount from the original amount with respect to which payment is being made. In addition, the taxpayer is entitled to a 5% discount in the amount of taxes owed with respect to the last payment made.

During 1997, fiscal policy was oriented towards strengthening and consolidating economic growth. To this end, the Government enacted certain policies to stimulate employment and investment, mainly: (a) businesses that in 1996 accumulated income up to Ps. 8.9 million were exempted from the Asset Tax in 1997, (b) businesses whose investments in 1997 exceeded their investments in 1995 were allowed to deduct a total of 62.5% of the amount of such additional investment, (c) businesses that in 1997 employed a greater average number of workers than in 1996 were granted a credit that could be applied against their taxes on income and assets for 1997; this credit was equal to 20% of the yearly minimum wage of each additional worker, and (d) to stimulate the creation of employment in the automotive industry, businesses were allowed to deduct, without any conditions, up to 71% of their investments in new automobile production.

Certain changes to the tax laws to strengthen the income of the states and their participation in the tax system eliminated the exclusive power of the Government to impose certain special taxes. Since 1997, local governments have been permitted to impose (in addition to the federal taxes on these items), taxes on lodging services and new vehicles. Moreover, local governments are now able to require retail commercial establishments selling alcoholic beverages to obtain local licenses. Finally, a percentage of excise tax collections will be directly allocated to the states.

In 1990, Mexico began to negotiate bilateral treaties for the avoidance of double taxation with several countries. Double taxation treaties with Canada, the United States, Germany, France, Sweden, Spain, the Netherlands, the United Kingdom, Switzerland, Italy, Norway, South Korea, Japan, Denmark and Belgium are in effect in Mexico, and double taxation treaties with Ecuador and Singapore have been executed and ratified by the Mexican Senate. Negotiation of double taxation treaties with Romania, India, Finland, Austria, Australia, Argentina, Venezuela and Israel has been completed. Tax treaties with Brazil, Ireland, Poland, Malaysia, China, Chile, Hungary, Indonesia and Nicaragua are under negotiation. Finally, it is anticipated that tax treaties with Colombia, the Czech Republic, Thailand and Panama will be negotiated.

PUBLIC DEBT

General

Mexico's General Law of Public Debt, effective January 1, 1977, is designed to improve control of the public sector's access to domestic and international financial markets. Public borrowing programs contained in the Annual Revenue Law must be submitted annually to Congress for approval. The Executive Branch, through the Ministry of Finance and Public Credit, formulates a financial program on the basis of this authorization. The General Law of Public Debt also requires that the President inform Congress annually of the status of the indebtedness of the Government and budget-controlled agencies when presenting the Public Account and proposing the Annual Revenue Law and report to Congress on a quarterly basis on the status of such indebtedness. See "Public Finance—General—Budget Process".

The General Law of Public Debt specifies that the ministries comprising the Government may only contract financings through the Ministry of Finance and Public Credit. Budget- and administratively controlled agencies may only incur external indebtedness after obtaining the prior authorization of the Ministry of Finance and Public Credit.

Internal Public Debt

Internal debt is presented herein on a "net" basis, and includes the internal debt of the Government and budget controlled agencies, excluding Banco de México's General Account Balance (which was negative at March 31, 1998, indicating monies owed to the Government) and the assets of the *Fondo del Sistema de Ahorro Para el Retiro* (the Retirement Savings System Fund). In addition, net internal debt includes Tesobonos (short-term notes denominated in dollars but payable in pesos indexed to the value of the dollar) and other securities sold to the public in primary auctions, but not such debt allocated to Banco de México for its use in regulating liquidity (*"Regulación Monetaria"*). See footnote 2 to the table "Net Internal Public Debt" below.

Total net internal debt of the Government and budget-controlled agencies at March 31, 1998, was equivalent to U.S. $31.6 billion, a decrease of U.S. $0.6 billion from the U.S. $32.2 billion outstanding net internal public debt at December 31, 1997.

The outstanding principal amount of Tesobonos was reduced sharply during 1995, from U.S. $29.2 billion at December 31, 1994 to U.S. $246 million at December 31, 1995, a cumulative 99.2% decrease. By February 16, 1996, there were no outstanding Tesobonos, and Mexico has not issued Tesobonos since that date. At December 31, 1997, 100% of Mexico's net internal debt was denominated and payable in pesos, as compared with only 44.3% of such debt at the end of 1994.

The following table summarizes the net internal public debt of the Government and the budget-controlled agencies at each of the dates indicated.

Net Internal Public Debt

	December 31,					March 31,
	1993	1994	1995	1996	1997	1998
	(in billions of dollars)					
Total net internal debt (2)	$40.1	$31.4	$17.2	$23.1	$32.2	$31.6
Government	39.4	30.9	17.1	22.8	32.1	31.4
Peso-denominated	38.2	13.7	16.8	22.8	32.1	31.4
Foreign currency-denominated (Tesobonos) (2)	1.2	17.2	0.2	0.0	0.0	0.0
Budget-controlled agencies	0.7	0.5	0.2	0.3	0.1	0.2
Peso-denominated	0.4	0.2	0.1	0.1	0.0	0.0
Foreign currency-denominated	0.3	0.3	0.1	0.2	0.1	0.2

Note: Totals may differ due to rounding.
(1) Preliminary.
(2) Does not include Tesobonos sold by Banco de México in open-market operations pursuant to *Regulación Monetaria*, which amounted to approximately U.S. $2.6 billion at December 31, 1994. *Regulación Monetaria* does not increase the Government's overall level of internal debt, because Banco de México must reimburse the Government for any allocated debt that Banco de México sells into the secondary market and that is presented to the Government for payment. If Banco de México undertakes extensive sales of allocated debt in the secondary market, however, *Regulación Monetaria* can result in a situation in which the level of outstanding internal debt is higher than the Government's figure for net internal debt.
Source: Ministry of Finance and Public Credit.

External Debt

The following table sets forth a summary of the external public debt of Mexico, which includes the external debt of the Government, the budget-controlled agencies and the administratively-controlled agencies and a breakdown of such debt by currency. External public debt as used in this section does not include, among others, repurchase obligations of Banco de México with the IMF. See footnote 1 to the table "Summary of External Public Debt" below.

Summary of External Public Debt(1)
By Type

	Long-Term Direct Debt of the Federal Government	Long-Term Debt of Budget Controlled Agencies	Other Long-Term Public Debt(2)	Total Long-Term Debt	Total Short-Term Debt	Total Long- and Short-Term Debt
	(in millions of dollars)					
December 31,						
1993	$40,528	$7,112	$26,861	$74,501	$4,246	$ 78,747
1994	40,617	9,138	29,327	79,082	6,354	85,436
1995	54,314	8,318	31,105	93,737	7,197	100,934
1996	55,569	9,172	28,553	93,294	4,991	98,285
1997	48,827	9,514	25,920	84,261	4,060	88,321
March 31, 1998	49,140	9,426	24,999	83,565	4,952	88,517

(footnotes appear on the following page)

By Currencies (3)

	December 31,										March 31,	
	1993		1994		1995		1996		1997		1998	
	(in millions of $)	(%)	(in millions of $)	(%)	(in millions of $)	(%)	(in millions of $)	(%)	(in millions of $)	(%)	(in millions of $)	(%)
U.S. Dollars	$64,818	82.3	$70,569	82.6	$86,902	86.1	$81,757	83.2	$71,750	81.3	$72,503	81.9
Japanese Yen	6,589	8.4	7,153	8.4	6,288	6.2	7,802	7.9	6,881	7.8	6,596	7.4
Deutsche Marks	2,460	3.1	2,699	3.2	2,593	2.6	3,239	3.3	3,940	4.4	3,812	4.3
Pounds Sterling	594	0.8	524	0.6	478	0.5	480	0.5	903	1.0	903	1.0
French Francs	2,338	3.0	2,511	2.9	2,620	2.6	2,317	2.4	1,909	2.2	1,843	2.1
Swiss Francs	313	0.4	337	0.4	370	0.4	302	0.3	268	0.3	254	0.3
Others	1,635	2.1	1,643	1.9	1,683	1.6	2,389	2.4	2,670	3.0	2,606	3.0
Total	$78,747	100.0	$85,436	100.0	$100,934	100.0	$98,285	100.0	$88,321	100.0	$88,517	100.0

Note: Totals may differ due to rounding.

(1) External debt denominated in foreign currencies other than dollars has been translated into dollars at exchange rates as of each of the dates indicated. External public debt does not include (a) repurchase obligations of Banco de México with the IMF, of which the equivalent of U.S. $9.0 billion was outstanding at March 31, 1998 (using an exchange rate of one SDR = U.S. $1.3357), (b) external borrowings by the public sector after March 31, 1998, including approximately U.S. $2.9 billion in capital market financings and (c) loans from the Commodity Credit Corporation to public sector Mexican banks. External debt is presented herein on a "gross" basis, and includes external obligations of the public sector at their full outstanding face or principal amount. For certain informational and statistical purposes, Mexico sometimes reports its external public sector debt on a "net" or "economic" basis, which is calculated as the gross debt net of certain financial assets held abroad. These financial assets include the value of principal and interest collateral on restructured debt (see "—External Debt Restructuring and Debt and Debt Service Reduction Transactions" below) and Mexican public sector external debt that is held by public sector entities but that has not been canceled.

(2) Including development banks and other administratively-controlled agencies whose finances are consolidated with the Government.

(3) Adjusted to reflect the effect of currency swaps.

Source: Ministry of Finance and Public Credit.

The total external debt of the public sector consists of the external portion of the long-term indebtedness incurred directly by the Government, the external long-term indebtedness incurred by budget-controlled agencies and the external long-term indebtedness incurred directly or guaranteed by administratively controlled agencies (including but not limited to national development banks), and the short-term debt of the public sector. Private-sector debt guaranteed by the Government is not included unless and until the Government is called upon to make payment under its guaranty. For purposes hereof, long-term debt includes all debt with maturities of one year or more from the date of issue.

During the period from 1988 to 1990, much of Mexico's bank credits were transformed into bonds through two debt exchange transactions. See "—External Debt Restructuring and Debt and Debt Service Reduction Transactions" below. Since 1990, the majority of public sector's new external borrowings have consisted of debt securities placed in the international capital markets, although during the 1995 financial crisis official creditors provided important amounts of financing. See "The Economy—The Government's Response—International Support". At December 31, 1997, commercial banks held approximately 11.2% of Mexico's total public sector external debt (excluding bonds issued in debt exchange transactions), multilateral and bilateral creditors (excluding the IMF) held 31.6%, bondholders (including commercial banks holding bonds issued in debt exchange transactions) held 57.2% and suppliers held the remainder (less than 0.1%).

At December 31, 1997, Mexico's gross external debt totaled U.S. $88.3 billion, a 10.1% decrease from the level at December 31, 1996. Of this amount, U.S. $84.3 billion represented long-term debt and U.S. $4.0 billion represented short-term debt, as compared to U.S. $93.3 billion of long-term debt and U.S. $5.0 billion of short-term debt at December 31, 1996. At March 31, 1998, Mexico's gross external public sector debt totaled U.S. $88.5 billion. Of this amount, U.S. $83.6 billion represented long-term debt and U.S. $4.9 billion represented short-term debt. Overall, total public debt (gross external debt plus net internal debt) at March 31, 1998 represented approximately 28.4% of nominal GDP.

Since March 31, 1998, the Government and public sector entities have issued the following debt securities in the international capital markets: the Government issued Lira 750 billion of 15-year notes in April 1998, and Portuguese escudo 18.5 billion of 5-year notes and U.S. $475 million equivalent of 7-year notes in June 1998, Pemex issued U.S. $350 million of 7-year notes and U.S. $350 million of 20-year bonds in April 1998, Nafin issued U.S. $150 million of 5-year notes in April 1998 and Pemex issued U.S. $1,000 million of 7-year notes in July 1998. In addition, the Government arranged a U.S. $2.5 billion standby credit facility with a group of commercial and investment banks in November 1997 to provide liquidity to Mexico in the event that external shocks or volatility in the international capital markets should limit Mexico's access to other sources of credit. The facility has a term of one year, renewable for another year. To date, Mexico has not needed to borrow any funds under this facility.

The Government's debt policy during the past few years, together with the dynamic behavior of exports, have made possible a significant reduction of interest payments on external public sector debt as a percentage of total exports, with such payments decreasing from 9.3% of total exports in 1993 to 5.9% in 1997. In 1997, interest payments on public sector debt totaled Ps. 129,600 million, a 2.8% decrease in real terms from the amount of such payments in 1996. Debt service payments on public sector debt were equivalent to 4.1% of GDP in 1997, as compared to 3.8% of GDP in 1996. The reduction in debt service costs is attributable to lower domestic interest rates and better debt service terms, including lower financial costs and an improved maturity profile, applicable to public sector debt.

On March 31, 1998, the Government proposed to the Congress legislation which, if enacted, would include as pubic sector debt the liabilities incurred by FOBAPROA in connection with its support of the Mexican financial system during the financial crisis that began with the devaluation of the peso in late 1994. Those liabilities totaled the equivalent of Ps. 552.3 billion at February 28, 1998. If this proposed legislation is enacted, it is estimated that public sector debt as a percentage of GDP will increase by approximately 14.4 percentage points.

External Debt Restructuring and Debt and Debt Service Reduction Transactions

In August 1982, Mexico requested and received from its major commercial bank creditors a 90-day rollover of principal payments on most external public sector debt; bilateral credits were also restructured. No such request was made to bondholders or multilateral financial institutions (primarily the World Bank, the IMF and the IDB) and no restructuring of bond debt or of debt owed to multilateral institutions has taken place since then.

Over the five years following 1982, Mexico and its commercial bank creditors concluded three separate debt restructuring and new money exercises. In 1983, 1985 and 1987, Mexico and the banks agreed to extend the maturities of agreed-upon portions of the outstanding external public sector debt and, in some cases, to alter the interest rates and currencies applicable to the restructured debt. In connection with each restructuring exercise (and with the 1989-92 Financing Package referred to below), Mexico requested and received 90-day rollovers of maturing principal payments pending finalization of documentation for the respective restructurings. During this period, Mexico also entered into agreements with the Paris Club to reschedule payments on loans made or guaranteed by official, bilateral creditors to the Mexican public sector and received support (in the form of structural adjustment and project loans from the World Bank and the IDB and standby facilities, extended fund arrangements and contingency facilities with the IMF) from its multilateral creditors.

The 1989-92 Financing Package for Mexico, implemented in March 1990, was intended to reduce the principal amount of, and the debt service burden associated with, Mexico's commercial bank debt, and to secure sufficient future financing to allow Mexico to resume sustained economic growth. The Financing Package offered commercial banks options for debt reduction, interest reduction and new money. Under the interest reduction option, existing indebtedness was exchanged for 30-year bonds ("Par Bonds") that, in the case of bonds denominated in dollars, bear interest at the fixed rate of 6.25% per annum. Under the principal reduction option, existing indebtedness was exchanged for 30-year bonds ("Discount Bonds") having a principal amount equal to 65% of the principal amount of such existing indebtedness and an interest rate of LIBOR plus 13/16% per annum. Under the new money option, certain banks committed to provide Mexico with new money (through a combination of bonds, traditional bank credits and bank credits prepayable to fund trade credits or public sector loans) over three years in an aggregate amount equal to 25% of their holdings of then-existing indebtedness.

The Discount Bonds and Par Bonds are secured, as to repayment of principal at maturity, by zero-coupon bonds sold to Mexico by the U.S. Treasury Department. Cash and short-term investments under the control of the Federal Reserve Bank of New York, as collateral agent, have been pledged to secure the payment of approximately 18 months of interest on the Discount and Par Bonds. In addition, the Discount Bonds and Par Bonds also provide for certain additional, limited contingent payments based on the performance of Mexico's oil export revenues.

Of the approximately U.S. $48 billion of external debt held by Mexico's commercial bank creditors in 1989, approximately U.S. $43 billion participated in the principal and interest reduction options; approximately U.S. $20.6 billion was exchanged for Discount Bonds and the balance was exchanged for Par Bonds. Thus, Mexico was able to reduce the principal amount of its external debt by approximately U.S. $7 billion. The balance of Mexico's commercial bank creditors agreed to participate in the new money option and to lend Mexico approximately U.S. $1.07 billion in new credits over four years.

In addition to Mexico's strong commitment to work closely with its commercial bank and multilateral creditors on the path to economic recovery, debt reduction has been another of its goals. In mid-1986, Mexico began to authorize the conversion of debt into equity investment as a means of reducing its stock of external obligations. The total value of debt-equity swaps grew from U.S. $363.2 million in 1986 to U.S. $1.48 billion in 1987, when the debt equity conversion program was suspended in order to evaluate the impact on the economy of the program as then structured. In March 1990, Mexico introduced a new debt-equity swap program which was implemented by two auctions of transferable debt conversion rights held in July and October 1990. Proceeds of the conversions could be used only to acquire public sector assets being privatized and to finance infrastructure projects. Pursuant to the program, a total of U.S. $3.5 billion of conversion rights were awarded in the auctions at a discount of approximately 52% of the nominal value of the eligible debt to be converted. Only approximately one-third of these rights (which expired in April 1992) were exercised since Mexico's debt generally traded well above 52% after the issuance of the rights. In addition, since 1989 and through December 31, 1997 approximately U.S. $1.4 billion of debt was acquired by the Government in exchange for peso deposits to non-profit private or public organizations in the principal amount thereof to be used to finance approved education, environmental, housing, public works and other social projects undertaken by nonprofit organizations.

Under a debt-for-debt exchange which took place in the first quarter of 1988, Mexico retired a net amount of U.S. $1.1 billion of commercial bank debt at an average discount of 30.3% through the issuance of 20-year collateralized bonds offered to its bank creditors on an auction basis. Mexico redeemed all of those outstanding collateralized bonds at par in March 1997. In the third quarter of 1991, Mexico issued U.S. $1.151 billion of ten-year floating rate notes, called Floating Rate Privatization Notes, in exchange for the cancellation of U.S. $1.171 billion of deposits held by international commercial banks with foreign branches and agencies of Mexican banks. Virtually all of the Floating Rate Privatization Notes were tendered at par in payment for shares of Mexican commercial banks that were privatized in 1991 and 1992.

In 1992, the Government canceled U.S. $7.181 billion of its external debt acquired through the exercise of the conversion rights described above, through exchanges of debt to fund social projects as described above and through various debt-for-debt exchanges and cash purchases during the 1990-1992 period.

In May 1996, the Government issued U.S. $1.75 billion in 30-year bonds in exchange for the cancellation of U.S. $2.059 billion of its outstanding U.S. dollar-denominated Discount Bonds and U.S. $306 million of its outstanding U.S. dollar-denominated Par Bonds pursuant to an exchange offer open to all of the holders of those bonds. The price at which the bonds were exchanged was determined through a "modified dutch" auction.

Debt Record

Following the 1946 rescheduling of debt incurred prior to the Revolution of 1910, Mexico has not defaulted in the payment of principal or interest on any of its external indebtedness. See "—External Debt Restructuring and Debt and Debt Service Reduction Transactions" above.

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GENERAL INFORMATION

1. The New Notes and the New Bonds have been accepted for clearance through Cedel Bank and Euroclear with Common Codes of 009013130 and 009013164, respectively. The International Securities Identification Numbers for the New Notes and the New Bonds are US71654QAN25 and US71654QAP72, respectively.

2. In connection with the application to list the New Notes and the New Bonds on the Luxembourg Stock Exchange, a legal notice relating to the issue of the New Notes and the New Bonds and copies of the Organic Law and Regulations of the Issuer will be deposited with the *Greffier en Chef du Tribunal d' Arrondissement de et à Luxembourg* (Chief Registrar of the District Court in Luxembourg) where such documents may be examined and copies obtained.

3. The Issuer has obtained the authorization of the Ministry of Finance and all necessary consents, approvals and authorizations in Mexico in connection with the issue of, and performance of its rights and obligations under, the New Notes and the New Bonds, including the registration of the Indenture, the Guaranty Agreement and the forms attached to the Indenture. The issue of the New Notes and the New Bonds was authorized by resolution of the Board of Directors of the Issuer passed on February 18, 1998. The Issuer is obliged and has undertaken to register the New Notes and the New Bonds with the Special Section of the Registry. The Board of Directors of each of Pemex-Refining, Pemex-Gas and Basic Petrochemicals and Pemex-Exploration and Production authorized the signing of the Guaranty Agreement on June 19, 1996 and June 25, 1996.

4. Except as disclosed in this document, there has been no material adverse change in the financial position of the Issuer or the Guarantors since the date of the latest financial statements included herein.

5. Neither PEMEX nor any of the Guarantors is involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the New Notes and the New Bonds nor so far as the Issuer or any of the Guarantors is aware is any such litigation or arbitration pending or threatened.

6. PEMEX is a decentralized public entity of the Government. None of the directors and executive officers of PEMEX are residents of the United States, and all or a substantial portion of the assets of PEMEX and such persons are located outside the United States. It may not be possible for investors to effect service of process within the United States upon PEMEX or such persons or to enforce against any of them in United States courts judgments obtained in United States courts predicated upon the civil liability provisions of the federal securities laws of the United States.

7. Copies of the latest annual report and consolidated accounts of PEMEX including each of the Guarantors (which are consolidated with those of the Issuer) may be obtained, and copies of the Organic Law constituting the Issuer and the Guarantors and of the Indenture, including the forms of New Notes and New Bonds and the Guaranty Agreement, will be available for inspection during usual business hours on any day (except Saturday and Sunday and legal holidays) at the specified offices of the Trustee and the Luxembourg Paying Agent and Transfer Agent, so long as any of the New Notes or the New Bonds are outstanding. The Issuer is not required to, and does not, publish non-consolidated financial statements. The Guarantors do not publish their own accounts and will not publish interim financial statements. The Issuer and the Guarantors do not publish interim consolidated financial statements, the figures set forth on page 54 hereof having been prepared only for the purpose of the Exchange Offers.

8. The principal offices of Coopers & Lybrand, Despacho Roberto Casas Alatriste, auditors of PEMEX, are located at Durango 81, Mexico D.F. 06700, Mexico.

9. The Government is not legally liable for, and is not a guarantor of, the New Notes or the New Bonds.

10. Under Mexican law, all domestic hydrocarbon reserves are permanently and inalienably vested in Mexico and Mexico can exploit such hydrocarbon reserves only through PEMEX.

11. Article 27 of the Constitution, Articles 1, 2, 3 and 4 (and related Articles) of the Regulatory Law, Articles 15, 16 and 19 of the Regulations to the Regulatory Law, Articles 16 and 60 (and other related Articles) of the General Law on National Patrimony, Articles 1, 2, 3 and 4 (and other related Articles) of the Organic Law and Article 4 of the Federal Code of Civil Procedure of Mexico, set forth, *inter alia,* that (i) attachment prior to judgment, attachment in aid of execution and execution of a final judgment may not be ordered by Mexican courts against property of the Issuer and the Subsidiary Entities, (ii) all domestic petroleum and hydrocarbon resources (whether solid, liquid or in gas form) are permanently and inalienably vested in Mexico (and, to that extent, subject to immunity), (iii) (a) the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of crude oil, (b) the exploration, exploitation, production and first-hand sale of natural gas, as well as the transportation and storage inextricably linked with such exploitation and production, and (c) the Petroleum Industry, are reserved exclusively to Mexico (and, to that extent, assets related thereto are entitled to immunity); and (iv) the public entities created and appointed by the Federal Congress of Mexico to conduct, control, develop and operate the Petroleum Industry of Mexico are the Issuer and the Guarantors (and, therefore, entitled to immunity in respect of such exclusive rights and powers). Except for the rights of immunity granted to the Issuer and the Guarantors by the above mentioned provisions, neither the Issuer nor the Guarantors nor their respective properties or assets has any immunity in Mexico from jurisdiction of any court or from set-off or any legal process (whether through process or notice, or otherwise).

12. In the event that proceedings are brought in Mexico seeking performance of the obligations of the Issuer or the Guarantors in Mexico, pursuant to the Monetary Law, the Issuer or any of the Guarantors may discharge its obligations by paying any sum due in currency other than Mexican currency, in Mexican currency at the rate of exchange prevailing in Mexico on the date when payment is made. Such rate is currently determined by Banco de México and published in the *Diario Oficial* every business day in Mexico.

No person has been authorized to give any information or to make any representation in connection with the Exchange Offers other than those contained in this Prospectus and, if given or made, such other information must not be relied upon as having been authorized by the Issuer or any other person. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer or any Guarantor since the date hereof or that the information contained herein is correct as of any time subsequent to its date. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any security other than the securities to which it relates. This Prospectus does not constitute an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful.

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Until October 4, 1998, all dealers effecting transactions in the securities, whether or not participating in this distribution, may be required to deliver a prospectus. This is in addition to the obligations of dealers to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

OFFERS TO EXCHANGE

U.S. $350,000,000
$8^{3}/_{8}\%$ Global Guaranteed Notes due 2005
and
U.S. $350,000,000
$9^{1}/_{4}\%$ Global Guaranteed Bonds due 2018
which have been registered under
the Securities Act of 1933, as amended,
for
any and all of its outstanding unregistered
$8^{3}/_{8}\%$ Global Guaranteed Notes due 2005
and
$9^{1}/_{4}\%$ Global Guaranteed Bonds due 2018,
respectively,

of

Petróleos Mexicanos

jointly and severally guaranteed by

Pemex-Exploración y Producción
Pemex-Refinación
and
Pemex-Gas y Petroquímica Básica

PROSPECTUS

PEMEX

August 24, 1998

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