

Petróleos Mexicanos

(A Decentralized Public Entity of the Federal Government of the United Mexican States)

jointly and severally guaranteed by

Pemex-Exploración y Producción,

Pemex-Refinación and

Pemex-Gas y Petroquímica Básica



US\$350,000,000 8³/₈% Global Guaranteed Notes due 2005

Issue price: 99.782%

US\$350,000,000 9¹/₄% Global Guaranteed Bonds due 2018

Issue price: 99.892%

Issued under Medium-Term Note Program, Series B

The 8³/₈% Global Guaranteed Notes due 2005 (the "Notes") and the 9¹/₄% Global Guaranteed Bonds due 2018 (the "Bonds", and, together with the Notes, the "Securities"), will be issued by Petróleos Mexicanos ("Petróleos Mexicanos" or the "Issuer"), a decentralized public entity of the Federal Government of the United Mexican States ("Mexico"), and are part of a program for the issuance from time to time of Medium-Term Notes, Series B, Due from 1 Year to 30 Years from Date of Issue (the "Program") described in the accompanying Offering Circular dated February 26, 1998 (the "Offering Circular"). The payment of principal of and interest on the Securities will be unconditionally guaranteed jointly and severally by Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica (collectively, the "Guarantors"), each of which is a decentralized public entity of the Federal Government of Mexico. The Notes will mature on March 30, 2005. The Bonds will mature on March 30, 2018. Interest on the Notes will be payable semiannually on March 30 and September 30 of each year, commencing September 30, 1998. Interest on the Bonds will be payable semiannually on March 30 and September 30 of each year, commencing on September 30, 1998.

Application will be made to list the Securities on the Luxembourg Stock Exchange. The Securities have been designated for trading in the PORTAL system of The NASDAQ Stock Market, Inc.

THE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE OFFERED, SOLD OR DELIVERED IN THE UNITED STATES OR TO OR FOR THE ACCOUNT OR BENEFIT OF ANY U.S. PERSON, EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR IN ACCORDANCE WITH AN AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. ACCORDINGLY, THE SECURITIES ARE BEING OFFERED AND SOLD ONLY (A) TO QUALIFIED INSTITUTIONAL BUYERS (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN RELIANCE ON RULE 144A AND (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT. FOR CERTAIN RESTRICTIONS ON TRANSFER, SEE "NOTICE TO INVESTORS" IN THE OFFERING CIRCULAR.

	Price to investors ⁽¹⁾	Discounts and commissions ⁽²⁾	Proceeds to the Issuer ⁽¹⁾⁽³⁾
Per Note	99.782%	.550%	99.232%
Per Bond	99.892%	.875%	99.017%
Total	US\$698,859,000	US\$4,987,500	US\$693,871,500

(1) Plus accrued interest, if any, from April 1, 1998 for the Notes and the Bonds.

(2) The Issuer and the Guarantors have agreed jointly and severally to indemnify the Agents against certain liabilities, including liabilities under the Securities Act.

(3) Before deduction of expenses payable by the Issuer.

The Securities are offered, subject to prior sale, when, as and if accepted by the Agents and subject to the approval of certain legal matters. It is expected that delivery of the Securities will be made on or about April 1, 1998 through the facilities of DTC, Euroclear and Cedel Bank against payment therefor in immediately available funds.

For the Notes:
As Sole Bookrunner,
J.P. Morgan & Co.

SBC Warburg Dillon Read

Goldman, Sachs & Co.

ABN AMRO Incorporated

Barclays Capital

Deutsche Morgan Grenfell Inc.

Société Générale
Securities Corporation

UBS Securities

For the Bonds:
As Sole Bookrunner,
J.P. Morgan & Co.

Goldman, Sachs & Co.

SBC Warburg Dillon Read

Chase Securities Inc.

Lehman Brothers

Merrill Lynch & Co.

Morgan Stanley Dean Witter

Salomon Smith Barney

March 25, 1998

CERTAIN PERSONS PARTICIPATING IN THIS OFFERING (OR, IN THE CASE OF ANY TRANSACTIONS IN THE UNITED KINGDOM, J.P. MORGAN SECURITIES LTD.) MAY ENGAGE IN TRANSACTIONS THAT STABILIZE, MAINTAIN OR OTHERWISE AFFECT THE PRICE OF THE SECURITIES. SPECIFICALLY, J.P. MORGAN SECURITIES INC. MAY OVERALLOT IN CONNECTION WITH THE OFFERING, AND MAY BID FOR, AND PURCHASE, THE SECURITIES IN THE OPEN MARKET. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE “PLAN OF OFFERING”.

This Pricing Supplement is supplementary to, and should be read in conjunction with, the Offering Circular. Terms used but not defined herein have the same meanings as in the Offering Circular. Any reference in the Offering Circular to “Notes” shall be deemed to include the Securities, including the Bonds, described herein.

This Pricing Supplement does not constitute, and may not be used for the purposes of, an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it is unlawful to make such offer or solicitation, and no action is being taken to permit an offering of the Securities or the distribution of this Pricing Supplement in any jurisdiction where such action is required.

No person has been authorized to give any information or to make any representations other than those contained in this Pricing Supplement and Offering Circular and, if given or made, such information or representations must not be relied upon as having been authorized. This Pricing Supplement and Offering Circular do not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or any offer to sell or the solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this Pricing Supplement and Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of PEMEX since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

Except as disclosed herein and in the Offering Circular, there has been no material adverse change in the consolidated financial position of the Issuer and the Guarantors since the date of their consolidated financial statements included in the Offering Circular.

The Issuer will file an application to register the Securities with the Special Section of the National Registry of Securities and Intermediaries of Mexico (the “Special Section of the Registry”) maintained by the Mexican National Banking and Securities Commission. Registration of the Securities with the Special Section of the Registry does not imply any certification as to the investment quality of the Securities, the solvency of the Issuer or the Guarantors or the accuracy or completeness of the information contained herein or in the Offering Circular. The Securities may not be offered or sold publicly in Mexico.

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DESCRIPTION OF SECURITIES

The following items under this heading "Description of Securities" are the particular terms that relate to the Securities that are the subject of this Pricing Supplement.

- | | | | |
|-----|--|---|---------------------------|
| 1. | Tranche No.: | For the Notes: | 2 |
| | | For the Bonds: | 3 |
| 2. | Principal Amount: | For the Notes: | U.S. \$350,000,000 |
| | | For the Bonds: | U.S. \$350,000,000 |
| 3. | Issue Price: | For the Notes: | 99.782% |
| | | For the Bonds: | 99.892% |
| 4. | Issue Date: | April 1, 1998 | |
| 5. | Form of Securities: | Registered Securities | |
| 6. | Authorized Denomination(s): | U.S. \$1,000 and integral multiples thereof | |
| 7. | Specified Currency: | U.S. dollars | |
| 8. | Stated Maturity Date: | For the Notes: | March 30, 2005 |
| | | For the Bonds: | March 30, 2018 |
| 9. | Interest Basis: | Fixed Rate Securities | |
| 10. | Interest Commencement Date (if different from the Issue Date): | For the Notes: | N/A |
| | | For the Bonds: | N/A |
| 11. | Interest Rate: | For the Notes: | 8 3/8% per annum |
| | | For the Bonds: | 9 1/4% per annum |
| 12. | Interest Payment Dates: | For the Notes: | March 30 and September 30 |
| | | For the Bonds: | March 30 and September 30 |
| 13. | Fixed Rate Day Count Fraction: | 30/360 | |
| 14. | Discount Securities: | For the Notes: | No |
| | | For the Bonds: | No |
| 15. | Redemption at the option of the Issuer: | No | |
| 16. | Repayment at the option of the holders: | No | |
| 17. | Indexed Securities: | No | |

18. Additional provisions relating to the Securities:

The Issuer reserves the right to increase the size of the issue of either the Notes or the Bonds, or from time to time, without the consent of the holders of either the Notes or the Bonds, create and issue further securities either having the same terms and conditions thereof, or the same except for the amount of the first payment of interest, which additional securities may be consolidated and form a single series with the Notes or the Bonds, as the case may be.

Pursuant to a registration rights agreement (the "Registration Rights Agreement") to be entered into between the Issuer and the Agents, the Issuer will agree to use its best efforts to (a) file with the United States Securities and Exchange Commission (the "Commission") a registration statement (the "Exchange Offer Registration Statement") on an appropriate form under the Securities Act with respect to an offer to exchange (the "Exchange Offer") the Notes and the Bonds for two series of securities of the Issuer (the "Exchange Notes" and the "Exchange Bonds", respectively, and, together, the "Exchange Securities") with terms identical to the Notes and the Bonds (subject to certain exceptions) within 150 days after the date of issue of the Notes and the Bonds, (b) to use its best efforts to cause such registration statement to become effective under the Securities Act within 240 days after such date of issue and (c) to consummate the Exchange Offer within 270 days after such date of issue. In the event that applicable law, regulation or policy of the Commission does not allow the consummation of the Exchange Offer, or upon the occurrence of certain other conditions, the Issuer may be required to file a "shelf" registration statement covering resales of the Notes and the Bonds by the holders thereof. With respect to any Notes or Bonds, if a Registration Default (as defined herein) relating to the filing or declaration of effectiveness of the Exchange Offer occurs, the per annum interest rate on all outstanding Notes and Bonds or, in the case of all other Registration Defaults, the per annum interest rate on the Notes or Bonds to which such Registration Default relates, will increase by 0.25% per annum with respect to each 90-day period during the existence of such failure, until all Registration Defaults are cured, up to an aggregate maximum of 1.00% per annum over the rates shown on the cover page of this Pricing Supplement. See "Exchange Offer; Registration Rights" below.

Other Relevant Terms

- | | | |
|----|--------------|--|
| 1. | Listing: | Luxembourg Stock Exchange |
| 2. | Syndicated: | Yes |
| 3. | Lead Agents: | For the Notes:
J.P. Morgan Securities Inc.
SBC Warburg Dillon Read
Goldman, Sachs & Co. |

For the Bonds:

J.P. Morgan Securities Inc.

Goldman, Sachs & Co.

SBC Warburg Dillon Read

- 4. Stabilizing Agent in the United Kingdom:**

J.P. Morgan Securities Ltd.

- 5. Commissions and Concessions:**

For the Notes: .550%

For the Bonds: .875%

- 6. Codes:**

- (a) Common Code:

For the Notes: 8600643

For the Bonds: 8600686

- (b) ISIN:

For the Notes: US71654YAE59 (Regulation S Global Security)

For the Bonds: US71654YAF25 (Regulation S Global Security)

- (c) CUSIP

For the Notes: 71654XAE7 (Restricted Global Security)

For the Bonds: 71654XAF4 (Restricted Global Security)

- (d) CINS:

For the Notes: 71654YAE5 (Regulation S Global Security)

For the Bonds: 71654YAF2 (Regulation S Global Security)

- 7. Identity of Agents:**

See "Plan of Offering" below

- 8. Provisions for Registered Securities:**

- (a) Rule 144A eligible:

Yes

- (b) Regulation S Global Security deposited with or on behalf of DTC:

Yes

- (c) Restricted Global Security deposited with or on behalf of DTC:

Yes

- (d) Regulation S Global Security deposited with Common Depositary:

No

- (e) Certificated Securities:

No, except in the limited circumstances described under "Description of Notes—Certificated Notes and Definitive Bearer Notes" in the Offering Circular

- 9. Use of Proceeds (if different from Offering Circular):**

N/A

- 10. Details of any additions or variations to the Distribution Agreement:**

To be set forth under "Plan of Offering" below or in the Terms Agreement

RECENT DEVELOPMENTS

Set forth below is a summary of certain unaudited financial and statistical data of PEMEX as at or for the year ended on December 31, 1997. This summary supplements the information contained in the Offering Circular. Terms defined in the Offering Circular and used but not defined herein have the meanings set forth in the Offering Circular.

Exchange Rates

The Noon Buying Rate for cable transfers in New York reported by the Federal Reserve Bank of New York on March 25, 1998 was Ps. 8.5250 = U.S. \$1.00.

Capitalization

The following table sets forth the capitalization of PEMEX, in accordance with Mexican GAAP, at December 31, 1996 (audited) and December 31, 1997 (unaudited).

	At December 31, 1996 ⁽¹⁾	At December 31, 1997 ⁽²⁾	
	(In millions of nominal pesos or U.S. dollars)		
Long-Term External Debt.....	Ps. 33,425	Ps. 48,075	\$ 5,947
Long-Term Domestic Debt.....	9,110	8,264	1,022
Total Long-Term Debt	42,535	56,339	6,969
Certificates of Contribution.....	22,341	10,222	1,265
Specific Oil-Field Exploration and Depletion Reserve	8,637	8,238	1,019
Revaluation Surplus.....	99,225	100,522	12,436
Retained Earnings (Prior Years)	9,082	19,230	2,379
Income	16,495	7,371	912
Total Equity.....	155,780	145,583	18,011
Total Capitalization ⁽³⁾	Ps. 198,315	Ps. 201,922	\$ 24,980

Note: Totals may differ due to rounding.

- (1) Audited. Includes both the Subsidiary Entities and Subsidiary Companies.
- (2) Unaudited. Includes 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. 8.0833 = U.S. \$1.00 as at December 31, 1997.
- (3) Except for the issue of \$200,000,000 Guaranteed 11.25% Fixed/Reverse Floating Rate Bonds due 2008 in March 1998, there has been no material change in the capitalization of PEMEX since December 31, 1997.

Selected Financial Data

The selected financial data set forth below have been derived from the consolidated financial statements of Petróleos Mexicanos, the Subsidiary Entities and the Subsidiary Companies as at and for the year ended December 31, 1996, which have been audited by Coopers & Lybrand, Despacho Roberto Casas Alatríste, independent accountants, and the unaudited consolidated financial statements of Petróleos Mexicanos and the Subsidiary Entities as at and for the year ended December 31, 1997. For the year ended December 31, 1997, the selected financial data do not include the accounts of Subsidiary Companies. The selected financial data set forth below as at and for the year ended December 31, 1996 should be read in conjunction with, and are qualified in their entirety by reference to, the audited consolidated balance sheets of Petróleos Mexicanos, the Subsidiary Entities and Subsidiary Companies as at December 31, 1996, and the related consolidated statements of income, changes in equity, and changes in financial position for the years then ended (the "1996 Financial Statements") set forth in the Offering Circular.

The Financial Statements are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with NIF-06-BIS/A. See Notes 2(c) and 13 to the 1996 Financial Statements for a discussion of the inflation accounting rules applicable to PEMEX. Mexican GAAP differs in certain significant respects from U.S. GAAP. The material differences as they relate to PEMEX's 1996 Financial Statements are described in Note 15 to the 1996 Financial Statements.

	Year ended December 31,		
	1996 ⁽²⁾ (audited)	1997 ⁽²⁾⁽³⁾ (unaudited)	
	(In thousands of nominal pesos or U.S. dollars)		
INCOME STATEMENT DATA			
Amounts in accordance with Mexican GAAP:			
Total Revenues ⁽²⁾	Ps. 235,819,924	Ps. 259,263,862	\$ 32,074,012
Total Revenues Net of the IEPS Tax.....	216,053,033	221,535,533	27,406,571
Net Sales ⁽²⁾	231,992,934	254,014,339	31,424,584
Income.....	16,494,601	7,371,082	911,890
Approximate Amounts in accordance with U.S. GAAP ⁽¹⁾ :			
Income.....	10,231,096	n.a.	n.a.
BALANCE SHEET DATA (end of period)			
Amounts in accordance with Mexican GAAP:			
Cash and Marketable Securities.....	Ps. 17,999,663	Ps. 14,844,968	\$ 1,836,498
Total Assets.....	312,049,087	318,650,614	39,420,857
Long-Term Debt.....	42,534,637	56,338,936	6,969,794
Total Long-Term Liabilities.....	91,595,615	112,821,098	13,957,307
Equity.....	155,779,537	145,583,487	18,010,403
Approximate Amounts in accordance with U.S. GAAP ⁽¹⁾ :			
Equity.....	69,256,789	n.a.	n.a.
OTHER FINANCIAL DATA			
Amounts in accordance with Mexican GAAP ⁽¹⁾ :			
Depreciation and Amortization	Ps. 10,398,324	Ps. 10,770,102	\$ 1,332,389
Investments at Cost ⁽⁴⁾	18,094,915	n.a.	n.a.
Weighted Average Price for Crude Oil			
Exported by PEMEX.....	\$18.94	\$16.46	\$16.46

n.a. = Not available.

- (1) The financial statements of PEMEX are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with NIF-06-BIS/A. For information concerning the manner in which PEMEX, as opposed to private Mexican corporations, accounts for the effect of inflation, see Notes 2(c) and 13 to the 1996 Financial Statements.
- (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. 37,728 million in 1997. The financial condition and results of operations of the Subsidiary Companies are included for data as, at and for the year ended December 31, 1996, and are not included for data as, at and for the year ended December 31, 1997.
- (3) Conversions into U.S. dollars of amounts in pesos have been made at the established exchange rate for accounting purposes of Ps. 8.0833 = U.S. \$1.00 as at December 31, 1997.
- (4) Includes investments in fixed assets and capitalized interest and excludes certain expenditures charged to the oil field exploration and depletion reserve. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources".

Management's Discussion and Analysis of Financial Condition and Results of Operations

Risk Management and Financial Instruments

Foreign Currency Exchange Rate Risk. Excluding the results of the Subsidiary Companies, PEMEX recorded Ps. 69 million of net foreign exchange losses in the period ended December 31, 1997.

Results of Operations—1997 Compared to 1996

The selected financial data set forth below as at and for December 31, 1997 has been derived from unaudited balance sheets of PEMEX as at such date and related unaudited income statements and include the accounts of Petróleos Mexicanos and the Subsidiary Entities only.

In 1997, PEMEX earned income (before duties) of Ps. 166.5 billion on total revenues (net of the IEPS tax) of Ps. 221.5 billion, as compared with income (before duties) during 1996 of Ps. 161.5 billion on total revenues (net of the IEPS tax) of Ps. 216.1 billion, an increase of 3.1% in such income. For 1997, total revenues (net of the IEPS tax) increased by 2.5%, mainly as a result of higher production volume and sales, and notwithstanding the fall in the weighted average price of crude oil exported by PEMEX. The weighted average price of crude oil exported by PEMEX was U.S. \$16.46 per barrel for 1997 as compared to U.S. \$18.94 per barrel for 1996, a 13.1% decrease in such price. During 1997, PEMEX's income (after taxes and duties) amounted to Ps. 7.4 billion, as compared with earned income (after taxes and duties) during 1996 of Ps. 16.5 billion, a 55.2% decrease in such income, due primarily to the aforementioned decrease in crude oil prices.

Export sales decreased by 12.5% 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. 88.5 billion in 1997, and decreased as a percentage of total sales revenues (net of the IEPS tax), from 47.7% in 1996 to 40.9% in 1997. Excluding the operations of P.M.I. Comercio Internacional, S.A. de C.V. ("PMI Comercio"), crude oil exports accounted for 92% of export sales, petroleum products (including natural gas) accounted for 6% of export sales, and petrochemical products accounted for the remainder of export sales in 1997.

Net of collection of the IEPS tax, domestic sales increased by 14.9%, from Ps. 111.1 billion in 1996 to Ps. 127.7 billion in 1997. Domestic sales of petroleum derivatives (other than natural gas) increased by 16.2% from Ps. 88 billion in 1996 to Ps. 102.3 billion in 1997, led by an increase in the prices of domestic sales. 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. Other income increased from Ps. 3.3 billion in 1996 to Ps. 5.3 billion in 1997.

In addition, in 1997 PEMEX recorded exchange losses of Ps. 68 million, primarily due to the depreciation of the peso in relation to foreign exchange currencies.

Excluding the IEPS tax, total costs and operating expenses increased by 7.3% from Ps. 199.6 billion in 1996 to Ps. 214.2 in 1997, primarily due to a Ps. 12.5 billion increase in cost of sales which resulted from an increase in imports. Cost of sales as a percentage of total net sales (net of the IEPS tax) increased from 26.7% in 1996 to 32.0% in 1997. Transportation and distribution expenses increased by Ps. 2.6 billion over their 1996 level of Ps. 4.9 billion and other expenses (including rental expenses and write-offs of accounts receivable) decreased to Ps. 1,417 million from their 1996 level of Ps. 1,844 million. Net interest income (expense) represented an expense of Ps. 994 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 servicing interest expenses.

Liquidity and Capital Resources

General. PEMEX's total equity as of December 31, 1997 was Ps. 145.6 billion, and its total capitalization (long-term debt plus equity) amounted to Ps. 201.9 billion. During 1997, Petróleos Mexicanos made advance payments to the Government of Ps. 5,804 million of minimum guaranteed dividends relating to the *Certificados de Aportación* ("CAPs"), as compared to Ps. 6,782 million in 1996.

From 1990 through 1997, PEMEX's total indebtedness increased from U.S. \$8.1 billion to U.S. \$11 billion, while PEMEX financed a capital expenditure program that averaged U.S. \$2.6 billion per year during the same period. See "Financial Statements—Consolidated Balance Sheets".

In March 1998, Petróleos Mexicanos placed in the euromarkets ItL 200 billion (equivalent to U.S. \$111.5 million) of guaranteed bonds with a 10-year maturity and a 11.25% fixed rate/reverse floating rate structure.

Results of Operations by Business Segment

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

	Year ended December 31, ⁽¹⁾		Fiscal Year 1997 ⁽²⁾
	1996	1997 ⁽²⁾	vs. 1996
	(In millions of nominal pesos)		
Pemex-Exploration and Production			
Trade sales.....	Ps. 81,337	Ps. 81,653	0.4%
Intersegment sales.....	<u>87,249</u>	<u>91,378</u>	4.7%
Total net sales.....	168,586	173,031	2.6%
Pemex-Refining			
Trade sales.....	101,169	127,838	26.4%
Intersegment sales.....	<u>7,952</u>	<u>8,562</u>	7.7%
Total net sales.....	109,121	136,400	25.0%
Pemex-Gas and Basic Petrochemicals			
Trade sales.....	23,084	31,148	34.9%
Intersegment sales.....	<u>14,662</u>	<u>14,651</u>	(0.1%)
Total net sales.....	37,746	45,799	21.3%
Pemex-Petrochemicals			
Trade sales.....	13,624	13,375	(1.8%)
Intersegment sales.....	<u>4,283</u>	<u>3,496</u>	(18.4%)
Total net sales.....	17,907	16,871	(5.8%)
Corporate and Other and Intercompany Eliminations			
Trade sales.....	12,779	0	(100%)
Intersegment sales.....	<u>(114,146)</u>	<u>(118,087)</u>	3.4%
Total net sales.....	(101,367)	(118,087)	16.5%
Total Sales	<u>Ps. 231,993</u>	<u>Ps. 254,014</u>	9.5%

(1) 1996 figures include Petróleos Mexicanos, Subsidiary Entities and Subsidiary Companies; 1997 figures include Petróleos Mexicanos and the Subsidiary Entities, but not the Subsidiary Companies.

(2) Unaudited.

The table below sets forth PEMEX's income by business segment for the years ended December 31, 1996 and 1997, as well as the percentage change in income for the periods indicated.

	Year ended December 31, ⁽¹⁾		Fiscal Year 1997 ⁽²⁾
	1996	1997 ⁽²⁾	vs. 1996
	(in millions of nominal pesos)		
Exploration and Production.....	Ps. 15,178	Ps. 12,671	(16.5%)
Refining.....	(1,086)	(6,619)	(509.5%)
Gas and Petrochemicals			
Pemex-Gas and Basic Petrochemicals	1,415	2,109	49.0%
Pemex-Petrochemicals.....	1,562	(380)	(124.3%)
Total	2,977	1,729	(41.9%)
Corporate and Other.....	(574)	(410)	28.6%
Total Income	Ps. 16,495	Ps. 7,371	(55.3%)

(1) 1996 figures include Petróleos Mexicanos, Subsidiary Entities and Subsidiary Companies; 1997 figures include Petróleos Mexicanos and the Subsidiary Entities, but not the Subsidiary Companies.

(2) Unaudited.

1997 Compared to 1996. Trade sales relating to exploration and production activities increased 0.4% in peso terms from 1996 to 1997 as a result of lower crude oil prices, which were partially offset by increases in the volume exported, from 1,544,000 bpd in 1996 to 1,721,000 bpd in 1997. The weighted average price of crude oil exported by PEMEX was U.S. \$16.46 per barrel in 1997 as compared to U.S. \$18.94 per barrel in 1996. Intersegment sales increased by 4.7%, as a result of an increase in domestic prices and the sale of higher quality crude oil to affiliates, which resulted in a higher weighted average price for such sales. Income related to exploration and production activities decreased from Ps. 15,178 million in 1996 to Ps. 12,671 million in 1997, mainly as a result of increased costs and expenses relative to revenue, including a decrease in taxes and hydrocarbon extraction duties from Ps. 124,412 million in 1996 to Ps. 120,253 million in 1997.

In 1997, Pemex-Refining registered a loss amounting to Ps. 6,619 million, as compared to a loss of Ps. 1,086 million in 1996. The loss in 1997 in the refining segment was due to an increase in labor-related expenses, increased expenditures related to imported inputs for unleaded gasoline refining as a consequence of environmental regulations as well as increased general costs, expenses and financing costs.

Trade sales related to the natural gas and petrochemical business segment (including Pemex-Petrochemicals) increased by 21.3%, from Ps. 36,708 million in 1996 to Ps. 44,523 million in 1997. The increase in trade sales was driven by increases in the volume of domestic sales of natural and liquid gas, as well as an increase in prices in the domestic market. The volume of domestic sales of natural gas increased by 5.1% from 596.1 bcf in 1996 to 626.7 bcf in 1997; the value of natural gas sales increased by 25.5%, from Ps. 9,999 million in 1996 to Ps. 12,554 million in 1997.

Total costs and operating expenses related to the natural gas and petrochemical business increased by 16.7%, from Ps. 53,920 million in 1996 to Ps. 62,968 million in 1997, due primarily to a Ps. 7,199 million increase in costs of sales and a Ps. 161 million increase in sales and administrative expenses. The increase in cost of sales resulted primarily from materials imported, depreciation and an increase in reserves for retirement payments, pensions and indemnities. The combined income of Pemex-Gas and Basic Petrochemicals and Pemex-Petrochemicals decreased by 42%, from Ps. 2,977 million in 1996 to Ps. 1,729 million in 1997, due to a 14.1% increase in costs of sales of Ps. 7,199 million and a 32% decrease in other revenue of Ps. 497 million during 1997.

Recent Developments

Oil Prices. The weighted average price per barrel of crude oil exported by PEMEX was U.S. \$16.46 in 1997, as compared to U.S. \$18.94 in 1996. At December 31, 1997, the weighted average spot price of crude oil exported by PEMEX was U.S. \$13.43. In February 1998, the average sales price per barrel of West Texas Intermediate ("WTI") crude oil was U.S. \$15.36 as compared to U.S. \$16.69 in January 1998 and \$18.90 in December 1997. PEMEX estimates that during the first quarter of 1998, income from crude oil exports will have decreased by U.S. \$891 million as compared to the same period of 1997.

Exports. 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, in order to stabilize world crude oil prices. Although certain other petroleum-exporting nations have indicated that they are also considering reducing 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. A reduction of PEMEX's crude oil exports by 100,000 bpd would represent a decrease of approximately 6.0% of PEMEX's daily crude oil exports in 1997.

Product Prices. The prices at which PEMEX's products are sold in the domestic market are set by committees composed of representatives of PEMEX and the Government and may differ from international prices. PEMEX's sales revenues (net of the IEPS tax) for these products are linked to their international reference prices. As of March 13, 1998, the retail price of Magna Sin unleaded gas was U.S. \$64.12 per barrel as compared to a retail price of U.S. \$65.68 per barrel of unleaded gasoline in Houston, Texas. See "Business—Commercial Activities".

Business

Production

The following table sets forth the average daily crude oil and natural gas production rates for the years ended December 31, 1996 and 1997.

	Year ended December 31,	
	1996	1997
	(in thousands of bpd)	
Crude Oil.....	2,858	3,022
Condensates ⁽¹⁾	<u>419</u>	<u>388</u>
Total Liquids Production	<u>3,277</u>	<u>3,410</u>
Natural Gas (millions of cfpd)	4,195	4,467

Note: Numbers may not total due to rounding.

(1) Includes NGLs.

Source: PEMEX's December 1997 Indicadores Petroleros.

In 1997, production averaged 3.02 million bpd of crude oil, 4.46 billion cfpd of natural gas and 388,000 bpd of condensates. Crude oil production in 1997 increased 4.06% as compared to 1996, natural gas production in 1997 increased by 6.48% as compared to 1996, and condensates production decreased by 7.39% as compared to 1996. Production of refined products totaled 1.59 million bpd in 1996 and 1.55 million bpd in 1997. Annual petrochemical production totaled 18.4 million tons in 1996 and 16.0 million tons in 1997.

In 1997, Mexico's daily crude oil production was 5.7% greater than in 1996 as a result of increased production of heavy crude oil in the offshore facilities located in the Campeche Sound in the Gulf of Mexico. Total liquids production increased by 4.0% over the 1996 level. Natural gas production increased by 6.5% over the 1996 level.

Refining

Production of refined products (including NGLs) totaled 1,452 thousand bpd in 1997, down from 1,510 thousand bpd in 1996. During 1997, PEMEX imported approximately 299 thousand bpd in 1997 as compared to 177 thousand bpd in 1996.

PEMEX has entered into an eight-year crude oil supply agreement (the "Maya Supply Agreement") with Clark USA, Inc. ("Clark"), under which PEMEX will supply Clark with 150,000 to 210,000 barrels of Maya crude oil per day for refining at Clark's Port Arthur, Texas refinery. The Maya Supply Agreement is expected to go into effect by January 1, 2001. 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 needed to process Maya heavy crude oil.

Commercial Activities

During 1997, the overall increase in the retail price of diesel and gasolines was approximately 18.66% and 17.18%, respectively. At December 31, 1997, the retail price of Nova leaded gasoline was Ps. 2.84 per liter and the retail price of Magna Sin unleaded gasoline was Ps. 2.90 per liter. During 1997, the retail price of unleaded gasoline in Mexico was higher than the price of unleaded gasoline in Houston, Texas.

The following table shows the value of PEMEX's gross sales by product (including the IEPS tax and the value-added tax) for the years ended December 31, 1996 and 1997.

	Year ended December 31, ⁽¹⁾	
	1996	1997
	(In millions of U.S. dollars)	
Crude Oil.....	\$10,705	\$10,312
Natural Gas	1,348	1,623
Refined Products.....	14,856	18,337
Petrochemicals	1,910	1,809
Total	<u>\$28,819</u>	<u>\$32,081</u>
Indirect Taxes		
IEPS	\$2,608	\$4,765

Note: Numbers may not total due to rounding.

(1) 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 Unaudited Financial Statements.

Exports and Imports

The following table shows the average crude oil prices for oil exported by PEMEX during the years ended December 31, 1996 and 1997.

	Year ended December 31,	
	1996	1997
	(In U.S. dollars per barrel)	
Weighted Average Price	\$18.94	\$16.46
Isthmus.....	20.02	18.19
Maya	17.25	14.65
Olmecca.....	21.50	19.52

Source: PEMEX's December 1997 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 years ended December 31, 1996 and 1997.

	Year ended December 31, ⁽¹⁾⁽²⁾	
	1996	1997
	(in thousands, except as provided otherwise)	
Exports:		
Crude Oil (bpd)	1,543.9	1,721.0
Refined Products (bpd).....	90.8	93.0
Petrochemicals (tpy).....	1,123.4	1,061.3
Natural Gas (cfpd).....	36.2	36.8
Imports:		
Refined Products (bpd).....	177.3	298.8
Petrochemicals (tpy).....	90.4	144.4
Natural Gas (cfpd) ⁽³⁾	83.7	108.1

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 December 1997 Indicadores Petroleros.

The following table sets forth the value of exports and imports of crude oil, natural gas and petroleum products for the years ended December 31, 1996 and 1997.

	Year ended December 31, ⁽¹⁾⁽²⁾⁽³⁾	
	1996	1997
	(in millions of U.S. dollars)	
Exports:		
Crude Oil.....	\$10,705	\$10,313
Refined Products.....	709	649
Petrochemicals.....	257	184
Natural Gas.....	32	37
Total Exports.....	\$11,704	\$11,183
Imports:		
Refined Products.....	\$ 1,528	\$ 2,595
Petrochemicals.....	26	27
Natural Gas.....	67	94
Total Imports.....	1,620	2,716
Net Exports.....	\$10,084	\$ 8,467

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 from third parties and resold in the international markets.

Source: PEMEX's 1997 Unaudited Financial Statements.

United Mexican States

External Sector of the Economy—Foreign Trade. 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, in order to stabilize world crude oil prices. Although certain other petroleum-exporting nations have indicated that they are also considering reducing their crude oil exports, no assurance can be given that such actions will stabilize world oil prices and that oil prices will not drop in the future.

Public Finance—1998 Budget. 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 such 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. No changes in the 1998 Budget with respect to the Government's welfare programs and the federal contributions to states and municipalities are expected.

EXCHANGE OFFER; REGISTRATION RIGHTS

Pursuant to the Registration Rights Agreement, the Issuer will agree to use its best efforts to file with the Commission the Exchange Offer Registration Statement on an appropriate form under the Securities Act with respect to an offer to exchange the Notes and the Bonds for the Exchange Notes and the Exchange Bonds. Upon the effectiveness of the Exchange Offer Registration Statement, the Issuer will offer to the holders of the Notes and the Bonds who are able to make certain representations the opportunity to exchange their Notes for Exchange Notes and their Bonds for Exchange Bonds. The Exchange Securities will have terms identical to the Securities, with certain exceptions, including that (i) the Exchange Securities will be issued pursuant to an Indenture between the Issuer and Bankers Trust Company, as Trustee (the "Trustee") and not under the Fiscal Agency Agreement, (ii) the Exchange Securities will not be issued under the Program, and (iii) the Exchange Securities will not contain the restrictions on transfer that are applicable to the Securities. A draft of the Indenture, including the form of Exchange Securities, will be available for inspection during normal business hours at the corporate trust office of the Trustee, which is currently located at Four Albany Street, 7th Floor, New York, New York 10006.

If (i) the Issuer is not permitted to file the Exchange Offer Registration Statement or to consummate the Exchange Offer because the Exchange Offer is not permitted by applicable law or Commission policy, (ii) the Exchange Offer is not consummated within 270 days after the date of issue of the Securities, (iii) any holder of Securities notifies the Issuer within a specified time period that (a) due to a change in law or Commission policy it may not resell the Exchange Securities acquired by it in the Exchange Offer to the public without delivering a prospectus and the prospectus contained in the Exchange Offer Registration Statement is not appropriate or available for such resales by such holder, (b) it is an Agent and owns Securities acquired directly from the Issuer or an affiliate of the Issuer or (c) the Holders of a majority of the Securities may not resell the Exchange Securities acquired by them in the Exchange Offer to the public without restriction under applicable blue sky or state securities laws, then the Issuer will use its best efforts to file with the Commission a shelf registration statement (the "Shelf Registration Statement") to cover resales of all Transfer Restricted Securities (as defined below) by the holders thereof. The Issuer will use its best efforts to cause the applicable registration statement to be declared effective by the Commission as soon as practicable after the filing of such registration statement. For purposes of the foregoing, "Transfer Restricted Securities" means each Security until (i) the date on which such Security is exchanged by a person other than a broker-dealer for an Exchange Security in the Exchange Offer, (ii) following the exchange by a broker-dealer in the Exchange Offer of a Security for an Exchange Security, the date on which such Exchange Security is sold to a purchaser who receives from such broker-dealer on or prior to the date of such sale a copy of a prospectus, (iii) the date on which such Security is effectively registered under the Securities Act and disposed of in accordance with the Shelf Registration Statement, (iv) the date on which such Security is distributed to the public pursuant to Rule 144 under the Securities Act (or any similar provision then in force, but not Rule 144A under the Securities Act), (v) the date on which (A) such Security is otherwise transferred by the holder thereof and a new Security not bearing a legend restricting further transfer is delivered by the Issuer and (B) subsequent disposition of such Security shall not require registration or qualification under the Securities Act or any similar state law then in force or (vi) the date on which such Security ceases to be outstanding.

Under existing Commission interpretations, the Exchange Securities would, in general, be freely transferable after the Exchange Offer without further registration under the Securities Act; *provided* that any broker-dealer participating in the Exchange Offer must deliver a prospectus meeting the requirements of the Securities Act upon any resale of Exchange Securities. Subject to certain exceptions, the Issuer has agreed, for a period of 180 days after consummation of the Exchange Offer, to make available a prospectus meeting the requirements of the Securities Act to any such broker-dealer for use in connection any resale of any Exchange Security acquired in the Exchange Offer. A broker-dealer which delivers such a prospectus to purchasers in connection with such resales will be subject to certain of the civil liability provisions under the Securities Act and will be bound by the provisions of the Registration Rights Agreement, including certain indemnification obligations.

Each holder of Securities that wishes to exchange Securities for Exchange Securities in the Exchange Offer will be required to make certain representations, including representations that (i) any Exchange Securities to be received by it will be acquired in the ordinary course of its business, (ii) it has no arrangement with any person to participate in a distribution of the Exchange Securities and it does not intend to participate in any such distribution and (iii) it is not an "affiliate", as defined in Rule 405 of the Securities Act, of the Issuer, or if it is an affiliate, it will comply (at

its own expense) with the registration and prospectus delivery requirements of the Securities Act to the extent applicable.

If the holder is a broker-dealer that will receive Exchange Securities for its own account in exchange for Securities that were acquired as a result of market-making activities or other trading activities, it will be required to acknowledge that it will deliver a prospectus in connection with any resale of such Exchange Securities.

The Registration Rights Agreement will provide that: (i) unless the Exchange Offer would not be permitted by applicable law or Commission policy, the Issuer will use its best efforts (a) to file the Exchange Offer Registration Statement with the Commission on or prior to 150 days after the date of issue of the Securities, (b) to have the Exchange Offer Registration Statement declared effective by the Commission on or prior to 240 days after the date of issue of the Securities, and (c) to commence promptly the Exchange Offer after such declaration of effectiveness and to issue, on or prior to 270 days after the date of issue of the Securities, Exchange Securities in exchange for all Securities tendered prior to 270 days after the date of issue of the Securities, and (ii) if obligated to file the Shelf Registration Statement, the Issuer will use its best efforts to file the Shelf Registration Statement prior to the later of 150 days after the date of issue of the Securities or 30 days after such filing obligation arises and the Issuer will use its best efforts to cause the Shelf Registration Statement to be declared effective by the Commission on or prior to 90 days after such filing was required to be made, *provided* that if the Issuer has not consummated the Exchange Offer within 270 days after the date of the issue of the Securities, then the Issuer will file the Shelf Registration Statement with the Commission on or prior to the 271st day after the date of issue of the Securities. The Issuer will use its best efforts to keep such Shelf Registration Statement continuously effective, supplemented and amended until the second anniversary of the effective date of the Shelf Registration Statement or such shorter period that will terminate when all the Transfer Restricted Securities covered by the Shelf Registration Statement have been sold pursuant thereto or may be sold pursuant to Rule 144(k) under the Securities Act.

If (i) the Exchange Offer Registration Statement (or a Shelf Registration Statement in lieu thereof) is not filed within 150 days after the date of issue of the Securities, (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 Securities, (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 preceding paragraph 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 preceding paragraph 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 Transfer Restricted Securities 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 Securities, in the case of a Registration Default referred to in clause (i), (ii) or (iii) above, the interest rate on all Notes and Bonds or, in the case of a Registration Default referred to in clause (iv), (v) or (vi) above, the interest rate on the Notes or 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. 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 Securities will revert to the original rate.

PLAN OF OFFERING

Subject to the terms and conditions set forth in a terms agreement dated March 25, 1998 (the "Terms Agreement") among the Issuer and the Agents relating to the Notes and the Bonds, which incorporates by reference the Distribution Agreement, the Agents named below have severally agreed to purchase and the Issuer has agreed to sell to them, severally, at the offering price set forth on the cover page hereof, less discounts and commissions, as set forth on the cover page hereof, the respective principal amounts of Notes and Bonds set forth below:

<u>Agents for the Notes</u>	<u>Principal Amount of Notes</u>
J.P. Morgan Securities Inc.	\$154,000,000
SBC Warburg Dillon Read	154,000,000
Goldman, Sachs & Co.	15,750,000
ABN AMRO Incorporated	5,250,000
Barclays de Zoete Wedd Ltd.	5,250,000
Deutsche Morgan Grenfell Inc.	5,250,000
Société Générale Securities Corporation	5,250,000
UBS Securities LLC	5,250,000
	<u>\$350,000,000</u>

<u>Agents for the Bonds</u>	<u>Principal Amount of Bonds</u>
J.P. Morgan Securities Inc.	\$154,000,000
Goldman, Sachs & Co.	154,000,000
SBC Warburg Dillon Read	15,750,000
Chase Securities Inc.	5,250,000
Lehman Brothers Inc.	5,250,000
Merrill Lynch, Pierce, Fenner & Smith Incorporated	5,250,000
Morgan Stanley & Co. Incorporated	5,250,000
Salomon Brothers Inc	5,250,000
	<u>\$350,000,000</u>

The Terms Agreement provides that the obligations of the several Agents to purchase the Notes and the Bonds are subject to the approval of certain legal matters by counsel and certain other conditions. The Agents are obligated to take and pay for all of the Notes and the Bonds, if any are taken.

The Issuer has been advised that the Agents propose to offer part of the Notes and the Bonds directly to investors at the respective offering prices set forth on the cover hereof and to certain dealers at such offering price less a selling concession not in excess of .375% of the principal amount, in the case of the Notes, or .500% of the principal amount, in the case of the Bonds. The selected dealers may reallow a concession not in excess of .188% of the principal amount, in the case of the Notes, or .250% of the principal amount, in the case of the Bonds, to certain brokers and dealers. After the initial offering, the offering price, the concession to selected dealers and the reallowance may be changed by the Agents.

The Notes and the Bonds may be reoffered by the Agents and resold at negotiated prices which will not be the same for each purchaser to whom the Agents resell the Notes and the Bonds.

Application has been made to list the Notes and the Bonds on the Luxembourg Stock Exchange.

The Terms Agreement provides that the Issuer will indemnify the Agents against certain liabilities, including liabilities under the U.S. federal securities laws, and will contribute to payments the Agents may be required to make in respect thereof.

The Securities have not been and will not be registered under the Securities Act. Subject to certain exceptions, the Securities may not be offered or sold within the United States, or to, or for the benefit or account of, United States persons. See "Notice to Investors" in the Offering Circular. Each Agent has agreed that, except as permitted by the Terms Agreement, it will not offer or sell the Securities as part of its distribution at any time within the United States or to, or for the account or benefit of, United States persons.

In addition, through and including the 40th day after the commencement of the offering, an offer or sale of the Securities within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

Although application will be made to list the Securities on the Luxembourg Stock Exchange, the Notes and the Bonds are each a new issue of securities with no established trading market. No assurance can be given as to the liquidity of, or the trading markets for, the Securities. Purchasers of the Securities may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the issue price set forth on the cover page hereof. The Issuer has been advised by the Agents that they intend to make a market in the Securities, but they are not obligated to do so and may discontinue such market-making at any time without notice.

See "Offering and Sale" in the Offering Circular for additional restrictions on the offer and sale of the Securities in certain jurisdictions.

Each of the Agents may from time to time perform various investment banking services for the Issuer.

The Issuer will file an application to register the Securities with the Special Section of the Registry. Registration of the Securities with the Special Section of the Registry does not imply any certification as to the investment quality of the Securities, the solvency of the Issuer or the Guarantors or the accuracy or completeness of the information contained herein or in the Offering Circular. The Securities may not be offered or sold publicly in Mexico.



U.S. \$1,500,000,000
Petróleos Mexicanos

(A Decentralized Public Entity of the Federal Government of the United Mexican States)

Medium-Term Notes, Series B
Due from 1 Year to 30 Years from Date of Issue

jointly and severally guaranteed by

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

Petróleos Mexicanos ("Petróleos Mexicanos" or the "Issuer") may offer from time to time its Medium-Term Notes, Series B, due from 1 year to 30 years from date of issue, as selected by the purchaser and agreed to by Petróleos Mexicanos, in an aggregate initial offering price not to exceed U.S. \$1,500,000,000 or its equivalent in one or more currencies or currency units, subject to increase by Petróleos Mexicanos. The currency or currency unit of denomination and payment, form, interest rate, interest payment dates, issue price (and the U.S. dollar equivalent thereof, in the case of Notes denominated in other than U.S. dollars) and maturity date of any Note will be set forth in the related Pricing Supplement. See "Description of Notes". The payment of principal, premium (if any) and interest on the Notes will be unconditionally guaranteed jointly and severally by Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica (collectively, the "Guarantors"), each of which is a decentralized public entity of the Federal Government of the United Mexican States ("Mexico"). The Notes are not obligations of, or guaranteed by, Mexico.

The principal amount payable at or prior to maturity, the amount of interest payable and any premium payable with respect to the Notes may be determined by the difference in the price of crude oil on certain dates, or by some other index or indices, as set forth in the related Pricing Supplement.

Unless a Redemption Commencement Date is specified in the applicable Pricing Supplement, the Notes will not be redeemable prior to their Stated Maturity except in the event of certain changes in Mexican Withholding Taxes (as defined herein). If a Redemption Commencement Date is so specified, the Notes will be redeemable at the option of Petróleos Mexicanos at any time after such date as described herein. Unless otherwise specified in the applicable Pricing Supplement, the Notes will not be subject to repayment at the option of the holder prior to their Stated Maturity.

The Notes are being offered for sale in offshore transactions in reliance on Regulation S under the United States Securities Act of 1933, as amended (the "Securities Act"). A portion of the Notes may also be offered for sale in the United States pursuant to an available exemption from registration under the Securities Act. Unless otherwise specified in the applicable Pricing Supplement, each Registered Note (as defined herein) offered hereby will be represented by one or more global Registered Notes without interest coupons (each, a "Global Note"), which will be deposited with, or on behalf of, The Depository Trust Company ("DTC") or with a common depository for Morgan Guaranty Trust Company of New York, Brussels Office, as operator of the Euroclear System ("Euroclear") and Cedel Bank, *société anonyme* ("Cedel Bank"). Prior to the 40th day after the completion of the distribution of Notes constituting an identifiable tranche (the "Exchange Date"), beneficial interests in the related Global Note deposited with DTC or the common depository may be held only through Euroclear or Cedel Bank. Unless otherwise specified in the applicable Pricing Supplement, Bearer Notes (as defined herein) will initially be represented by a temporary global Bearer Note, without interest coupons, which will be deposited with a common depository for Euroclear and Cedel Bank. Such temporary global Bearer Note will be exchangeable for a permanent global Bearer Note or definitive Bearer Notes, as specified in the applicable Pricing Supplement, on or after the Exchange Date therefor and after the requisite certifications as to non-U.S. beneficial ownership have been provided as described herein. See "Form of the Notes—Bearer Notes". Except as described herein, Notes in definitive certificated form will not be issued in exchange for Global Notes or Bearer Notes in global form or interests therein. See "Description of Notes—Certificated Notes and Definitive Bearer Notes".

Petróleos Mexicanos has applied to have the Notes sold in the United States designated as PORTAL securities. Unless otherwise specified in the applicable Pricing Supplement, application has been made to list the Notes on the Luxembourg Stock Exchange. No assurance can be given that the Notes will be sold or that an active trading market for the Notes will develop.

See "Investment Considerations" and "Currency Risks and Risks Associated with Indexed Notes" for certain considerations relevant to an investment in the Notes.

THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OR ANY STATE SECURITIES LAWS AND MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS. ACCORDINGLY, THE NOTES MAY BE OFFERED AND SOLD ONLY (A) TO "QUALIFIED INSTITUTIONAL BUYERS" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN COMPLIANCE WITH RULE 144A AND (B) PURSUANT TO OFFERS AND SALES THAT OCCUR OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT. FOR CERTAIN RESTRICTIONS ON RESALE AND TRANSFER, SEE "OFFERING AND SALE" AND "NOTICE TO INVESTORS".

Offers to purchase Notes are being solicited, on a reasonable efforts basis, from time to time by the Agents on behalf of Petróleos Mexicanos. Notes may be sold to the Agents on their own behalf at negotiated discounts for resale as described above. Petróleos Mexicanos may also sell Notes directly on its own behalf or to or through other brokers or dealers. Petróleos Mexicanos reserves the right to withdraw, cancel or modify the offering contemplated hereby without notice. No termination date for the offering of the Notes has been established. Petróleos Mexicanos, or any Agent if it solicits the offer, may reject any offer to purchase Notes as a whole or in part. See "Offering and Sale".

Goldman, Sachs & Co.

Credit Suisse First Boston
Merrill Lynch & Co.

Lehman Brothers
Salomon Smith Barney

The date of this Offering Circular is February 26, 1998.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Guarantors to subscribe for or purchase, any of the Notes. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Guarantors and the Agents to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of the Notes and distribution of this Offering Circular, see "Offering and Sale" and "Notice to Investors".

The Issuer 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 *Pemex-Exploración y Producción*, *Pemex-Refinación*, *Pemex-Gas y Petroquímica Básica* and *Pemex-Petroquímica* (each a "Subsidiary Entity", 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 (i) this Offering Circular contains all information in relation to the Issuer, the Guarantors, PEMEX, Mexico and the Notes which is material in the context of the issue and offering of the Notes, (ii) there are no untrue statements of a material fact contained in it in relation to the Issuer, the Guarantors, PEMEX, Mexico or the Notes, (iii) 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 or the Notes, in light of the circumstances under which they were made, not misleading in any material respect, (iv) the opinions and intentions expressed in this Offering Circular 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 (v) 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 Notes have not been and will not be registered under the Securities Act and may include Notes in bearer form that are subject to U.S. tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the United States or to U.S. persons.

THE ISSUER WILL FILE AN APPLICATION TO REGISTER THE NOTES WITH 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 "SPECIAL SECTION OF THE REGISTRY"). REGISTRATION OF THE NOTES WITH THE REGISTRY DOES NOT IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE NOTES, THE SOLVENCY OF THE ISSUER OR THE GUARANTORS OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION CONTAINED IN THIS OFFERING CIRCULAR. THE NOTES MAY NOT BE PUBLICLY OFFERED OR SOLD IN MEXICO.

IN CONNECTION WITH AN ISSUE OF NOTES OFFERED HEREBY, THE AGENT OR AGENTS SPECIFIED IN THE APPLICABLE PRICING SUPPLEMENT MAY ENGAGE IN TRANSACTIONS THAT STABILIZE MAINTAIN, OR OTHERWISE AFFECT THE PRICE OF THE NOTES, INCLUDING OVER-ALLOTMENT, STABILIZING AND SHORT-COVERING TRANSACTIONS IN THE NOTES, AND THE IMPOSITION OF A PENALTY BID, IN CONNECTION WITH SUCH ISSUANCE. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE "OFFERING AND SALE".

AVAILABLE INFORMATION

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 United States Securities and Exchange Commission (the "Commission"). Such reports and other information can be inspected and copied at the public reference facilities maintained by the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549; 7 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. So long as any of the Notes are outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act of 1933, as amended (the "Securities Act"), if at any time Petróleos Mexicanos is neither a reporting company under Section 13 or Section 15(d) of the Exchange Act nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, Petróleos Mexicanos will be required under the Distribution Agreement referred to under "Plan of Distribution" to furnish to a holder of a Note and a prospective purchaser designated by such holder, upon the request of such holder in connection with a transfer or proposed transfer of such Note pursuant to Rule 144A, the information required to be delivered under Rule 144A(d)(4)(i) under the Securities Act.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents shall be deemed to be incorporated by reference in this Offering Circular: (i) the most recent audited annual consolidated financial statements of PEMEX; (ii) all supplements to this Offering Circular circulated by the Issuer from time to time; and (iii) any Pricing Supplement prepared in respect of any issue of Notes hereunder.

Any statement contained herein or in any document incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Offering Circular to the extent that a statement contained in any subsequent document incorporated by reference herein modifies or supersedes such statement. The Issuer may be required to give an undertaking in connection with the listing of any issue of Notes on the Luxembourg Stock Exchange to the effect that, so long as any of such Notes remains outstanding and listed on such exchange, in the event of any material adverse change in the financial condition of PEMEX which is not reflected in the Offering Circular, as amended or supplemented, the Issuer will prepare a further supplement to the Offering Circular or publish a new Offering Circular for use in connection with any subsequent issue of Notes to be listed on the Luxembourg Stock Exchange. If the terms of such issue of Notes are modified or amended in a manner that would make the Offering Circular, as amended or supplemented, inaccurate or misleading, so long as any Note of such issue remains outstanding and listed on the Luxembourg Stock Exchange, the Issuer will prepare a further supplement to the Offering Circular or publish a new Offering Circular in connection with any subsequent issue of Notes to be listed on the Luxembourg Stock Exchange.

Copies of the most recent audited annual consolidated financial statements of PEMEX, as well as this Offering Circular (and any amendment or supplement hereto) and any Pricing Supplement relating to any issue of Notes which may be listed on the Luxembourg Stock Exchange will be available free of charge at the office of the Paying Agent and the Transfer Agent in Luxembourg. Such documents will also be available free of charge at the principal executive office of the Issuer.

NOTICE TO INVESTORS

Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of the Notes offered hereby.

Each purchaser of Notes offered and sold in reliance on Rule 144A under the Securities Act ("Rule 144A") will be deemed to have represented and agreed as follows (terms used herein that are defined in Rule 144A, Regulation D ("Regulation D") or Regulation S ("Regulation S") under the Securities Act, are used herein as defined therein):

- (a) The purchaser (1) is a qualified institutional buyer; (2) is aware that the sale to it is being made in reliance on Rule 144A; and (3) is acquiring such Notes for its own account or for the account of a qualified institutional buyer;
- (b) The purchaser understands that the Notes have not been registered under the Securities Act and may not be reoffered, resold, pledged or otherwise transferred except (1) to a person who such purchaser reasonably believes is a qualified institutional buyer in a transaction meeting the requirements of Rule 144A; (2) in an offshore transaction meeting the requirements of Rule 903 or Rule 904 of Regulation S; or (3) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available); or (4) pursuant to an effective registration statement under the Securities Act and (B) in accordance with all other applicable securities laws;
- (c) Such Notes will bear a legend to the following effect unless the Issuer determines otherwise in compliance with applicable law:

THE NOTES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) TO A PERSON WHO THE TRANSFEROR REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT ACQUIRING FOR ITS OWN ACCOUNT OR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A; (B) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT; (C) PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE); OR (D) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION;

- (d) It understands that such Notes will be represented by a Restricted Global Note (as defined herein). Before any interest in a Restricted Global Note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in a Regulation S Global Note, the transferor will be required to provide the Fiscal Agent with a written certification (in the form provided in the Fiscal Agency Agreement) as to compliance with the transfer restrictions referred to in clause (b)(2) or (b)(3) above.

The Notes will constitute "restricted securities" within the meaning of Rule 144(a)(3)(iv) of the Securities Act and any sale pursuant to Rule 144 will be subject to the requirements of that rule, including the holding period requirements. **Because affiliates of the Issuer will not be prohibited from purchasing and reselling the Notes, no representation can be made as to the availability of the exemption provided by Rule 144 under the Securities Act for the resale of the Notes.**

CURRENCY OF PRESENTATION

PEMEX maintains its financial statements and records in nominal pesos.

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 from 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 Offering Circular means one thousand million.

This Offering Circular 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. 7.8509 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, 1996. On February 25, 1998, the noon buying rate for cable transfers in New York reported by the Federal Reserve Bank of New York was Ps. 8.5830 to U.S. \$1.00.

The consolidated financial statements of PEMEX included herein (the "Financial Statements") are prepared in accordance with Mexican generally accepted accounting principles ("Mexican GAAP") except as described below with respect to inflation accounting. See Notes 2(c) and 13 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 15 to the Financial Statements.

ENFORCEMENT OF CIVIL LIABILITIES

The Issuer and the Guarantors are decentralized public entities of the Government of Mexico. 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 "Investment Considerations—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 Notes brought by any holder of Notes. The Issuer and the Guarantors reserve the right to plead immunity under the United States 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 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 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.

GLOSSARY OF CERTAIN TECHNICAL TERMS

Unless the context indicates otherwise, the following terms have the meanings shown below:

API. The American Petroleum Institute.

Basic Petrochemicals. Ethane, propane, butanes, pentanes, hexanes, heptanes, raw materials for black carbon, naphthas 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. Billions of cubic feet.

boe. Barrels of crude 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.

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 22°.

Light crude oil and other: Crude oil with API density higher than 22°.

PEMEX exports three varieties with the following typical characteristics:

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

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

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

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 propane gas.

NGL. Natural gas liquids, including ethane, propane, butane, 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

Issuer:	Petróleos Mexicanos (the "Issuer"), a decentralized public agency of the United Mexican States ("Mexico").
Guarantors:	Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica, each a decentralized public entity of Mexico (collectively, the "Guarantors" and each, a "Guarantor").
Security:	Medium-Term Notes, Series B, Due from 1 Year to 30 Years from Date of Issue (the "Notes").
Guaranties:	The unconditional obligations of the Guarantors to be jointly and severally liable for payment of principal, premium (if any) and interest on the Notes (the "Guaranties").
Form of Notes; Denominations:	Notes may be issued in registered form without interest coupons ("Registered Notes") or in bearer form with or without interest coupons ("Bearer Notes"). Unless otherwise specified in the applicable Pricing Supplement, Registered Notes of the same tranche and of like tenor sold in offshore transactions in reliance on Regulation S will be represented by one or more Registered Notes in global form (each, a "Regulation S Global Note") which will be deposited with, or on behalf of, The Depository Trust Company ("DTC") in New York or with a common depository in London, in each case for the account of Morgan Guaranty Trust Company of New York, Brussels Office, as operator of the Euroclear System ("Euroclear") and Cedel Bank, <i>société anonyme</i> ("Cedel Bank"). Prior to the 40th day after the completion of the distribution of Notes constituting an identifiable tranche (the "Exchange Date"), beneficial interests in the related Registered Note deposited with DTC or a common depository may be held only through Euroclear or Cedel Bank. Unless otherwise specified in the applicable Pricing Supplement, Registered Notes initially sold within the United States and eligible for resale in reliance on Rule 144A will be represented by one or more Registered Notes in global form (each, a "Restricted Global Note" and, together with any Regulation S Global Notes, the "Global Notes"), which will be deposited with, or on behalf of, DTC in New York. Bearer Notes may only be sold in offshore transactions in reliance on Regulation S. Unless otherwise specified in the applicable Pricing Supplement, Bearer Notes will initially be represented by a temporary Bearer Note in global form, without interest coupons, which will be deposited with a common depository for Euroclear and Cedel Bank. Such temporary Bearer Note in global form will be exchangeable for a permanent Bearer Note in global form or definitive Bearer Notes, as specified in the applicable Pricing Supplement, on or after the Exchange Date therefor and after the requisite certifications as to non-U.S. beneficial ownership have been provided as described herein. See "Description of Notes—Form and Denomination". Except as described herein or as specified in the applicable Pricing Supplement, Notes in definitive certificated form will not be issued in exchange for a Global Note or Bearer Notes in global

form or interests therein. Registered Notes may not be exchanged for Bearer Notes and, unless otherwise specified in the applicable Pricing Supplement, Bearer Notes may not be exchanged for Registered Notes. Unless otherwise specified in the applicable Pricing Supplement, Registered Notes will be issued in denominations of U.S. \$10,000 and integral multiples thereof and Bearer Notes will be issued in denominations of U.S. \$10,000 and U.S. \$100,000 (or, in each case, the approximate equivalent thereof in a specified currency or currency unit).

Amount of Notes

Outstanding at any Time:

Not to exceed U.S. \$1,500,000,000 (or the equivalent thereof in one or more currencies or currency units) in aggregate initial offering price, subject to increase by the Issuer.

Currency of Denomination and Payment:

United States dollars or in one or more foreign currencies or currency units (each, a "Specified Currency").

Maturities:

Maturities from 1 year to 30 years from date of issue, as indicated in each Note and the applicable Pricing Supplement.

Interest Rate:

Notes may bear interest at a fixed rate ("Fixed Rate Notes"), or at a floating rate ("Floating Rate Notes") determined by reference to one or more base rates, which may be adjusted by a Spread and/or a Spread Multiplier (in each case, as defined herein), in each case as indicated in the Note and the applicable Pricing Supplement.

Interest Payments:

Interest on the Notes will be payable on the dates specified therein and in the applicable Pricing Supplement.

Interest Rate Computation:

Unless otherwise specified in the applicable Pricing Supplement, interest on Fixed Rate Notes will be calculated on the basis of a 360-day year of twelve 30-day months, and interest on Floating Rate Notes will be calculated on the basis of a daily interest factor computed by dividing the interest rate applicable to such day by 360 (or, in the case of Treasury Rate Notes (as defined herein), by the actual number of days in the year).

Redemption:

Except as described in "Tax Redemption" below, no Note will be subject to redemption prior to its maturity at the option of the Issuer unless so indicated in such Note and the applicable Pricing Supplement.

Tax Redemption:

In the event that, as a result of certain changes in Mexican law, the Issuer becomes obligated to pay Additional Amounts (as defined herein) in excess of the Additional Amounts that it would be obligated to pay if payments on any Notes were subject to withholding tax at a rate in excess of 15% then, at the Issuer's option, such Notes may be redeemed at any time in whole, but not in a part, at a price equal to 100% of the outstanding principal amount thereof, except as specified in the applicable Pricing Supplement, plus accrued interest and any Additional Amounts due thereon to the date of such redemption. See "Description of Notes—Redemption—Tax Redemption".

Early Repayment:

No Note will be subject to repayment at the option of the holder prior to its maturity unless indicated in such Note and the applicable Pricing Supplement.

Indexed Notes:

The principal amount payable at or prior to maturity, the amount of interest payable and any premium payable with respect to each Note may be determined by the difference in the price of crude oil on certain dates, or by some other index or indices, if and as indicated in such Note and the applicable Pricing Supplement.

Offering Price:

At par, unless otherwise indicated in the applicable Pricing Supplement.

Fiscal Agent:

Bankers Trust Company.

Status of the Notes:

The Notes will constitute direct, unsecured and unsubordinated Public External Indebtedness (as defined under "Description of Notes—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 Notes—Ranking of Notes". The Issuer currently has outstanding certain financial leases which will, with respect to the assets securing such financial leases, rank prior to the Notes. See Note 8 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 "Description of Notes". See Note 8 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.

Governing Law:

State of New York.

Agents:

Goldman, Sachs & Co., Goldman Sachs International
Credit Suisse First Boston Corporation, Credit Suisse First
Boston (Europe) Limited
Lehman Brothers Inc., Lehman Brothers International (Europe)
Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith
Incorporated, Merrill Lynch International
Salomon Brothers Inc, Salomon Brothers International Limited

Pricing Supplements:

The Issuer will prepare a Pricing Supplement for each
issuance of Notes setting forth, among other things, certain
information about the terms of such Notes and the offering
and sale thereof. Such information may differ from that set
forth herein and in all cases will supplement and, to the
extent inconsistent herewith, supersede the information
herein.

INVESTMENT CONSIDERATIONS

Prospective investors in the Notes should consider carefully all the information in this Offering Circular 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. Since the beginning of 1995, the Government has 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 Notes).

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 1988, the sum of these duties and taxes totaled 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 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. \$13.50 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—Risk Management and Financial Instruments—Income" and "Regulatory Framework and Relationship with the Government—Federal 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 1992, 1993, 1994, 1995 and 1996, the Issuer paid the Government advance payments of Ps. 1,417 million, Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million and Ps. 6,782 million, respectively, in respect of minimum guaranteed dividends. In the first nine months of 1997, Petróleos Mexicanos made advance payments to the Government of Ps. 4,230 million in respect of minimum guaranteed dividends.

The total dividends paid by the Issuer to the Government in respect of the CAPs regarding the 1992, 1993, 1994, 1995 and 1996 fiscal years amounted to Ps. 3,313 million, Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million and Ps. 6,782 million, respectively. See Note 12 to the Financial Statements.

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 are currently negotiating a reduction in the minimum guaranteed dividend payable to the Government in respect of the CAPs, although no assurances can be made as to whether or when such reduction will be effected, and whether or to what extent the total dividends payable to the Government for 1998 and future years may be reduced.

Ownership 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 the United Mexican States (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 estimates 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. 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. \$14.88 in 1992, U.S. \$13.20 in 1993, U.S. \$13.88 in 1994, U.S. \$15.70 in 1995 and U.S. \$18.94 in 1996. The weighted average price per barrel of crude oil exported by PEMEX was U.S. \$16.73 at November 1997, a 11.7% decline from the average price for 1996.

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. In December 1993 the average sales price per barrel of West Texas Intermediate ("WTI") crude oil hit a five-year low of approximately U.S. \$14.00 per barrel, as compared with approximately U.S. \$17.70 for December 1994, U.S. \$19.57 for December 1995, U.S. \$22.14 per barrel for December 1996 and U.S. \$18.90 for December 1997. In January 1998, the average sales price per barrel of WTI crude oil was approximately U.S. \$16.69 per barrel. At February 24, 1998, the spot price for WTI crude oil was U.S. \$15.31. 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 has required PEMEX to reduce its 1998 operating budget by 6.5%, which includes a 12% decrease in PEMEX's capital expenditures budget for 1998, from Ps. 38,945 million to Ps. 34,453 million, an amount that nevertheless constitutes an increase of 9.2% over the 1997 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 all of its infrastructure to produce and deliver crude oil and natural gas, including projects initiated under the new 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 Notes.

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 1996, the peso fluctuated between Ps. 7.3 and Ps. 8.0 per U.S. dollar, and throughout 1997, between Ps. 7.7 and Ps. 8.4 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 Notes brought by any holder of Notes. 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 Notes—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 Notes 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 Notes

The Notes are subject to restrictions on resales and transfer. See "Notice to Investors" and "Offering and Sale". The Notes will constitute new issues of securities with no established trading market. There can be no assurance that an active market for the Notes will develop or, if such market develops, that it will continue. Future trading prices of the Notes will depend on many factors, including, among other things, prevailing interest rates and the liquidity of the trading market for the Notes. See "Description of Notes" and "Offering and Sale".

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. The head office of PEMEX is located at Avenida Marina Nacional No. 329, 11311 México, D.F. PEMEX's telephone number is (52-5) 722-2500.

The activities of Petróleos Mexicanos and the Subsidiary Entities are regulated by the *Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo* (the 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 December 31, 1977, May 12, 1995 and November 14, 1996, and its statutory charter, the *Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios* (the Organic Law of Petróleos Mexicanos and Subsidiary Entities, or the "Organic Law"), effective July 17, 1992, as amended effective January 1, 1994. 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. PEMEX's principal objectives are the exploration, exploitation, refining, transportation, storage, distribution, and first-hand sale of crude oil and products obtained from its refining; the exploration, exploitation, production and first-hand sales of natural gas and the transportation and storage of natural gas, if essential and necessary to link the exploitation with the production of natural gas; and the production, transportation, storage, distribution and first-hand sales of petroleum derivatives that serve as basic industrial raw materials and that are classified as Basic Petrochemicals. Except as specified above, the transportation, storage and distribution of natural gas may be carried out by private-sector entities, with the approval of the Ministry of Energy. 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 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; and (iii) Pemex-Gas and Basic Petrochemicals: processing of natural gas, natural gas liquids and derivatives that may be used as basic raw materials and the storage, transportation, distribution and marketing thereof, obtaining 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.

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

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

production in 1996. It is one of the major suppliers of crude oil to the United States and Spain, accounting for 12% and 9%, respectively, of those countries' imports of crude oil in 1996. Mexico is not a member of the Organization of Petroleum Exporting Countries ("OPEC").

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 Ps. 9.8 billion on total revenues (net of the IEPS tax) of Ps. 143.8 billion in 1995, an increase of 50.3% in such total revenues. In 1996 PEMEX earned income after costs and expenses but before hydrocarbon extraction duties and taxes of Ps. 161.5 billion, as compared with Ps. 102.5 billion of such income in 1995, an increase of 57.6%. Total sales revenues for 1996 (net of the IEPS tax) reached Ps. 212.2 billion as compared with total sales revenues of Ps. 139.6 billion in 1995, an increase of 52% in such revenues. Of this amount Ps. 111.1 billion resulted from sales in the domestic market and Ps. 101.1 billion came from exports to 196 clients in 46 countries. Excluding the operations of P.M.I. Comercio Internacional, S.A. de C.V. ("PMI Comercio"), crude oil exports accounted for 92% of export sales, petroleum products (including natural gas) accounted for 6% of export sales, and petrochemical products accounted for the remainder of export sales in 1996. The weighted average price of crude oil exported by PEMEX was U.S. \$18.94 per barrel in 1996, 20.64% higher than the weighted average price of U.S. \$15.70 per barrel observed in 1995. As of November 1997, the weighted average price of crude oil exported by PEMEX was U.S. \$16.73, an 11.7% decline from the average price for 1996. The total equity of PEMEX as of December 31, 1996 was Ps. 155.8 billion, and total capitalization (long-term debt plus equity) amounted to Ps. 198.3 billion.

In the first nine months of 1997, PEMEX earned income of Ps. 9.1 billion on total revenues (net of the IEPS tax) of Ps. 163.8 billion as compared with Ps. 17.1 billion on total revenues (net of the IEPS tax) of Ps. 144.4 billion in the same period of 1996, an increase of 13% in such total revenues. In the first nine months of 1997, PEMEX earned income after costs and expenses but before hydrocarbon extraction duties and taxes of Ps. 126.5 billion, as compared with Ps. 117.8 billion of such income in the same period of 1996, an increase of 7%. Of this amount Ps. 93.5 billion resulted from sales in the domestic market and Ps. 65.8 billion came from exports.

In 1996, production averaged 2.86 million bpd of crude oil, 4.19 billion cfpd of natural gas, and 426,000 bpd of condensates. The production level of crude oil in 1996 was 9.2% higher than in 1995. Natural gas production in 1996 increased by 11.6% with respect to 1995 production, and condensates production decreased by 5.4% with respect to 1995. 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 totaled 1.60 million bpd in 1995 and 1.59 million bpd in 1996. PEMEX is one of the major producers of crude oil worldwide that experience a significant domestic demand for their refined products.

In the first nine months of 1997, production averaged 3.00 million bpd of crude oil, 4.43 billion cfpd of natural gas, and 380,000 bpd of condensates. The production of crude oil was 5% higher than in the same period of 1996. Natural gas production increased by 5.62% with respect to the same period in 1996, and condensates production decreased by 15% with respect to the same period in 1996.

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 19.4 million tons in 1995 and 18.4 million tons in 1996.

USE OF PROCEEDS

Unless otherwise indicated in the applicable Pricing Supplement, the net proceeds from the issuance of the Notes offered hereby will be used by PEMEX to refinance debt and to finance its investment program.

EXCHANGE RATES

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

Year ended December 31	Free Market Rate ⁽¹⁾			
	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 February 25, 1998 was Ps. 8,5830 = U.S. \$1.00.

CAPITALIZATION

The following table sets out the capitalization of PEMEX in accordance with Mexican GAAP at December 31, 1996 (audited) and September 30, 1997 (unaudited).

	At December 31, 1996 ⁽¹⁾⁽²⁾		At September 30, 1997 ⁽³⁾	
	(In millions of nominal pesos or U.S. dollars)			
Long-Term External Debt ⁽⁴⁾	Ps. 33,425	\$ 4,258	Ps. 44,314	\$ 5,703
Long-Term Domestic Debt ⁽⁴⁾	<u>9,110</u>	<u>1,160</u>	<u>5,391</u>	<u>694</u>
Total Long-Term Debt	42,535	5,419	49,705	6,397
Certificates of Contribution ⁽⁵⁾	22,341	2,846	22,341	2,875
Specific Oil-Field Exploration and Depletion Reserve	8,637	1,100	9,615	1,237
Revaluation Surplus	99,225	12,639	100,393	12,919
Retained Earnings (Prior Years)	9,082	1,157	19,230	2,475
Income	<u>16,495</u>	<u>2,101</u>	<u>9,052</u>	<u>1,165</u>
Total Equity	155,780	19,843	160,631	20,671
Total Capitalization ⁽⁶⁾	<u>Ps.198,315</u>	<u>\$25,261</u>	<u>Ps.210,336</u>	<u>\$ 27,068</u>

Note: Totals may differ due to rounding.

(1) Audited. Includes both the Subsidiary Entities and Subsidiary Companies.

(2) Conversions into U.S. dollars of amounts in pesos have been made at the established exchange rate for accounting purposes of Ps. 7.8509 = U.S. \$1.00 as at December 31, 1996.

(3) Unaudited. Includes 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. 7.7707 = U.S. \$1.00 as at September 30, 1997.

(4) Excludes current portion of long-term debt. Effective as of December 1997, the Issuer determined that approximately U.S.\$ 609,000,000 of obligations previously included in PEMEX's balance sheet as long-term external debt could be accounted for as incurred in connection with PIDIREGAS-eligible projects. See "Management's Discussion and Analysis of Financial Condition and Results of Operation—Capital Expenditures". Accordingly, as of December 31, 1997, PEMEX's long-term external debt, as shown on its balance sheet, will be reduced by approximately U.S.\$ 609,000,000 (with the obligations related thereto being accounted for as off-balance sheet financing), and PEMEX's total equity will be increased by an equivalent amount.

(5) In December 1997, the Issuer and the Government agreed to a Ps. 12,118.05 million reduction in the equity (CAPs) of the Issuer. See "Investment Considerations—External Debt Restructuring".

(6) Except as described in notes (4) and (5) above and for the issue of ItL 350,000,000,000 Guaranteed Floating Rate Bonds due 2004 in April 1997, the issue of U.S. \$300,000,000 Guaranteed Bonds due 2002 in May 1997, the issue of U.S. \$250,000,000 Guaranteed Bonds due 2007 in June 1997 and the issue of U.S. \$600,000,000 Global Guaranteed Notes due 2007, U.S. \$400,000,000 Global Guaranteed Bonds due 2027 and the issue of ItL 200,000,000,000 Guaranteed Floating Rate Bonds due 2008 in March 1998 described herein, there has been no material change in the capitalization of PEMEX since December 31, 1996.

SELECTED FINANCIAL DATA

The selected financial data set forth below as at and for the five years ended December 31, 1996 have been derived from the consolidated financial statements of PEMEX as at and for the five years ended December 31, 1996, all of which have been audited by Coopers & Lybrand, Despacho Roberto Casas Alatríste, independent accountants. For the years ended December 31, 1996, 1995, 1994 and 1993, the consolidated financial statements include the accounts of PEMEX, the Subsidiary Entities and the Subsidiary Companies (as defined below). For the year ended December 31, 1992, the consolidated financial statements include the accounts of PEMEX and the Subsidiary Entities only. The selected financial data as at and for the nine-month periods ended September 30, 1996 and 1997 have not been audited. The selected financial data set forth below should be read in conjunction with, and are qualified in their entirety by reference to, the audited and consolidated balance sheets of PEMEX, the Subsidiary Entities and Subsidiary Companies as of December 31, 1995 and 1996, and the related consolidated statements of income, changes in equity, and changes in financial position for the years then ended (the "Financial Statements"). The Financial Statements are set forth elsewhere in this document.

The Financial Statements are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with NIF-06-BIS/A. See Notes 2(c) and 13 to the Financial Statements for a discussion of the inflation accounting rules applicable to PEMEX. 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 15 to the Financial Statements.

	Year ended December 31, (audited)				
	1992 ⁽¹⁾	1993 ⁽¹⁾⁽²⁾	1994 ⁽¹⁾⁽²⁾	1995 ⁽²⁾⁽³⁾⁽⁴⁾	1996 ⁽²⁾⁽⁴⁾
	(in thousands of nominal pesos or U.S. dollars)				
INCOME STATEMENT DATA					
Amounts in accordance with Mexican GAAP:					
Total Revenues ⁽⁴⁾	Ps. 77,739,727	Ps. 84,201,636	Ps. 100,299,725	Ps. 161,547,025	Ps. 235,819,900
Total Revenues Net of the IEPS Tax	66,038,727	66,752,136	78,502,779	143,843,855	216,053,000
Net Sales ⁽⁴⁾	77,002,774	82,790,455	95,159,781	157,309,598	231,992,900
Income	3,313,394	3,024,670	3,326,259	9,808,638	16,494,600
Approximate Amounts in accordance with U.S. GAAP ⁽¹⁾ :					
Income	3,717,595	1,916,237	(21,084,652)	(8,275,621)	10,231,000
BALANCE SHEET DATA (end of period)					
Amounts in accordance with Mexican GAAP:					
Cash and Marketable Securities	Ps. 1,768,131	Ps. 1,910,949	Ps. 5,781,485	Ps. 11,787,227	Ps. 17,999,600
Total Assets	155,333,854	153,102,379	201,518,067	244,438,124	312,049,000
Long-Term Debt	20,118,875	18,030,113	35,141,909	47,538,903	42,534,600
Total Long-Term Liabilities	28,274,065	27,143,313	58,579,375	78,470,363	91,595,600
Equity	113,728,808	107,808,558	118,231,566	126,601,993	155,799,800
Approximate Amounts in accordance with U.S. GAAP ⁽¹⁾ :					
Equity	102,486,284	98,231,995	74,856,730	64,680,247 ⁽⁶⁾	69,256,700
OTHER FINANCIAL DATA					
Amounts in accordance with Mexican GAAP ⁽¹⁾ :					
Depreciation and Amortization	Ps. 5,920,749	Ps. 6,765,214	Ps. 6,618,095	Ps. 9,385,382	Ps. 10,398,300
Investments at Cost ⁽⁷⁾	6,704,396	9,110,730	8,027,485	14,366,084	18,094,300
Weighted Average Price for Crude Oil Exported by Pemex	\$14.88	\$13.20	\$13.88	\$15.70	\$18.00

n.a. = Not available.

- (1) The financial statements of PEMEX are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with NIF-06-B-1994 address (i) the material differences between Mexican GAAP and U.S. GAAP, as applied to the financial statements, (ii) the effect of certain material differences and (iii) the manner in which PEMEX, as opposed to private Mexican corporations, accounts for the effect of inflation.
- (2) For the years ended December 31, 1993, 1994, 1995 and 1996, the financial condition and results of the PMI Group (as defined below) are included in the financial condition and results of KOT Insurance Co. Ltd. are included, and for the years ended December 31, 1995 and 1996 the financial condition and results of the PMI Group are included in the "Management's Discussion and Analysis of Financial Condition and Results of Operations—General—Consolidation below. In 1996, net sales by the PMI Group are included in the "Management's Discussion and Analysis of Financial Condition and Results of Operations—General—Consolidation below.
- (3) The financial statements of PEMEX are prepared in accordance with Mexican GAAP and, as to the recognition of inflation, in accordance with NIF-06-B-1994 address (i) the material differences between Mexican GAAP and U.S. GAAP, as applied to the financial statements, (ii) the effect of certain material differences and (iii) the manner in which PEMEX, as opposed to private Mexican corporations, accounts for the effect of inflation, see Notes 2(c) and 11 to the Financial Statements.
- (4) 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. 26,107 million in the first quarter of 1996.
- (5) Conversions into U.S. dollars of amounts in pesos have been made at the established exchange rate for accounting purposes of Ps. 7.7707 = U.S. \$1.00.
- (6) Includes equity adjustment for unrealized gains from investment securities due to the cumulative effect of a change in accounting principles for the adoption of NIF-06-B-1994.
- (7) Includes investments in fixed assets and capitalized interest, and excludes certain expenditures charged to the oil field exploration and depletion reserve. See "Management's Discussion and Results of Operations—Liquidity and Capital Resources".

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 recognition of inflation, in accordance with guidelines established in NIF-06-BIS/A. See Notes 2(c) and 13 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 15 to the Financial Statements of PEMEX 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 products 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 are sold, reflect international prices. The international prices of crude oil and petroleum products have fluctuated widely over the last 14 years, with the weighted average price per barrel of crude oil exported by PEMEX reaching 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. \$14.88 in 1992, 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. \$16.74 during the period from January 1, 1997 to September 30, 1997, with a spot price on September 30, 1997 of U.S. \$16.08. In December 1993 the average sales price per barrel of WTI crude oil hit a five-year low of approximately U.S. \$14.00, as compared with approximately U.S. \$17.70 for December 1994, U.S. \$19.57 for December 1995, U.S. \$22.14 for December 1996 and U.S. \$18.90 for December 1997. In January 1998, the average sales price per barrel of WTI crude oil was U.S. \$16.69. At February 24, 1998, the spot price for WTI crude oil was U.S. \$15.31 per barrel. 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—Pricing Policy".

The prices at which PEMEX's products are sold in the domestic market are set by committees composed of representatives of PEMEX and the Government, and may differ from international prices. PEMEX's sales revenues (net of the IEPS tax) for these products are linked to their international reference prices.

The IEPS tax is an indirect tax on gasoline, automotive diesel and natural gas for automotive use sales (an IEPS tax on jet fuel sales was eliminated in 1994). 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—Federal 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 fixed percentage of the retail price of such product.

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 much of the last decade. The rate of inflation (as measured by the change in the National Consumer Price Index, or "NCPI") has been reduced from a high of 159.2% in 1987 to 11.9% in 1992, 8% in 1993, and 7.1% in 1994. However, in light of the economic events that followed from the devaluation of the peso against the U.S. dollar in late 1994 and 1995, Mexico registered an inflation rate of 52% in 1995, 27.7% in 1996 and 15.72% in 1997. See "Annex A—United Mexican States—The Economy". For 1998, the Government expects the annual rate of inflation to be 12%. In accordance with NIF-06 BIS/A, the inflation accounting guideline applicable to PEMEX, 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(c) and 11 to the Financial Statements.

Mexican inflation has affected PEMEX's consolidated financial results in the following principal ways: (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 revalued annually to reflect the effect of inflation; and (iii) PEMEX's income each year is affected negatively by increased 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 and the increased peso value of dollar-denominated assets following the devaluation of the peso in 1994. 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 price 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.

Risk Management and Financial Instruments

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

cost of sales and other expenses are payable in pesos and are not linked to U.S. dollars. As a result, any depreciation of the peso relative to 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, PEMEX has borrowed in currencies other than U.S. dollars, since 1991, PEMEX generally enters into currency swaps to hedge against movements in exchange rates. In addition, since a significant portion of PEMEX's revenues are dollar-denominated while hydrocarbon duties are peso-denominated, PEMEX from time to time enters into forward contracts with Mexican banks for the sale of dollars. Due to the December 1994 peso devaluation, PEMEX incurred an unrealized loss of Ps. 830 million for 1994 under certain of such contracts, which was reported in PEMEX's 1994 income statement. In 1995, PEMEX's hedging activities were concentrated mainly in interest rate and currency swaps, without new participation in the peso/dollar forward market. All forward contracts expired in 1995. In 1996, PEMEX did not enter into any new contracts for interest rate or currency swaps or peso/dollar forwards. In 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 and non-U.S. dollar currency for U.S. dollars.

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. In 1994, PEMEX capitalized Ps. 21,099 million of foreign exchange losses in respect of its debt, primarily due to the fact that the devaluation of the peso at the end of 1994 increased the value in peso terms of PEMEX's indebtedness and other liabilities denominated in foreign currencies. See "Annex A—United Mexican States—The Economy—Events During 1994 and 1995". In 1995, PEMEX (excluding the results of the Subsidiary Companies) capitalized Ps. 20,952 million of foreign exchange losses in respect of its debt, due to the further devaluation of the peso during the year. In 1996, PEMEX (excluding the results of the Subsidiary Companies) capitalized Ps. 1,043 million of foreign exchange losses in respect of its debt. 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. 2,603 million of foreign exchange gains related to its operations in 1994, Ps. 1,601 million of foreign exchange gains in 1995 and Ps. 475 million of foreign exchange gains in 1996. Excluding the results of the Subsidiary Companies, PEMEX recorded Ps. 614 million of net foreign exchange gains in the nine-month period ended September 30, 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 certificates of contribution "A" (see "—Liquidity and Capital Resources" below) fluctuate in parallel with changes in international interest rates. PEMEX's hedging committee, composed of representatives of PEMEX, Banco de México, the Ministry of Finance and Public Credit and PMI Comercio, authorizes PEMEX's hedging strategy and supervises the hedging activities carried out by PEMEX's Finance Department. In 1994, 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) and interest rate collars (which set both a floor and a ceiling on floating-rate payments). Since 1995, PEMEX has not entered into any such contracts.

Credit Risk. As a creditor, PEMEX faces the risk that counterparties might fail to meet 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.

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.

In 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 the holder the amount, if any, calculated with reference to a notional principal amount, by which the floating interest rate exceeds the rates specified in the cap agreement on the exercise date of the cap.

At September 30, 1997, PEMEX was a party to interest rate swap agreements with an aggregate notional amount of U.S. \$6.65 billion, with average remaining maturities of 1.72 years, and average fixed interest rates of 6.88%. At September 30, 1997, the aggregate notional principal amount of written caps totaled U.S. \$1 billion, with fixed rate caps that ranged from 7.5% to 10.0%, and with expiration dates ranging from 1997 to 2001.

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, 1996, PEMEX was a party to interest rate swap agreements with an aggregate notional amount of U.S. \$6.65 billion with a weighted average of approximately 2 years and 6 months and with average fixed interest rates of approximately 6.82%. As of December 31, 1996, the aggregate notional amount of written caps totaled U.S. \$600 million, with fixed rate caps that ranged from 7.5% to 10%, and with expiration dates from 1997 to 2001. During 1995, PEMEX entered into "corridors" (short cap and long cap transactions). Under these transactions, PEMEX is entitled to receive payments based on the floating three-month LIBOR interest rate, if the LIBOR interest rate is within a specified range. As of December 31, 1995, PEMEX was a party to such transactions with an aggregate notional amount of U.S. \$400 million (U.S. \$400 million in caps written and U.S. \$400 million in caps bought). As of December 31, 1996, the aggregate notional amount of written floors totaled U.S. \$700 million with fixed rate floors that ranged from 5.3% to 6.0%, and with expiration dates from 1997 to 1998. As of December 31, 1996, PEMEX had U.S. \$700 million outstanding in long floors, with fixed rate floors that ranged from 5.3% to 6.0% and with expiration dates in 1998. In addition, beginning in 1994, PEMEX entered into transactions ("swaptions") that give its counterparty the right to enter into an interest rate swap at an agreed future date, which would obligate PEMEX to make fixed interest rate payments and receive floating rate payments. All swaptions expired during December 1995, reducing the outstanding number at year end to zero. For 1994 and 1995, the weighted average fixed rates in the swaptions were 7.77% and 6.42%, respectively.

QUANTITATIVE DISCLOSURE OF MARKET RISK (Interest Rate Risk)
(at December 31, 1996)

(1) See Note 3 in Financial Statements for foreign exchange rates except for Ps. 1.5089 per French franc and Ps. 5.8457 per Swiss franc.

(2) The outstanding amount in hedging interest rate derivatives in U.S. \$7,050 million (Ps. 55,349 million) from which U.S. \$5,660 million variable rate debt. Short-term debt such as commercial paper, bankers' acceptances and purchasing loans are swapped with strategy considers the yearly renewal of these instruments. The rest of the hedging interest rate derivatives, U.S. \$1,381 million related to the minimum guaranteed dividend in connection with the Certificates of Contribution "A" denominated in U.S. Dollars.

QUANTITATIVE DISCLOSURE OF MARKET RISK (Interest Rate Risk)(3)
(at December 31, 1996)

Derivative financial instruments held or issued for purposes other than tra

	Expected Maturity Date				
	1997	1998	1999	2000	2001
	(In thousands of pesos)				
Interest Rate Derivatives					
Hedging Instruments⁽²⁾					
Interest Rate Swaps (U.S. Dollars)					
Variable to Fixed	1,570,180	20,019,795	9,421,080	18,449,615	1,962,725
Average Pay Rate.....	5.33	6.25	7.47	6.76	7.31
Average receive rate.....	5.70	5.81	6.12	6.20	6.35
Interest Rate Options (U.S. Dollars)⁽²⁾					
Caps Purchased.....	—	2,355,270	785,090	—	—
Average receive rate.....	—	5.91	6.08	—	—
Average pay rate (strike price)	—	7.50	8.00	—	—
Cross-Currency Swaps (1).....	1,044,170	5,674,984	604,380	—	—
French Francs to U.S. Dollars.....	—	1,047,252	—	—	—
Swiss Francs to U.S. Dollars.....	1,044,170	764,450	—	—	—
Canadian Dollars to U.S. Dollars.....	—	—	604,380	—	—
Austrian Shillings to U.S. Dollars	—	747,209	—	—	—
Italian Liras to U.S. Dollars.....	—	1,512,212	—	—	—
Japanese Yen to U.S. Dollars.....	—	1,603,861	—	—	—
British Pounds to U.S. Dollars.....	—	—	—	—	—
Non-Hedging Instruments					
Interest Rate Options (U.S. Dollars)					
Floors Written	1,177,635	4,317,995	—	—	—
Average receive rate (strike price) .	5.60	5.47	—	—	—
Average pay rate.....	6.00	6.02	—	—	—
Floors Purchased	—	5,495,630	—	—	—
Average receive rate (strike price) .	—	5.58	—	—	—
Average pay rate.....	—	6.01	—	—	—
Caps Written.....	785,090	3,925,450	785,090	1,570,180	785,090
Average receive rate (strike price) .	7.50	8.70	9.50	8.00	9.84
Average pay rate.....	5.76	5.91	6.08	6.36	6.41

- (1) See Note 3 in Financial Statements for foreign exchange rates except for Ps. 1.5089 per French franc and Ps. 5.8457 per Swiss franc.
- (2) The outstanding amount in hedging interest rate derivatives in U.S. \$7,050 million (Ps. 55,349 million) from which U.S. \$5,666 million is related to the minimum guaranteed dividend in connection with the Certificates of Contribution "A" denominated in U.S. Dollars. The rest of the hedging interest rate derivatives, U.S. \$1,381 million, is related to the minimum guaranteed dividend in connection with the Certificates of Contribution "A" denominated in U.S. Dollars.
- (3) See Note 9 in Financial Statements for additional financial instruments information.

Income. From 1992 through 1994, PEMEX's income declined as a percentage of its total revenues (net of the IEPS tax), from 5.0% in 1992, 4.5% in 1993 and 4.2% in 1994. The decline in income relative to total revenues (net of the IEPS tax) from 1992 to 1994 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, higher depreciation expenses resulting from increases in PEMEX's fixed assets caused by increased capital expenditures. See "—General—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) was 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—The Government's Response". Income before taxes, duties, interests and other expenses, as a percentage of total net sales, increased to 70.6% in 1996 from 65.4% in 1995. This was due to a decrease in operating expenses (cost of goods sold only).

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—24.0% in 1992, 27.1% in 1993, 27.5% in 1994, 35.3% in 1995 and 37.6% in 1996— 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, beginning in 1993, 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 1996, 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 was not subject to the Hydrocarbon Income Tax in 1992, had no taxable income in 1993, 1994, 1995 and 1996 to which this tax was applicable and expects to have no such income in 1997, the difference between PEMEX's revenues and its costs and expenses is called "income". See "Regulatory Framework and Relationship with the Government—Federal Taxes and Duties".

Consolidation. PEMEX's financial statements include, on a consolidated basis, the accounts of Petróleos Mexicanos, the Subsidiary Entities and, beginning with PEMEX's financial statements for the year ended December 31, 1993, the Subsidiary Companies. The PEMEX subsidiaries that were consolidated with PEMEX's 1993, 1994, 1995 and 1996 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") and, starting in 1994, KOT Insurance Co. Ltd., and, since 1995, Integrated Trade Systems, Inc. (together with the PMI Group, the "Subsidiary Companies"). Each of these companies (other than P.M.I. Norteamérica, S.A. de C.V., which did not commence operations until March 1993, and KOT Insurance Co. Ltd., which did not commence operations until February 1993) was previously accounted for under the cost method. The consolidation, after inter-company eliminations, increased total assets of PEMEX by Ps. 560 million in 1993, Ps. 1,416 million in 1994, Ps. 947 million in 1995 and Ps. 1,865 million in 1996; decreased equity by Ps. 418 million in 1993, Ps. 392 million in 1994, Ps. 1,188 million in 1995 and Ps. 1,061 million in 1996; increased income by Ps. 43 million in 1993 and Ps. 130 million in 1994; and decreased income by Ps. 374 million in 1995 and Ps. 22 million in 1996. PEMEX's unaudited interim financial statements as at and for the

nine months ended September 30, 1996 and 1997 do not include the accounts of the Subsidiary Companies.

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 at December 31, 1996, PEMEX had 120,945 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—Nine-Month Period Ended September 30, 1997 Compared to Nine-Month Period Ended September 30, 1996

The selected financial data set forth below as at and for the nine months ended September 30, 1996 and 1997, have been derived from preliminary, unaudited balance sheets of PEMEX as at such dates and related preliminary, unaudited income statements and include the accounts of Petróleos Mexicanos and the Subsidiary Entities only.

During the first nine months of 1997, PEMEX earned income (before duties) of Ps. 126.6 billion on total sales revenues (net of the IEPS tax) of Ps. 159.3 billion, as compared with earned income (before duties) during the first nine months of 1996 of Ps. 117.7 billion on total sales revenues (net of the IEPS tax) of Ps. 140.9 billion, an increase of 7.6% in such income. For the nine months ended September 30, 1997, total sales revenues (net of the IEPS tax) increased by 13.1%, mainly as a result of higher volume of production and of sales despite the fall in the weighted average price of crude oil exported by PEMEX. The weighted average price of crude oil exported by PEMEX for the first nine months of 1997 was U.S. \$16.74 per barrel, versus U.S. \$18.03 per barrel for the same period of 1996, which represented a 7.2% decrease in such price. During the first nine months of 1997, PEMEX's income (after taxes and duties) amounted to Ps. 9.1 billion, as compared with earned income (after taxes and duties) during the first nine months of 1996 of Ps. 17.1 billion, a decrease of 46.8% in such income due primarily to the aforementioned decrease in crude oil prices.

Excluding the IEPS tax, total costs and operating expenses increased by 21.52% from Ps. 127.3 billion in the first nine months of 1996 to Ps. 154.7 billion in the same period of 1997, primarily due to a Ps. 16.9 billion increase in cost of sales, primarily as a result of the increase in purchases of imports. Cost of sales as a percentage of total net sales (net of the IEPS tax) increased from 22.1% in the first nine months of 1996 to 30.1% in the same period of 1997. In addition, transportation and distribution expenses increased by Ps. 2 billion over their 1996 level, interest (net) increased from a credit of Ps. 170 million in the nine-month period of 1996 to a debit of Ps. 905 million in the same period of 1997, and other expenses (including write-offs of accounts receivable and rental expenses) increased by Ps. 188 million from the level of Ps. 699 million in the first nine months of 1996. The change in interest was due to higher interest expenses from debt servicing.

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 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 1996 total sales revenues (net of the IEPS tax), 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 in 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 20.64% increase from the average of U.S. \$15.70 observed in 1995. Export sales of petroleum derivatives (including NGLs) 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 explosion at the "Cactus" natural gas processing complex and the decline in the sale 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 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 expenses) 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.

Results of Operations—1995 Compared to 1994

In 1995, PEMEX earned income of Ps. 9.8 billion on total revenues (net of the IEPS tax) of Ps. 143.8 billion, as compared with 1994 income of Ps. 3.3 billion on total revenues (net of IEPS tax) of Ps. 78.5 billion. The increase in income from 1994 to 1995 was attributable primarily to an increase in net sales, while the cost of sales decreased as a percentage of net sales. Total revenues (net of the IEPS tax) increased by 83.2%, due primarily to an increase in net sales. PEMEX's total sales revenues (net of the IEPS tax) in 1995 reached Ps. 139.6 billion, an increase of 90.3% over 1994 total sales revenues (net of the IEPS tax) of Ps. 73.4 billion, due to increases in the domestic prices and volume of petrochemicals products sold in the domestic market and in the international price of crude oil. Of 1995 total sales revenues (net of the IEPS tax), Ps. 65.2 billion (or 46.7%) resulted from exports and Ps. 74.4 billion (or 53.3%) resulted from domestic sales.

Export sales increased by 110.0% in peso terms (with dollar-denominated export revenues converted to pesos at the exchange rate for the date in which the export sale was made), from Ps. 31.0 billion in 1994 to Ps. 65.2 billion in 1995, and increased as a percentage of total sales revenues (net of the IEPS tax) from 42.3% in 1994 to 46.7% in 1995. Excluding the activities of the PMI Group, external sales increased by 114.3% from Ps. 25.0 billion in 1994 to Ps. 53.7 billion in 1995. In dollar terms, external sales (excluding the activities of the PMI Group) increased by 12.0% from U.S. \$7.5 billion in 1994 to U.S. \$8.4 billion in 1995. Crude oil exports accounted for 88.2% of export sales in 1994 and 89.3% in 1995, petroleum by-products (including natural gas) accounted for 5.7% of export sales in 1994 and 6.2% in 1995, and petrochemical products accounted for the remainder of export sales in those years. Crude oil export sales increased by 117.1% from Ps. 22.1 billion in 1994 to Ps. 47.9 billion in 1995, and increased in dollar terms by 13.1%, from U.S. \$6.6 billion in 1994 to U.S. \$7.5 billion in 1995, 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. \$15.70 in 1995, a 13.1% increase from the average of U.S. \$13.88 observed in 1994. External sales of petroleum derivatives (including NGLs) increased by 132.0% from Ps. 1.4 billion in 1994 to Ps. 3.3 billion in 1995, and increased in dollar terms by 24.3% from U.S. \$423.2 million in 1994 to U.S. \$526.0 million in 1995, due to increased prices in international markets. External sales of petrochemical products (including certain by-products of the petrochemical process) increased by 56.9% from Ps. 1.5 billion in 1994 to Ps. 2.4 billion in 1995, as a result of an increase in international prices of petrochemicals, and decreased in dollar terms by 16.9% from U.S. \$453.7 million in 1994 to U.S. \$376.8 million in 1995, mainly due to exchange rate differences. Net of collection of the IEPS tax, domestic sales increased by 75.9%, from Ps. 42.3 billion in 1994 to Ps. 74.4 billion in 1995. Domestic sales of petroleum derivatives increased by 72.5% from Ps. 34.1 billion in 1994 to Ps. 58.9 billion in 1995, primarily due to an increase in the domestic prices of unleaded gasoline and fuel oil. Domestic petrochemical sales (including sales of certain by-products of the petrochemical production process) increased from Ps. 4.9 billion in 1994 to Ps. 10.5 billion in 1995, due to an increase in international prices for petrochemicals and an increase in domestic demand. Sales of natural gas increased from Ps. 3.4 billion in 1994 to Ps. 5.1 billion in 1995. Other income increased, from Ps. 2.5 billion in 1994 to Ps. 2.6 billion in 1995.

In addition, in 1995 PEMEX recorded an exchange gain of Ps. 1.6 billion, 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 78.3%, from Ps. 75.2 billion in 1994 to Ps. 134.0 billion in 1995, primarily due to a Ps. 15.3 billion increase in cost of sales and a Ps. 41.8 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 41.4% in 1994 to 32.8% in 1995. Hydrocarbon extraction duties increased from Ps. 33.1 billion to Ps. 74.9 billion, largely because of the increase in the international price of crude oil. In addition, transportation and distribution expenses increased by Ps. 415 million over their 1994 level, interest expense (net) changed significantly, from a debit of Ps. 852 million in 1994, to a credit of Ps. 1,052 million in 1995, and other expenses increased by Ps. 746 million from the level of Ps. 726 million in 1994. The change in interest expense was due to the levels of the domestic market rates and an increase in the liquidity of the peso.

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 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, with the new indebtedness 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 1992, 1993, 1994, 1995 and 1996, Petróleos Mexicanos made advance payments to the Government of Ps. 1,417 million, Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million, and Ps. 6,782 million, respectively, of minimum guaranteed dividends. During the first nine months of 1997, Petróleos Mexicanos made advance payments to the Government of Ps. 4,230 million of these dividends. The total dividends paid by Petróleos Mexicanos to the Government in respect of the CAPs regarding 1992, 1993, 1994, 1995 and 1996 fiscal years amounted to Ps. 3,313 million, Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million and Ps. 6,782 million, respectively. See Note 10 to the Financial Statements.

In December 1997, the Issuer and the Government agreed to a reduction in the equity of Petróleos Mexicanos, and in connection therewith, the Board of Directors of Petróleos Mexicanos authorized a reduction in the CAPs by an amount of Ps. 12,118.05 million, and Petróleos Mexicanos paid the Government U.S. \$1,500 million in December 1997 as consideration for such reduction in the CAPs. Petróleos Mexicanos and the Government are currently negotiating a reduction in the minimum guaranteed dividend payable to the Government in respect of the CAPs, although no assurances can be made as to whether or when such reduction will be effected, and whether or to what extent the total dividends payable to the Government for 1998 and future years may be reduced.

From 1990 through 1996, PEMEX's total indebtedness increased from U.S. \$8.1 billion to U.S. \$10 billion, while PEMEX financed a capital expenditure program that averaged U.S. \$2.6 billion per year during the same period. See "Financial Statements—Consolidated Balance Sheets".

During 1996, net funds provided by operations were Ps. 29.7 billion, up Ps. 12.5 billion from 1995. Funds provided by income plus items not requiring cash outlays of Ps. 39.8 billion, were partially offset by a Ps. 11.2 billion increase in accounts and notes receivable. An additional Ps. 5 billion of net funds was provided by new financings (excluding Ps. 736.6 million of foreign exchange losses). During 1996, PEMEX applied net funds of Ps. 25.4 billion for net investments at cost, including net investments in fixed assets of Ps. 16 billion (consisting of Ps. 18.1 billion of new investments and capitalized interest less Ps. 2.1 billion of dispositions of fixed assets) and Ps. 1 billion of capitalized foreign exchange losses. More recently, a letter of credit facility for U.S. \$620 million was obtained by PEMEX and Pemex Capital Inc. from Société Generale, among other banks. In addition, a line of credit for U.S. \$550 million was obtained by PEMEX from Banco Nacional de Comercio Exterior, S.N.C. ("Bancomext"), and a revolving syndicated credit facility for U.S. \$1 billion was obtained by PEMEX from The Chase Manhattan Bank, among other banks.

At December 31, 1996, PEMEX had cash and marketable securities totaling Ps. 18.0 billion, as compared with Ps. 11.8 billion at December 31, 1995. 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 financings.

During the first nine months of 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. \$215 million, granted by, among other banks, Swiss Bank Corporation, Banco Español de Crédito, Banco Santander and Credit Agricole. Also, U.S. \$190.6 million was obtained from lines of credit with Texas Commerce Bank and Toronto Dominion Bank, among others. 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 Italian Lira 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 payable semi-annually 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. \$1 billion of global notes and bonds with registration rights divided into two tranches: one for U.S. \$600 million with a ten-year maturity at a rate of 8.85% and the other for U.S. \$400 million with a thirty-year maturity at a rate of 9.5% per annum.

During 1996, several short-term lines of credit were contracted to finance trade operations for imports and exports of crude oil and petroleum and petrochemical products, for a total amount of U.S. \$1.1 billion, granted by, among other banks, Société Générale, 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, as well as one credit line with Banque Européenne pour L'Amérique Latine, two credit lines with Société Générale, two credit lines with Kreditanstalt Für Wiederaufbau, one credit line with Export Development Corporation, and one credit line with Westdeutsche Landesbank Girozentrale. Three bond issues were placed, one for 300 billion Italian Lira at a rate of 12.25% equivalent to U.S. \$192.6 million with a two-year maturity at a rate of 9.084%, 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%. The size of the commercial paper program with Bank of America National Trust and Savings Association was increased to U.S. \$500 million from U.S. \$365 million. The bankers' acceptances facilities arranged by J.P. Morgan and the Industrial Bank of Japan in 1994 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 1995, several short-term lines of credit were contracted to finance imports and exports of oil and petrochemical products, for a total amount of U.S. \$648 million, granted principally by Banco Latinoamericano de Exportaciones, Chase Manhattan Bank N.A., Barclays Bank plc, and Fuji Bank Limited, among others. Additionally, four short-term revolving lines of credit were contracted for a total of U.S. \$880 million, of which U.S. \$800 million was repaid in the same year. During 1995,

U.S. \$229 million was obtained from buyers' credit in the U. S. market through one credit line with Deutsche Bank, one credit line with Banque Européenne pour L'Amérique Latine, two credit lines with Société Générale, two credit lines with Kreditanstalt für Wiederaufbau, one credit line with Export Development Corporation, and one credit line with Westdeutsche Landesbank Girozentrale, with differing maturities, the longest being for five years. A bond issue of 150 million Swiss francs at a rate of 6%, equivalent to U.S. \$133 million, was placed in the Swiss market with a two-year maturity. The size of the commercial paper program with Bank of America National Trust and Savings Association was increased by U.S. \$65 million from the U.S. \$300 million originally contracted in 1994.

In 1996, net payments on external borrowings amounted to U.S. \$2.7 billion, of which U.S. \$215 million was 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 advance sales of receivables, which amounted to U.S. \$10 billion as at December 31, 1996, long-term debt was approximately U.S. \$5.4 billion. At the end of 1996, PEMEX's ratio of equity to total assets fell to 49.9%, since the increase in PEMEX's liabilities was higher than the increase in its equity. Total assets, liabilities and equity of PEMEX increased by 27.7%, 32.6% and 23% respectively, from 1995 to 1996. See Notes 6, 7, 8 and 12 to the Financial Statements.

From January to September 1997, net payments on external borrowings amounted to U.S. \$2.7 billion, of which U.S. \$785 million was paid to amortize foreign trade lines, U.S. \$235.7 million to amortize buyers' credits, U.S. \$700 million to amortize bonds, U.S. \$425 million to amortize the existing bankers' acceptance facilities and U.S. \$277 million to reduce outstanding commercial paper. The remainder was used to amortize leases, project financings, restructured debt and direct loans. Of PEMEX's total debt and advance sales of receivables, which amounted to U.S. \$10.4 billion as at September 30, 1997, long-term debt was approximately U.S. \$8.1 billion.

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 1992 to 1996 and as at September 30, 1997.

	As at December 31,					As at September 30,
	1992	1993	1994 ⁽¹⁾	1995	1996	1997
	(In millions of U.S. dollars) ⁽²⁾					
Domestic Debt⁽³⁾:						
Pesos	—	—	—	—	—	—
Currencies other than Pesos	<u>\$1,826</u>	<u>\$1,633</u>	<u>\$1,777</u>	<u>\$2,100</u>	<u>\$1,235</u>	<u>\$ 1,187</u>
Total Domestic Debt	1,826	1,633	1,777	2,100	1,235	1,187
External Debt⁽³⁾⁽⁴⁾:						
MYRA's ⁽⁵⁾	710	589	543	532	498	479
Other Direct Bank Loans	983	707	533	388	224	132
Securities	1,539	2,582	3,405	3,256	3,577	5,223
Bonds ⁽⁸⁾	1,264	2,259	2,930	2,906	3,352	4,825
Commercial Paper	275	323	475	350	225	398
Revolving Loans	0	0	0	80	0	0
Trade Finance ⁽⁶⁾	2,714	1,749	1,452	1,638	2,835	1,840
Bankers' Acceptances	2,136	1,200	1,127	985	1,260	835
Advances from Commercial Banks	578	549	325	653	1,575	1,005
Purchasing Loans ⁽⁷⁾	430	520	332	296	370	322
Financial Leases	251	260	263	425	464	502
Project Finance ⁽¹⁾	577	559	657	519	507	449
Total External Debt	<u>7,202</u>	<u>6,966</u>	<u>7,184</u>	<u>7,134</u>	<u>8,476</u>	<u>8,947</u>
Sales of Receivables	—	361	352	330	294	258
Total Debt and Sales of Receivables	<u>\$9,028</u>	<u>\$8,960</u>	<u>\$9,214</u>	<u>\$9,564</u>	<u>\$10,004</u>	<u>\$10,392</u>

Note: Totals may differ due to rounding.

- (1) Includes PMI Group project finance debt of U.S. \$32 million.
- (2) Indebtedness payable in currencies other than U.S. dollars were converted into pesos at the exchange rates for accounting purposes and then to U.S. dollars at the following exchange rates: Ps. 3.1230 = U.S. \$1.00 at December 31, 1992; Ps. 3.1099 = U.S. \$1.00 at December 31, 1993; Ps. 5.3250 = U.S. \$1.00 at December 31, 1994; Ps. 7.6425 = U.S. \$1.00 at December 31, 1995; Ps. 7.8509 = U.S. \$1.00 at December 31, 1996; and Ps. 7.7707 = U.S. \$1.00 at September 30, 1997. See Note 3 to the Financial Statements. Figures for 1995, 1996 and September 30, 1997 do not include indebtedness of the Subsidiary Companies.
- (3) Excludes capitalized interest and other accrued interest. See Note 7(d) to the Financial Statements for amount of capitalized interest for 1995 and 1996.
- (4) Indebtedness payable other than in pesos and owed to persons or institutions outside Mexico.
- (5) Multi-Year Restructure Agreements.
- (6) To finance external trade of crude oil and derivatives.
- (7) To finance imports of equipment and spare parts.
- (8) As at September 30, 1997, included U.S. \$1,000 million of PIDIREGAS.

Capital Expenditures

PEMEX's total capital expenditures in 1996 amounted to Ps. 32.1 billion, of which Ps. 8.5 billion corresponded to financial investment and approximately Ps. 23.6 billion to capital expenditures. Capital expenditures represented a 62% increase from the Ps. 14.6 billion invested in 1995 and a 138% increase from the Ps. 9.9 billion invested in 1994.

The following table provides a breakdown of the allocation of PEMEX's capital expenditure program for the five years ended December 31, 1996. 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.

	As at December 31,				
	1992	1993	1994 ⁽¹⁾	1995	1996
	(In millions of nominal pesos)				
Construction in Progress	Ps. 3,135	Ps. 3,160	Ps. 5,751	Ps. 5,732	Ps. 6,488
Equipment for Oil Drilling.....	1,104	416	288	828	1,652
Drilling of Oil Wells by Contract	1,117	1,639	1,952	2,574	5,395
Real Estate	894	798	626	856	2,063
Maintenance	907	1,058	1,540	2,295	5,131
Labor for Exploration and Drilling.....	529	488	436	562	964
Other Investments.....	163	267	854	1,182	2,177
Exploration	534	738	461	556	707
Total.....	<u>Ps. 8,383</u>	<u>Ps. 8,564</u>	<u>Ps. 11,908</u>	<u>Ps. 14,585</u>	<u>Ps. 24,577</u>

Note: Numbers may not total due to rounding.

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

For 1997, the capital expenditures budget of PEMEX (excluding PIDIREGAS-eligible projects) called for a total investment of Ps. 31,541 million. Of that amount, Ps. 20,612 million, equivalent to 65.4% of total capital expenditures, was 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 all of its infrastructure to produce and deliver crude oil and natural gas. In its downstream activities, its main objectives are to improve the quality of all of its products slate, while achieving efficiencies similar to those of its international competitors. Emphasis is placed on industrial safety and environmental care is given to all of its investment projects.

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* (the General Law of Public Debt) and the *Ley de Presupuesto, Contabilidad y Gasto Público Federal* (the Law of Federal Budget, Accounting and Public Expenditure) were amended to allow for PIDIREGAS. PIDIREGAS-eligible infrastructure projects are those deemed essential for Mexico's economic development and must come under the rubric of the Government's annual budget, as enacted by the Mexican Congress. These projects must be economically profitable and thus able to meet debt obligations through self-generated income, and must also be capable of securing private long-term financing at favorable rates.

During the construction period, investment in a PIDIREGAS project is registered in contingent accounts. Recognition of investment for budgetary purposes and of ownership of assets for accounting purposes is made *pari passu* with the amortization schedule for payments of principal that will become due in the next fiscal year in addition to those principal payments becoming due in the subsequent year. PEMEX will classify as direct debt obligations and include, beginning at the time a project starts operations, on its balance sheet the payments due in the current two-year period (the current fiscal year and next succeeding fiscal year) and treat the balance as contingent debt obligations. The latter will be recorded in contingent accounts containing the total liability and

the related assets, each of which will be reduced each fiscal year by the amount of the then current payment obligations included on the balance sheet. PEMEX will record the direct debt obligations as current liabilities and the corresponding portion of the infrastructure project as an asset which will increase each year by the amount reflecting the payment obligation that will become current. PEMEX's Cantarell, Burgos and Cadereyta projects will benefit from PIDIREGAS treatment. See "— Recent Developments—PEMEX-Exploration and Production Cantarell Project".

The total capital expenditures budget of PEMEX for 1997, including Ps. 8,504 million for PIDIREGAS projects, amounted to Ps. 40,044 million, of which Ps. 29,432 million (73.5%) was directed to exploration and production programs.

Most of PEMEX's capital expenditure program will be financed with internally generated funds.

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 for 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, 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. 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, 1996, PEMEX's income under U.S. GAAP approximated Ps. 10.2 billion, which represented Ps. 6.2 billion decrease from Mexican GAAP income. In contrast, for the years ended December 31, 1995 and 1994, PEMEX reported losses under U.S. GAAP approximating Ps. 8.3 billion and Ps. 21.1 billion, respectively. The adjustments to Mexican GAAP income in 1996 are largely explained by the effect of the impairment of fixed assets of approximately Ps. 7.2 billion. The significant losses under U.S. GAAP for 1995 and 1994 principally resulted from the treatment of Ps. 21.1 billion of foreign exchange losses. 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 15 to the Financial Statements.

PEMEX's equity under U.S. GAAP approximated Ps. 69.3 billion as of December 31, 1996, up from Ps. 64.7 billion as of December 31, 1995. The 1996 increase in equity under U.S. GAAP principally reflected the income obtained under U.S. GAAP of Ps. 10.2 billion, offset by the advanced payments on minimum guaranteed dividends of Ps. 6.8 billion. See Note 7 to the Financial Statements. For a further discussion of these and other adjustments, see Note 15 to the Financial Statements.

Inflation Accounting Applicable to PEMEX

U.S. GAAP does not require the recognition of the effects of inflation on the financial statements. As mentioned in Note 2(c), 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 NCPI; 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 13), 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 prior year fixed asset revaluation 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.

Taxes and Duties

Instead of paying the income and asset taxes applicable to all Mexican 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. In 1992, this duty was set at a rate equal to 58.4% of the value of the hydrocarbons exported (based on the weighted average price of crude oil exported) and 53.4% of the value of hydrocarbons sold in the domestic market in the form of natural gas, refined products and petrochemicals.

The rate at which PEMEX's special duty was assessed has varied from year to year. The duty estimate generally was 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 and Public Credit established a new fiscal regime for PEMEX. For 1998, according to 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 and Public Credit (other than the corporate income tax and the assets 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 applicable 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—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 fuel 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 and Public Credit. 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 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 Derecho sobre Hidrocarburos (the "Hydrocarbon Duty"). This duty is calculated by applying a rate of 60.8% to the hydrocarbons sales revenues of PEMEX 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 Duty.

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 U.S. \$13.50 per barrel, effective January 15, 1998.

Starting in 1994, interest payments by PEMEX on its external debt were no longer 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 substantial amounts in terms of the total PEMEX's total tax liabilities.

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.

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 the crude oil and gas exploration and production activities, which are conducted through Pemex-Exploration and Production; refining includes the activities of refining of crude oil to produce petroleum products and derivatives and the storage, distribution and marketing thereof, 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, 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 and 1996 fiscal years and for the first nine months of 1997, as well as the percentage change in sales revenues for the periods indicated.

	Year ended December 31,			Nine Months ended Sept. 30, 1997 ⁽¹⁾	Fiscal Year 1995 vs. 1994	Fiscal Year 1996 vs. 1995	Nine Months ended Sept. 30, 1997 vs. Nine Months ended Sept 30, 1996 ⁽¹⁾⁽²⁾
	1994	1995	1996				
	(In millions of nominal pesos)						
Pemex-Exploration and Production							
Trade sales	Ps. 22,078	Ps. 47,931	Ps. 81,337	Ps. 61,378	117.1%	69.7%	7.4%
Intersegment sales	31,190	59,966	87,249	69,268	73.0%	61.7%	14.0%
Total net sales	53,268	101,897	168,586	130,646	91.3%	65.4%	10.8%
Pemex-Refining							
Trade sales	52,169	72,099	101,169	93,509	38.2%	40.3%	29.3%
Intersegment sales	2,321	5,987	7,952	5,751	157.9%	32.8%	(2.5%)
Total net sales	54,490	78,086	109,121	99,260	43.3%	39.7%	26.9%
Pemex-Gas and Basic Petrochemicals							
Trade sales	9,456	14,214	23,084	23,135	50.3%	62.4%	44.5%
Intersegment sales	6,519	8,169	14,662	9,105	25.3%	79.5%	(12.0%)
Total net sales	15,975	22,383	37,746	32,240	40.1%	68.6%	22.3%
Pemex-Petrochemicals							
Trade sales	5,631	11,538	13,624	7,383	104.9%	18.1%	(28.3%)
Intersegment sales	1,314	3,005	4,283	2,141	128.7%	42.3%	(28.3%)
Total net sales	6,945	14,543	17,907	9,524	109.4%	23.1%	(28.3%)
Corporate and Other and Intercompany Eliminations							
Trade sales	5,826	11,528	12,779	0	97.9%	10.9%	0%
Intersegment sales	(41,344)	(71,127)	(114,146)	(86,265)	72.0%	60.5%	7.8%
Total net sales	(35,518)	(59,599)	(101,367)	(86,265)	67.8%	70.1%	7.8%
Total Sales	Ps. 95,160	Ps. 157,310	Ps. 231,993	Ps. 185,405	65.3%	47.5%	19.0%

(1) Petróleos Mexicanos and the Subsidiary Entities without the Subsidiary Companies.

(2) Does not include the results of the PEMEX's petrochemical operations.

The table below sets forth PEMEX's income by business segment for each year in the two-year period ended December 31, 1996 and for the nine month period ended September 30, 1997, as well as the percentage change in income for the periods indicated.

	Year ended December 31,		Nine Months ended Sept. 30, 1997	Fiscal Year 1996 vs. 1995	Nine Months ended Sept. 30, 1997 vs. Nine Months ended Sept. 30, 1996 ⁽¹⁾⁽²⁾
	1995	1996			
(in millions of nominal pesos)					
Exploration and Production	Ps. 7,888	Ps. 15,178	Ps. 10,895	92.4%	(14.4%)
Refining	(2,372)	(1,086)	(4,315)	54.2%	(995.4%)
Gas and Petrochemicals					
Pemex-Gas and Basic Petrochemicals	1,840	1,415	1,221	(23.1%)	(44.9%)
Pemex-Petrochemicals	2,596	1,562	199	(39.8%)	(88.1%)
Total	4,436	2,977	1,420	(32.9%)	(63.4%)
Corporate and Other	(143)	(574)	1,052	(301.4%)	12,236.4%
Total Income	Ps. 9,809	Ps. 16,495	Ps. 9,052	68.2%	(47.0%)

(1) Petróleos Mexicanos and the Subsidiary Entities without the Subsidiary Companies.

(2) Does not include the results of PEMEX's petrochemical operations.

Nine-Month Period ended September 1997 Compared to Nine-Month Period ended September 1996. In the first nine months of 1996, trade sales relating to exploration and production activities showed an increase of 7.4% relative to export sales in the first nine months of 1996 and an increase in U.S. dollar terms of 2.7%, as a result of increases in the volume exported, from 1,541,000 bpd in the nine-month period ended September 30, 1996 to 1,711,000 bpd in the same period in 1997. The weighted average price of crude oil exported was U.S. \$16.74 per barrel in the first nine months of 1997 as compared to U.S. \$18.03 per barrel in the first nine months of 1996. Intersegment sales increased by 14.0%, 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 decreased from Ps. 12,733 million in the first nine months of 1996 to Ps. 10,895 million in the same period in 1997, mainly as a result of increased cost and expenses relative to revenue, including increased taxes and hydrocarbon extraction duties (such taxes and duties increased from Ps. 85,270 million in the first nine months of 1996 to Ps. 90,084 million in the same period in 1997). In the first nine months of 1997, Pemex-Refining registered a loss amounting to Ps. 4,315 million, as compared to a gain of Ps. 482 million in the first nine months of 1996. The loss in the first nine months of 1997 in the refining segment was due to increased purchase prices and financing costs.

Trade sales related to the natural gas and petrochemical business segment increased by 16.0%, from Ps. 26,308 million in the nine-month period ended September 30, 1996 to Ps. 30,518 million in the comparable period in 1997. The increase in trade sales was driven by increases in the volume of domestic sales of natural and liquid gas, as well as an increase in prices in the domestic market. The volume of domestic sales of natural gas increased by 4.3% from the first nine months of 1996 to the comparable period in 1997; total natural gas sales increased by 25.8%, from Ps. 6,968 million in the nine-month period ended September 30, 1996 to Ps. 8,769 million in the comparable period in 1997.

Total costs and operating expenses related to the natural gas and petrochemical business increased by 10.4%, from Ps. 37,134 million in the first nine months of 1996 to Ps. 40,981 million in the first nine months of 1997, due primarily to a Ps. 3,560 million increase in costs of sales and a Ps. 287 million increase in sales and administrative expenses. The increase in cost of sales resulted primarily from materials imported, depreciation, and an increase in reserves for retirement payments, pensions and indemnities. Income related to Pemex-Gas and Basic Petrochemicals decreased by 45%, from Ps. 2,214 million in the nine-month period ended September 30, 1996 to Ps. 1,221

million in the comparable period of 1997, due to an increase in costs of sales of Ps. 6,048 million (25.4%) and a decrease in other net revenue of Ps. 375 million (46%) from the nine-month period ended September 30, 1996 to the comparable period of 1997.

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 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 61.7%, 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 less 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 to Ps. 2,064 million. Intersegment sales increased by Ps. 1,965 million, largely due to an increase in 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.

1995 Compared to 1994. Trade sales relating to exploration and production activities, which in their entirety represent export sales, showed an increase of 117% relative to 1994 sales, and an increase in U.S. dollar terms of 13.1%, as a result of an increase in the international price of crude oil, notwithstanding a minor decrease in volume exported, from 1,307,100 bpd in 1994 to 1,306,000 bpd in 1995. The weighted average price of exported crude oil was U.S. \$15.70 in 1995 as compared to U.S. \$13.88 in 1994. Intersegment sales increased by 73%, principally as a result of an increase in domestic price 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. 5,914 million in 1994 to Ps. 7,888 million in 1995, 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. 32,668 million in 1994 to Ps. 74,196 million in 1995. In 1995, Pemex-Refining continued to register a loss, amounting to Ps. 2,372 million, as compared to a loss of Ps. 3,703 in 1994. The 1995 loss in the refining segment was due mainly to the slowdown in the Mexican economy which resulted in decreased domestic demand, as well as to increased inflation rates which reduced the purchasing power of domestic consumers and caused crude oil prices to rise and affect the operating costs of Pemex-Refining.

Trade sales related to refining activities increased by 38.2%, from Ps. 52,169 million in 1994 to Ps. 72,099 million in 1995. Export sales increased from Ps. 880 million in 1994 to Ps. 2,262 million in 1995, as a result of increased prices. Domestic sales increased by Ps. 18,548 million in 1995, principally due to an increase in the value of sales notwithstanding a decrease in the IEPS of

Ps. 4,269 million. Intersegment sales increased by Ps. 3,666 million, largely due to an increase in the sales of naphthas.

Trade sales related to the natural gas and petrochemical business segment increased by 70.7%, from Ps. 15,087 million in 1994 to Ps. 25,752 million in 1995. The increase in trade sales was driven by increases in the volume of exports and domestic sales of petrochemicals, as well as an increase in the prices of petrochemical products in international markets.

In 1995, the volume of petrochemical exports decreased by 21.3%, from 1,559,800 tpy in 1994 to 1,226,100 tpy in 1995. The volume of domestic sales of petrochemicals increased 5.1% in 1995, from 6,062,000 tpy in 1994 to 6,371,800 tpy in 1995. The volume of domestic sales of natural gas increased by 7% in 1995; natural gas sales increased by 49.2%, from Ps. 3,478 million in 1994 to Ps. 5,191 million in 1995.

Recent Developments

Oil Prices. In recent months, a sharp drop in world crude oil prices has had a negative effect on PEMEX's results, including those for the last quarter of 1997. At February 24, 1998, the spot price for WTI crude oil was U.S. \$15.31. In January 1998, the average sales price per barrel of WTI crude oil was approximately U.S. \$16.69 as compared to U.S. \$18.90 in December 1997. PEMEX does not hedge against such fluctuations in crude oil prices. See "—General—Prices". The lower crude oil prices have resulted in a reduction of PEMEX's 1998 budget by the Government. See "—Capital Expenditures".

Current Situation in Secondary Petrochemical Industry. Pursuant to the privatization process outlined by the Ministry of Energy on October 13, 1996 (See "Business—Petrochemicals"), PEMEX began divestiture of certain petrochemical assets. On January 30, 1997, PEMEX divested itself of four petrochemical complexes: Cosoleacaque, Camargo, Escolín and Tula. On February 28, 1997, the assets of two more complexes, La Cangrejera and Morelos, were divested. As of April 1, 1997, these first six subsidiaries were created as independent companies, incorporated under Mexican law as *sociedades anónimas de capital variable* (corporations). On June 25, 1997, the divestment of the assets for one more complex, Pajaritos, was authorized. In the future, the assets of the three remaining complexes are expected to be divested. PEMEX expects that fifty-one percent of the equity in each of the aforementioned new subsidiaries will be owned by PEMEX through Pemex-Petrochemicals, which will become a holding company for the stock owned in the new subsidiaries.

Pemex-Exploration and Production Cantarell Project. 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 U.S. \$1 billion, is expected to increase oil recovery rates through the following process: the plant will inject nitrogen into Cantarell oil reservoirs, thereby maintaining pressure during oil extraction. By maintaining favorable oil recovery rates at Cantarell, which is one of the world's largest hydrocarbon fields, investment in this nitrogen cryogenic process is expected to yield long-term benefits for PEMEX—including increasing the amount of exploitable reserves at Cantarell.

PEMEX-Refining Cadereyta Project. On November 17, 1997, PEMEX awarded a \$1.4 billion investment project relating to the construction of a delayed coker refining complex located in Cadereyta to a construction consortium. The winning consortium, CONPROCA, S.A. de C.V., was formed by Sunkyoung Engineering and Construction Limited, Siemens AG and Truturados 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.

PEMEX-Exploración y Producción Burgos Project. In 1997, Pemex-Exploración y Producción initiated a 15-year, U.S. \$5.5 billion investment project to develop the Burgos basin gas fields in Northern Mexico and boost production of natural gas. Three major turnkey contracts worth U.S. \$108 million, U.S. \$96.4 million and U.S. \$71 million have been awarded for the project. PEMEX hopes that the Burgos project will convert Mexico from a marginal gas importer to a net gas exporter.

BUSINESS

Overview

PEMEX 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. According to data published in *Petroleum Intelligence Weekly* on December 22, 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 Petróleos de Venezuela ("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) published in *Petroleum Intelligence Weekly* on December 22, 1997, 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.

The activities of PEMEX are regulated by the Regulatory Law and the Organic Law. Under the Organic Law and related regulations, PEMEX is entrusted with the central planning and the strategic management of Mexico's petroleum industry, and PEMEX 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 that are used as basic industrial raw materials and that are considered Basic Petrochemicals.

The Organic Law separates the operating functions of PEMEX into four entities, the Subsidiary Entities, each of which is controlled by (and has the characteristics of a subsidiary of) PEMEX. 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: production of natural gas, natural gas liquids and derivatives that may be used as basic raw materials and the storage, transportation, distribution and marketing thereof, production of 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 Mexican private and social sector companies (which may be owned by non-governmental, non-Mexican companies or individuals) may participate, upon Governmental permission, in the storage, distribution and transportation of natural gas and to that end may construct, own and operate pipelines, installations and equipment. Implementing regulations to the amendment were published on November 8, 1995. The *Comisión Reguladora de Energía* (Energy Regulatory Commission or "CRE"), first established in October 1993 as a technical agency of the Ministry of Energy, was re-organized with new powers under the Law of the Energy Regulatory Commission, which was enacted on 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 methodologies and general contractual terms through issuance of directives, and the resolution of disputes between regulated parties and users of their services. Under the new regulatory framework, PEMEX maintains an important role in the supply of natural gas given its position as the sole domestic producer and dominant transporter of

natural gas. It applies methodologies established by the CRE for setting its first-hand sales prices of domestic natural gas (imported gas being excluded from such price regulation) and calculating its transportation rates. PEMEX will divest its existing distribution assets and will allow open access to its transportation system within a 24-month period of the effective date of the Regulations, providing such access to third parties as the necessary measurement and controls systems are implemented. It will continue to perform marketing functions and may develop storage systems. PEMEX nonetheless 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 1996, the Energy Regulatory Commission approved the *Programa de Acceso Gradual 1996-1997* ("Gradual Access Program"), which provides for the gradual opening of private-sector access to domestic natural gas distribution as well as open 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 issued. To date, the bidding process for pipelines located in Chihuahua, Cuauhtémoc-Anáhuac, Hermosillo and Toluca has been completed, and bidding for Delicias and the Tampico-Madero geographic zone has initiated. The Energy Regulatory Commission has designated the Tampico, Monterrey and Mexico City geographic zones as open-access distribution zones subject to a bidding process.

PEMEX supplies substantially all of Mexico's consumption of petroleum products, a market which is larger than that of Spain, similar to that of Canada or the United Kingdom and equivalent to four-fifths of the oil consumption of France or Italy in 1995.³ PEMEX's refining capacity totaled 2.1 million bpd at the end of both 1995 and 1996, with 1.8 million bpd of such capacity directed to the primary distillation of crude oil and the remainder (0.3 million bpd) used for the fractionation of condensates.

PEMEX is one of the major producers of crude oil in the world that experience a strong demand for their products in their domestic markets, which makes PEMEX less vulnerable to disruptions in the international markets. Domestic demand for PEMEX's products grew steadily from 1986 to 1992, but leveled off first in 1993, principally as a result of a slowdown in the Mexican economy, and then again in early 1995, as a consequence of the macroeconomic events that followed the devaluation of the peso against the U.S. dollar in December 1994. See "Annex A—United Mexican States—The Economy—Events During 1994 and 1995" and "—The Government's Response". Domestic demand for PEMEX's products grew significantly in 1996, due principally to the recovery of the Mexican economy relative to 1995.

PEMEX's exports accounted for approximately 12.1% of Mexico's foreign revenues in 1996 and 10.5% in 1995. If the indirect taxes (IEPS tax) collected by PEMEX are taken into account, PEMEX's contribution to the Federal Government's revenues was approximately 37.6% of total Government revenue in 1996 and 35.3% in 1995.

PEMEX owns a 5% interest in Repsol, S.A., a Spanish integrated oil company, 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 substantial growth in proven reserves from 11.2 billion barrels in 1976 to 72.1

³ *Petroleum Intelligence Weekly*, December 16, 1996.

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 666 wells and by December 31, 1996, had completed 661 exploration and development wells with an average success rate of 91%. From 1992 to 1996, this led to the discovery of 16 new crude oil and 11 new natural gas fields, bringing the number of PEMEX's crude oil and natural gas fields in production to 334 at the end of 1996.

Most of the offshore production in the Gulf of Mexico is obtained in waters under 100 meters in depth; however, the exploration program for 1996 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, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
Wells Drilled.....	121	66	72	104	118
Wells Completed.....	129	78	63	102	114
Exploratory Wells.....	41	25	16	10	10
Development Wells.....	88	53	47	92	104
Producing Wells at End of Period.....	4,741	4,641	4,555	4,616	4,718
Fields in Production.....	334	336	340	342	334

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

For 1997, PEMEX budgeted Ps. 29,432 million for investment in exploration and production, approximately 69% of which was budgeted for projects relating to field development, pipelines and exploration activities, including the continuation of certain projects started in 1996. The remaining 31% was budgeted for operational projects as well as projects relating to maintenance, installation, industrial safety, and environmental matters.

In 1996, PEMEX invested Ps. 18,136 million in exploration and production, with the majority of the investment corresponding to strategic projects (Ps. 10,043 million). Of these strategic projects, Ps. 5,445 million corresponded to field development projects and Ps. 1,882 million to investments in exploration activities, that were directed towards 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.

In 1995, PEMEX invested Ps. 9,656 million in exploration and production. Of the total investment in strategic projects (Ps. 5,672 million), 68.9% corresponded to field development projects, 26% to exploration activities, and 5.1% to other projects. The most significant field development projects were the Och-Uetch-Kax, Abkatun-Pol-Chuc and Cantarell projects in the Marine region, and the Jujo-Tecominoacan and Jacinto projects in the Southern region. The principal investments in exploration activities were directed towards 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 investments in artificial exploitation systems were the Ek-Balam project in the Marine region and the gas lift project in Cárdenas and Reforma.

Reserves

Mexico's proved reserves are determined by PEMEX and the IMP, a decentralized public entity of the Government. 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 Constitution and Mexican statutory law, all oil and other hydrocarbon reserves within Mexico are owned by the Mexican nation and not by PEMEX. Under the Organic Law, PEMEX has the exclusive right to extract and utilize those reserves. PEMEX's exploration and development activities are limited to reserves located in Mexico.

At the end of 1996, approximately 46% of Mexico's hydrocarbon reserves were located in the Marine region, 35% in the Northern region and 19% in the Southern or Chiapas-Tabasco region. Mexico's total hydrocarbon reserves reached their peak level at the beginning of 1984. Since then, they 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 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 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 has revised its procedures for estimating reserves to meet the standards of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers of the United States of America. These adjustments were applied in 1997 to estimates for marine reservoirs in the two production regions in the Campeche Sound in the Gulf of Mexico—the Northeast and the Southwest—and in 1998 to the Southern region. Based on these same standards, Pemex-Exploration and Production is estimating reserves in the remaining production region of Mexico, the Northern region, which estimate is expected to be published in 1999. PEMEX will continue to publish concurrently estimates based on its criteria established prior to 1996, until reserve estimates using the revised methodology are available for all regions, in order to provide for more meaningful inter-period comparisons.

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 amounted to 17,110 million boe. Using the criteria and information previously employed, PEMEX had estimated its proved reserves for these 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. Based on the information available to date, PEMEX expects that the process of

review and revision of its reserves will result in a downward revision of PEMEX's total reserve estimates.

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,				
	1992	1993	1994	1995	1996
	(In billions of barrels) ⁽¹⁾				
Proved Developed and Undeveloped Reserves					
Crude Oil.....	44.4	44.0	43.1	42.1	42.1
Condensates ⁽²⁾	6.8	6.7	6.6	6.7	6.4
Natural gas ⁽³⁾	13.9	13.8	13.5	13.3	12.4
Total	<u>65.1</u>	<u>64.5</u>	<u>63.2</u>	<u>62.1</u>	<u>60.9</u>
Reserves/Production ratio (years).....	50	49	48	48	43
Proved Developed Reserves					
Crude Oil.....	27.0	26.6	25.9	25.7	25.6
Condensates ⁽²⁾	4.4	4.3	4.2	4.3	4.1
Natural gas ⁽³⁾	7.2	7.1	6.9	6.8	5.9
Total	<u>38.6</u>	<u>38.0</u>	<u>37.0</u>	<u>36.8</u>	<u>35.6</u>

Note: Numbers may not total due to rounding.

(1) Figures for all years, including 1996, 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 Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers of the United States of America. With the new information gathered on the behavior of the reservoirs based on such adjusted procedures, as of December 31, 1996, the proved reserves for the Northeast and Southwest marine regions amounted to 17,110 million boe. Using the previous criteria and information, PEMEX had estimated its proved reserves for these regions at 27,923 million boe as at the same date, which is the figure reflected in the table. With the new information and standards, as of December 31, 1997, the proved reserves for the Southern region are estimated to total 7,669 million boe. 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, which is the figure reflected in the table.

(2) Includes NGLs.

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

Source: Pemex-Exploration and Production.

Production

In 1996, production averaged 2.86 million bpd of crude oil, 4.19 billion cfpd of natural gas and 426,000 bpd of condensates.

The production level of crude oil in 1996 was 9.2% higher than the 1995 level, the highest ever reached in the Mexican petroleum industry. Natural gas production in 1996 increased by 11.6% from 3.76 billion cfpd in 1995 to 4.19 billion cfpd in 1996, while condensates production decreased by 5.4% over the same period.

PEMEX produces three types of crude oil: Maya, a heavy crude oil; Isthmus, a light crude oil; and Olmeca, a very light crude oil. See "Glossary of Certain Technical Terms". Most of PEMEX's production is Isthmus and Maya crude oil. In 1996, 48% of PEMEX's total production of crude oil consisted of heavy crudes and 52% consisted of light and very light crudes. The Marine region predominately produces heavy crude oil (61.6% of the production of the region), although significant volumes of light crude oil are also produced (38.4%). The Southern region produces light and very light crudes and the Northern region produces roughly one-half heavy crudes.

The following table sets forth the annual crude oil and natural gas production rates for the five years ended December 31, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
	(In millions of barrels per year)				
(A) Crude Oil					
Marine Region	698.7	711.7	730.7	707.0	780.3
Southern Region	238.8	228.2	213.9	213.2	230.6
Northern Region	36.2	35.9	35.7	34.2	35.1
Total	973.7	975.8	980.3	954.4	1,046.0
(B) Condensates ⁽¹⁾	163.5	165.7	165.3	162.4	153.3
Total Liquids Production (A + B)	1,137.2	1,141.5	1,145.6	1,116.8	1,199.3
Natural Gas (billions of cfpv)	1,308.2	1,305.2	1,323.1	1,372.0	1,535.4

Note: Numbers may not total due to rounding.

(1) Includes NGLs.

Source: PEMEX's September 1997 Indicadores Petroleros.

In 1996, approximately 74.9% of Mexico's crude oil production was attributable to offshore facilities located mainly in the Campeche Sound in the Gulf of Mexico. Approximately 22% of the production came from onshore facilities in the Southern region. Inland facilities in the Northern region accounted for the remaining 3.1% of total production. Due to the high productivity of certain wells, 8 fields accounted for 72% of Mexico's crude oil production in 1996.

The Marine region covers an area of approximately 21,000 square kilometers located in the Campeche Sound. 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 2.1 million bpd in 1996. The oil fields located in the Campeche Sound are less than 100 meters below sea level and have an average 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 1996, the production in the Southern region totaled 629,949 bpd. This production area includes 49 oil fields with an average well depth of 5,500 meters.

During 1996, domestic consumption of crude oil amounted to approximately 1.31 million bpd, which represented approximately half of PEMEX's total crude oil production. The remainder of PEMEX's crude oil production was exported. See "—Exports and Imports" below. While total production of crude oil was evenly distributed between exports and domestic consumption, heavy crude oil accounted for 56% of exported volume but only 34% of domestic consumption.

Natural gas production associated with crude oil production accounted for approximately 83% of production of natural gas in 1996, 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 68.5% of all production in 1996, with 37.3% of total production originating from the Marine region, 47.4% from the Southern region, and the remainder from the Northern region.

Domestic consumption of natural gas in 1996 totaled 2.84 billion cfpd, representing no change from the 1995 figure. Of that figure, PEMEX's own consumption represented approximately 46%.

PEMEX imports natural gas to satisfy shortfalls in domestic production and to meet demand in areas of northern Mexico which, due to its distance from the fields, can be supplied more efficiently through imports from the United States. PEMEX imported 83.7 million cfpd of natural gas in 1996, down from 172.6 million cfpd in 1995.

PEMEX obtains and processes both sweet and sour condensates. Sweet condensates, which have very low sulfur content, are used by Pemex-Gas and Basic Petrochemicals for the production of 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 97,613 bpd in 1996 and 101,371 bpd in 1995. Of these amounts, 87,000 bpd (89.1%) resulted in stabilized condensates during 1996 and 90,100 bpd (88.9%) during 1995. Total production of condensates amounted to 433,000 bpd in 1996 and 460,000 bpd in 1995.

In 1994, Pemex-Gas and Basic Petrochemicals commenced the construction of three facilities for the sweetening and stabilizing of condensates in order to increase the production and recovery of natural gas liquids by 10%. At the end of 1996, two sweetening liquid plants, each with a capacity of 24,000 bpd, started services in "Ciudad Pemex," the gas processing center and one sweetening liquid plant, with a capacity of 24,000 bpd, started operations in June 1997 in the "Nuevo Pemex" gas processing center. In August 1997, Pemex-Gas and Basic Petrochemicals commenced operations of an additional sweetening liquid and a fractionation facility at the Nuevo Pemex gas processing center.

Explosions at the "Cactus" Natural Gas Processing Complex and "North Satellite" Terminal. On July 26, 1996, three explosions occurred in 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.

Recovery work and production increases at other centers helped to minimize the disruption of supply of natural gas during the period from the date of the accident to August 6, 1996, when PEMEX restored normal levels of supply with the aid of imports. On September 4, 1996, PEMEX resumed full supply of Mexico's consumption requirements via domestic production, and on September 5, 1996, PEMEX began intermittent exports of natural gas. As of October 22, 1996, the damaged ancillary facilities were operational again, allowing for the restoration of 92% of gas processing and 100% of sour condensates processing. Only the two damaged main cryogenic plants remained inoperative.

By April 15, 1997, PEMEX had restored its liquids recovery capacity to 180 million cfpd above such capacity prior to the accident, due to increases in production capacity, the start-up of Cryogenic Plant No. 1 and the construction of a new cryogenic plant in Nuevo Pemex, Tabasco. PEMEX expects each of these two plants to have a processing capacity of 500 million cfpd. PEMEX expects Cryogenic Plant No. 2 to be fully operational in 1998.

Settlement for U.S. \$136 million was reached and agreed in January 1998. Of this amount, only U.S. \$24 million are outstanding and PEMEX expects to receive payment shortly.

On November 11, 1996, during routine maintenance, a blast occurred at the Terminal Satelite Norte ("North Satellite" Terminal) in Tlalnepantla, north of Mexico City, destroying one tank and damaging two more. The estimated cost of repair and loss of fuel is approximately Ps. 40 million. Approximately 92 thousand barrels were destroyed out of the 240,204 stored at the terminal when the accident occurred.

Refining

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 totaled 1.60 million bpd in 1995 and 1.59 million bpd in 1996. PEMEX is one of the few top producers of crude oil worldwide that experience a significant domestic demand for their refined products while supplying most of such demand at international prices. See "— Commercial Activities".

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 68% of PEMEX's fuel oil production during 1996. Meanwhile, PEMEX consumed approximately 46% of its natural gas production during 1996 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 1996, PEMEX owned and operated six refineries, Cadereyta, Madero, Minatitlán, Salamanca, Salina Cruz, 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 1996, PEMEX's refineries processed 1.2 million bpd of crude oil and 204,000 bpd of condensates that remained in a liquid state from the process of reabsorption and separation of LPG. Of the total crude oil that was processed, 66% was light and 34% was heavy.

During 1996, PEMEX imported approximately 69,100 bpd of gasoline, which represented 14.3% of total domestic demand for unleaded gasoline in that year. During 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, increasing its ability to process heavier 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 capacity. In the short-term, however, PEMEX will continue to import unleaded gasoline to satisfy domestic demand.

PEMEX incorporated new units during 1996, which allowed it to obtain higher levels of production and better performance, while increasing the product quality. The most significant of these units were the second catalytic plant in Cadereyta, with a capacity of 25,000 bpd, the alkylation plants in Cadereyta and Salamanca with 9,400 bpd, and the isomerization plant in Salamanca with 5,800 bpd.

In 1997, PEMEX added new refining units in Tula and Salina Cruz with an additional capacity of 80,000 bpd, two more isomerization plants in Tula and Salina Cruz with an additional capacity of 30,000 bpd, two hydrodesulfurization plants in Salamanca and Tula with an additional capacity of 25,000 bpd and 27,000 bpd, respectively, and one MTBE (Methyl Tertiary Butyl Ether) plant and one TAME (Methyl Teramyl Ether) plant, both in Tula, with a total additional capacity of 4.8 thousand bpd.

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

Pemex-Refining invested approximately Ps. 5,232 million in 1996. Environmentally oriented projects comprised Ps. 2,198 million of the total investment, expansion projects in the Tula, Salina

Cruz and Cadereyta refineries comprised Ps. 327 million, and the remainder was dedicated mainly to projects dealing with the relocation of loading and storage facilities and the expansion of the pipeline system.

Pemex-Refining invested Ps. 6,205 million in 1997, 52% of which was set aside for maintenance projects and the remainder of which was earmarked for the expansion of refineries, relocation of storage facilities, upgrading of refineries and improvements of the pipeline system. Investment projects will focus mainly on the expansion of production, in order to meet the projected growth in domestic demand and to improve profitability.

In addition, during 1996, Pemex-Refining commenced the bidding process for a major project relating to the construction of a delayed coker complex located in Cadereyta. 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. The project was awarded on November 17, 1997 to a consortium formed by Sunkyong Engineering and Construction Limited, Siemens AG and Tribasa.

The following table sets forth the refining capacity of PEMEX for the five years ended December 31, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
	(In thousands of bpd)				
Primary Distillation					
Madero	195	195	195	195	195
Minatitlán	200	200	200	200	200
Salamanca	235	240	240	240	240
Reynosa ⁽¹⁾	9	0	0	0	0
Tula	320	320	320	320	320
Salina Cruz	330	330	330	330	330
Cadereyta	235	235	235	235	235
Total Primary Distillation Capacity	1,524	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 ⁽¹⁾	12	12	12	12	12
Cactus ⁽²⁾	113	113	113	113	113
La Cangrejera ⁽²⁾	113	113	113	113	113
Nuevo Pemex ⁽²⁾	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	2,081	2,077	2,077	2,077	2,077

Note: Numbers may not total due to rounding.

(1) The primary distillation unit at this facility was closed in 1993.

(2) Petrochemical centers.

Source: Pemex-Refining and Pemex-Gas and Basic Petrochemicals.

As a result of its strategy of investing in technology to improve the quality of its fuel, PEMEX has increased its production of unleaded gasoline by 175,700 bpd, from 10% of total gasoline production in 1991 to 52% in 1996. 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 77% in 1996. 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, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
	(In thousands of bpd)				
LPG	244.1	254.2	266.9	256.7	248.8
Gasolines ⁽¹⁾	463.9	482.5	509.4	492.0	498.2
Kerosenes	76.3	83.8	84.9	77.0	69.1
Diesel	277.8	266.7	284.4	254.8	269.6
Fuel Oil	407.7	419.4	420.0	416.7	418.1
Others	105.6	109.9	110.2	102.8	88.6
Total	<u>1,575.4</u>	<u>1,616.4</u>	<u>1,675.8</u>	<u>1,600.0</u>	<u>1,592.4</u>

Note: Numbers may not total due to rounding.

(1) Includes naphtha used as a raw material for petrochemicals and pentane exports.

Source: PEMEX's January 1996 Indicadores Petroleros.

In January 1993, Pemex-Refining entered into a joint venture with Impulsora Jalisciense, S.A. de C.V., to establish a new company called Mexicana de Lubricantes, S.A. de C.V. ("Mexlub"), which formulates, bottles, cans and distributes PEMEX's automotive and industrial lubricants and greases. PEMEX has a 49% participation in this venture. The new company 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 raw materials in the formulation of greases and lubricants.

Petrochemicals

At the end of 1996, PEMEX operated 121 industrial plants and auxiliary units located in 6 petrochemical complexes, 8 process centers and 6 petrochemical units. Pemex-Gas and Basic Petrochemicals operated 61 of these plants and auxiliary units and Pemex-Petrochemicals operated the remaining 60. Total production associated with petrochemical activities, including Basic Petrochemicals, Secondary Petrochemicals and other by-products totaled 19.4 million tons in 1995 and 18.5 million tons in 1996.

In 1995, total petrochemical production amounted to 19.4 million tons, a slight increase of 1.1% with respect to 1994. Natural gas supply problems related to an explosion of a sour condensates pipeline in February 1995 and hurricanes Opal and Roxanne in October 1995, together with reduced domestic economic activity were, on balance, outweighed by successful export programs by Mexican petrochemical producers, which purchase raw and other materials from PEMEX.

In 1996, petrochemical production amounted to 18.4 million tpy, a decrease of 4.9% from the level of 19.4 million tpy in 1995. This decrease was mainly due to shortages in natural gas supplies resulting from the explosion of a cryogenic plant in the "Cactus" natural gas processing complex in July 1996. See "—Production—Explosions at the 'Cactus' Natural Gas Processing Complex and 'North Satellite' Terminal".

PEMEX manufactures a variety of petrochemicals, including methane derivatives (such as ammonia and carbon dioxide, 32.9% of the total 1996 petrochemical production), ethane derivatives (16.7% of the total 1996 petrochemical production), propylene and derivatives (4.3% of the total 1996 petrochemical production) and aromatics and derivatives (10.2% of the total 1996 petrochemical production). The 1.1% increase observed from 1994 to 1995 in the total production

of petrochemicals consisted mainly of large increases in the production of pentanes, which represented approximately 95% of the total increase.

Pemex-Gas and Basic Petrochemicals and Pemex-Petrochemicals invested an aggregate of Ps. 1,135 million in 1995 and Ps. 1,651 million in 1996 and budgeted Ps. 2,839 million for 1997 in projects related to natural gas and condensates processing and petrochemicals production. These include investments intended to increase operating efficiency, investments in plant construction, transportation, maintenance and industrial safety and investments in environmental compliance.

The following table shows the annual production associated with the petrochemical activities of PEMEX for the five years ended December 31, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
	(In thousands of tons)				
Basic Inputs	4,689	5,090	5,385	5,433	4,814
Gases.....	3,649	4,256	4,329	4,142	3,357
Ethane.....	3,592	3,530	3,587	3,362	3,042
Butane.....	57	726	742	780	315
Liquids.....	1,040	834	1,056	1,291	1,457
Pentanes.....	775	624	822	1,032	1,163
Hexanes.....	82	75	83	79	81
Heptanes.....	14	12	13	14	21
Carbon Black Feedstocks.....	169	123	138	166	192
Other Inputs	683	639	614	603	633
Oxygen.....	526	490	456	444	476
Nitrogen.....	118	106	110	110	115
Hydrogen.....	39	43	48	49	42
Petrochemicals	12,864	11,065	12,148	12,303	11,902
Methane Derivatives.....	6,565	5,307	6,058	5,989	6,076
Ethane Derivatives.....	3,377	3,087	3,048	3,140	3,088
Aromatics and Derivatives.....	2,131	1,857	2,006	1,981	1,875
Propylene and Derivatives.....	740	538	647	855	796
Others.....	51	276	389	338	67
Other products⁽¹⁾	958	981	1,033	1,060	1,110
Hydrochloric Acid.....	155	147	141	135	128
Muriatic Acid.....	28	23	15	42	61
Sulfur.....	775	811	877	883	921
Total	19,194	17,775	19,180	19,399	18,459

Note: Numbers may not total due to rounding.

(1) By-products obtained during the production of petrochemicals.

Source: 1996 Memoria de Labores.

PEMEX has a total installed capacity sufficient to produce 20 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 of November 14, 1996 to the Regulatory Law, the Ministry of Energy was responsible for determining which petrochemical products were classified as Basic Petrochemicals.

Before 1986, nearly all petrochemicals were classified as Basic Petrochemicals and accordingly, PEMEX had a monopoly on the production and first-hand sale of all such products. In this environment, PEMEX expanded its petrochemical division at a very fast rate. From 1986 until November 14, 1996, the number of petrochemicals classified as basic was reduced gradually. On November 14, 1996, the amendment to the Regulatory Law became effective, thereby limiting petrochemicals classified as Basic Petrochemicals to nine products (down from 34 in 1986 and 19 in 1989) used in the petrochemical production process, such as ethane, butanes, NGLs and pentanes.

The November 14, 1996 amendment further provides that companies engaged in the production of Secondary Petrochemicals which produce Basic Petrochemicals as by-products may use them in the production process within the plants of the same unit or complex, or deliver them to PEMEX or its Subsidiary Entities, pursuant to an agreement and under terms issued 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 June 1993, PEMEX announced that it would delay the privatization program due to the unfavorable conditions then prevailing in the international petrochemical industry. In November 1995, after a recovery in the petrochemicals market, PEMEX issued a public tender whereby certain assets from the Cosoleacaque petrochemical complex would be sold to private entities. However, on October 13, 1996, the Ministry of Energy canceled the Cosoleacaque bidding process, and announced that the privatization process would continue under a redesigned strategy that contemplates the creation of ten subsidiaries of Pemex-Petrochemicals; one subsidiary for each of Pemex-Petrochemicals' ten complexes. PEMEX anticipates that fifty-one percent of the equity in the new subsidiaries will be owned by PEMEX through Pemex-Petrochemicals, which will become a holding company for the stock owned in the new subsidiaries. Pemex-Gas and Basic Petrochemicals retains the exclusive right to produce and handle nine products: ethane, propane, butane, pentane, hexane, heptane, carbon-black feedstocks, naphthas, and methane used as a raw material. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Current Situation in Secondary Petrochemical Industry".

Amendment of Mexican laws relating to secondary petrochemicals allow both foreign and domestic private investors to own 100 percent of any petrochemical plant producing Secondary Petrochemicals. Private investors have two options to invest in Mexico's secondary petrochemical sector: investing in the ten new petrochemical subsidiaries or directly establishing new petrochemical complexes. Through these two investment mechanisms, the Government seeks to permit greater private participation in managing and investing in the petrochemical sector.

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 which, in 1996, was equivalent to approximately four-fifths of the domestic demand in France or Italy.

In 1996, PEMEX's sales in domestic and international markets 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 tpy of petrochemicals. PEMEX's sales in domestic and international markets in 1995 consisted of 1.30 million bpd of crude oil, 1.55 million bpd of refined products (including LPG and pentanes), 1.57 billion cfpd of natural gas and 7.52 million tpy of petrochemicals.

The following tables show PEMEX's sales by product (net of the IEPS tax) for the five years ended December 31, 1996.

	Year ended December 31,				
	1992	1993	1994	1995	1996
	(In thousands, except as provided otherwise)				
Crude Oil (bpd).....	1,367.8	1,337.1	1,307.4	1,305.6	1,544.0
Natural Gas (cfpd) ⁽¹⁾	1,447.1	1,379.9	1,450.5	1,551.7	1,633.3
Refined Products (bpd) ⁽²⁾	1,548.2	1,599.9	1,664.9	1,552.9	1,572.3
Petrochemicals (tpy) ⁽³⁾	7,727.6	6,782.6	7,621.8	7,519.6	7,780.9
	Year ended December 31, ⁽⁴⁾				
	1992	1993	1994	1995	1996
	(In millions of U.S. dollars)				
Crude Oil.....	\$ 7,448.1	\$ 6,441.0	\$ 6,624.1	\$ 7,480.0	\$10,705.0
Natural Gas.....	981.6	1,089.3	1,045.4	1,946.1	1,347.8
Refined Products.....	11,306.4	10,821.2	10,675.5	11,396.9	12,248.3
Petrochemicals.....	1,408.4	1,298.1	1,729.3	1,860.1	1,910.0
Total.....	<u>\$21,144.5</u>	<u>\$19,649.5</u>	<u>\$20,074.4</u>	<u>\$22,665.2</u>	<u>\$26,211.1</u>

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 1996 Statistical Yearbook, PMI Comercio, Pemex-Petrochemicals and PEMEX's December 1996 Indicadores Petroleros.

Approximately half of the crude oil produced by PEMEX is sold in the domestic market in the form of refined products and petrochemicals, and the remainder is exported. In 1996, domestic sales revenues amounted to Ps. 130.8 billion, or 56.4% of total sales revenues. In 1995, 58.6% of PEMEX's sales revenues were obtained in the domestic market, where such sales totaled Ps. 92.1 billion.

Domestic gasoline sales in 1996 increased by 0.4% from 1995 levels, from 480,700 bpd in 1995 to 482,500 bpd in 1996. Due to environmental regulations requiring installation of catalytic converters in all new automobiles starting with the 1993 model year, and a price policy aimed at reducing 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 291,800 bpd in 1996, a 13% increase over 1995 sales of 257,500 bpd. Meanwhile, sales of leaded gasoline decreased by 15%, from 221,300 bpd in 1995 to 188,800 bpd in 1996. By the end of 1996, unleaded gasoline accounted for 63% of the value of total gasoline sales. Diesel sales fell by 7% from 1995 to 1996, totaling 243,900 bpd in 1996, with the transportation sector accounting for 85.4% of total demand and the industrial, marine, electrical and agricultural sectors accounting for 14.6% of total demand.

Prices. In accordance with the *Alianza para la Recuperación Económica* (Alliance for Economic Recovery or "ARE") announced by the Government on October 29, 1995, among the Government, business, labor, and agricultural sectors, the retail price of gasolines and diesel increased by 7% in December 1995 and by 6% in April 1996. In addition, these prices continued to increase at a monthly rate of 1.2% in 1996 (excluding April 1996). During 1995, the overall increase in the retail price of diesel and gasolines was approximately 58.5%. For 1996, the overall increase in retail price for gasolines and diesel was 21.17%. At December 31, 1996, the retail price of Nova leaded gasoline was Ps. 2.84 per liter and the retail price of Magna Sin unleaded gasoline was Ps. 2.90 per liter. From 1991 to 1994, the price of unleaded gasoline in Mexico was higher than the price of

unleaded gasoline in Houston, Texas, which is the lowest price for such gasoline in the United States. Following the peso devaluation at the end of 1994, in 1995, the price of unleaded gasoline in Mexico was lower than that in Houston, Texas; however, during 1996 and 1997, the retail price of unleaded gasoline was again higher than the price of unleaded gasoline in Houston.

The retail price of LPG increased by 21% on April 1, 1995 and a 0.8% monthly increase applied for the remainder of the year. By the end of 1995, the overall increase in the retail price for LPG was approximately 41%.

On October 26, 1996, the Zedillo Administration announced the establishment of a new accord among the Government and the business, labor and agricultural sectors of the economy known as the *Alianza para el Crecimiento Económico* (Alliance for Economic Growth, or "ACE"). The chief objectives of the ACE were 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, (iii) private consumption, and (iv) fiscal and monetary discipline in order to encourage an environment of greater price stability and lower interest rates. As part of the ACE, the retail price of gasoline and diesel increased by 8% on December 1, 1996, and the price of gasoline and diesel increased at a monthly rate of 1.03% and 1.2%, respectively, in 1997. On December 20, 1997, the price of gasoline increased 4%. The ACE expired on December 31, 1997.

Exports and Imports

The PMI Group 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 by 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 sells abroad crude oil and petroleum products produced by PEMEX and acquires in the international markets those petroleum products required by PEMEX to satisfy domestic demand. Sales and purchases of petroleum products (refined and petrochemical products and LPG) in the international market are carried out through P.M.I. Trading Ltd. Third-party trading and risk management activities are also performed by P.M.I. Trading Ltd. The PMI Group is currently in the process of being restructured in order to maximize cash flow in certain operating subsidiaries, and to achieve certain tax advantages.

PMI Comercio was incorporated in 1989. As of December 31, 1997, 93% of its stock was directly owned by PEMEX and the remaining 7% was owned by *Nacional Financiera, S.N.C.* and *Banco Nacional de Comercio Exterior, S.N.C.*, both of which are 99% owned directly or indirectly by the Government. The PMI Group is in the process of being restructured in order to optimize the financing of PMI Norteamérica, one of its affiliates, and to fulfill some tax advantages.

Crude oil sales are carried out by PMI Comercio, which has focused its marketing effort on strengthening customer relationships by analyzing and understanding specific purchasing patterns, closely monitoring market conditions, and reacting promptly to price variations. PEMEX's marketing strategy is based on maintaining long-term commercial relationships and customer loyalty. As of December 31, 1997, PMI Comercio had 196 customers in 46 countries. In 1997, crude oil exports by volume were distributed as follows:

<u>Country</u>	<u>Percentage of Exports</u>
United States	78.35%
Spain	6.17
Japan	5.63
Canada	1.33
Belgium	0.84
United Kingdom	0.20
Others	7.48
Total	<u>100.0%</u>

Source: PMI Comercio.

PMI Comercio purchases crude oil from Pemex-Exploration and Production. Sale prices of products sold by PEMEX are determined by PEMEX's pricing steering committee (consisting of representatives from the Ministry of Energy, Ministry of Finance and Public Credit, *Secretaría de Comercio y Fomento Industrial* (Ministry of Commerce and Industrial Development, or "SECOFI"), *Secretaría de la Contraloría y Desarrollo Administrativo* (General Comptroller's Office, or "SECODAM"), Banco de México and PEMEX. See "Regulatory Framework and Relationship with the Government".

Since 1986 PEMEX has applied a policy of differential crude oil prices by region and type of crude oil. For these purposes the global market was divided into three segments (the Americas, Europe and the Far East) and a mechanism that considers a basket of benchmark crude oil or product prices plus/minus a constant was established to determine prices through formulas. Individual weights are applied to each benchmark crude oil or product in a given formula for a specific Mexican crude oil, and are determined based on the adjustment required to reflect significant changes that might arise in the relevant market. As a result, all customers within a particular region are charged prices calculated with the same formula. An important percentage of crude oil sales are related to evergreen long-term contracts, with a three-month phase-out clause. Most of the remaining quantity available for exports is sold to contractual customers, 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, 1996 and the nine-month period ended September 30, 1997.

	Year ended December 31,					Nine-Months Ended September 30,
	1992	1993	1994	1995	1996	1997
	(In U.S. dollars per barrel)					
Weighted Average Price	\$14.88	\$13.20	\$13.88	\$15.70	\$18.94	\$16.74
Isthmus	18.01	15.81	15.33	16.66	20.02	18.29
Maya	13.11	11.44	12.57	14.41	17.25	14.95
Olmecca	19.54	16.95	16.27	17.51	21.50	19.74

Source: PEMEX's December 1996 and September 1997 *Indicadores Petroleros* and PMI Comercio.

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, 1996.

	Year ended December 31, ⁽¹⁾⁽²⁾				
	1992	1993	1994	1995	1996
	(in thousands, except as provided otherwise)				
Exports:					
Crude Oil (bpd)	1,367.8	1,337.1	1,307.4	1,305.6	1,543.9
Refined Products (bpd)	117.1	155.9	109.7	118.8	90.8
Petrochemicals (tpy)	1,237.6	1,324.1	1,559.4	1,226.1	1,123.4
Natural Gas (cfpd)	—	4.7	19.3	21.4	36.2
Imports:					
Refined Products (bpd)	172.0	176.6	188.7	139.5	177.3
Petrochemicals (tpy)	70.1	86.8	178.1	97.4	90.4
Natural Gas (cfpd) ⁽³⁾	245.7	96.6	125.1	172.9	83.7

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: September 1997 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, 1996.

	Year ended December 31, ⁽¹⁾⁽²⁾⁽³⁾				
	1992	1993	1994	1995	1996
	(in millions of U.S. dollars)				
Exports:					
Crude Oil	\$7,448.1	\$6,441.0	\$6,624.1	\$7,480.1	\$10,705.3
Refined Products	693.4	827.9	601.7	661.2	671.0
Petrochemicals	203.3	186.3	276.6	247.4	201.0
Natural Gas	—	3.4	14.8	12.4	31.8
Total Exports	\$8,344.8	\$7,458.6	\$7,517.2	\$8,401.1	\$11,609.1
Imports:					
Refined Products	\$1,358.6	\$1,341.2	\$1,326.6	\$1,074.9	\$1,550.1
Petrochemicals	26.3	26.9	57.1	32.2	24.9
Natural Gas	175.2	77.5	82.2	99.1	67.1
Total Imports	1,560.1	1,445.6	1,465.9	1,206.2	1,642.1
Net Exports	<u>\$6,784.7</u>	<u>\$6,013.0</u>	<u>\$6,051.3</u>	<u>\$7,194.9</u>	<u>\$9,967.0</u>

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 from third parties and resold in the international markets.

Source: PEMEX's 1996 Statistical Yearbook.

From 1989 through 1996, increasing domestic demand led to a deficit in the petroleum products trade balance. In 1996, PEMEX imported 174.1 thousand bpd of refined products. The largest components were gasolines (62.2 thousand bpd) and fuel oil (30.7 thousand 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 decreased in relative terms (51.5%), from 172.6 million cfpd in 1995 to 83.7 million cfpd in 1996. Imports of petrochemical products experienced an important increase from 86,800 tpy in 1993 to 178,100 tpy in 1994, but then declined to 97,400 tpy in 1995 and 90,400 tpy in 1996. The 1994 increase was mainly due to PEMEX's purchases of

xylene which are used as raw materials in the production of aromatics, while the 1995 contraction was due primarily to the recession in the Mexican economy.

During the first nine months of 1997, PEMEX imported 270,100 bpd of refined products, a 61% increase from imports of refined products during the comparable period in 1996. The largest component of these imports was gasoline (mainly unleaded), which amounted to 110,600 bpd. In the first nine months of 1997, PEMEX imported natural gas at a rate of 108 billion cfpd.

P.M.I. Trading Ltd. engages in hedging operations to cover the spreads between its 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.

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 1996, PEMEX's pipeline network had a length of approximately 56,922 kilometers, which, after the restructuring of PEMEX, was distributed among the Subsidiary Entities according to the products transported. Of the total network, 4,324 kilometers were crude oil pipelines, 8,353 kilometers were for the delivery of petroleum products and petrochemicals, 10,880 kilometers were for the distribution of natural gas, approximately 1,811 kilometers were for the distribution of NGLs, 1,037 kilometers were for transportation of Basic Petrochemicals, and the balance was accounted for by oil and gas gathering pipelines.

During 1996, PEMEX transported approximately 34.3 billion tons-kilometer of crude oil to be processed in the refining system, and 33.8 billion tons-kilometer of petroleum products to satisfy domestic demand. Of the total amount of tons-kilometer transported, 59.9% was done through pipelines, 37.1% through vessels, and the difference through railroad tank cars and road tankers. At the end of 1996, PEMEX owned 81 major wholesale storage centers.

At the end of 1996, PEMEX owned 20 oil tankers and leased an additional 13. PEMEX also used the services of 2,664 road tankers during 1996.

PEMEX's exports of crude oil are generally made on an FOB (free on board) basis. PEMEX exports most of its refined products on a CIF (cost, insurance and freight) basis, and imports most of its refined products on an FOB basis, thereby assuming the risk for the transportation of such products.

At the end of 1996, there were approximately 3,808 retail service stations in Mexico, of which 3,377 were privately owned and operated as franchisees. From the remaining 431 stations, PEMEX owned 57 directly while the other 374 were privately owned and awaiting franchises. PEMEX plans to franchise a total of 6,000 retail service stations by the year 2000 and to retain ownership of only 9, which will be used as training centers.

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, installations and equipment. Regulations implementing the regulatory law amendment (the "Regulations") 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. The benefits of using natural gas as a substitute for fuel oil include 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 due to the amendment to the Regulatory Law discussed above; 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 Energy Regulatory Commission methodologies for establishing its first-hand sales prices and calculating its transportation rates and must submit such prices and rates to the Energy Regulatory Commission for approval. Under a transition regime established by the Regulations, PEMEX will continue to own and operate its transportation pipelines for an undetermined period, and accordingly, its system of pipelines will continue to be the principal means of transporting natural gas in Mexico. PEMEX is required to allow open access to third parties to its system, and is permitted to develop storage systems and to perform marketing.

In 1996, PEMEX continued to make advances with respect to opening access to the domestic market for natural gas. The Gradual Access Program 1996-1997 provides for the gradual opening of access to the domestic market for the distribution of natural gas. The main beneficiary of this new competitive environment will be the distribution sector in Mexico. As a first step under this program, the Naco-Hermosillo pipeline was opened for use by the private sector in September 1996. The second step consisted of granting open access to imports of more than 5 million cfpd in the northern region of the country.

The Gradual Access Program of 1996-1997 required PEMEX to sell certain distribution pipelines. Permits for such divestment were granted for distribution pipelines located in Mexicali, Chihuahua, Cuauhtémoc-Anáhuac, and Hermosillo. A bid for the Toluca geographic zone was published, and the bidding process for the Tampico-Madero and Delicias facilities is pending. The Energy Regulatory Commission named the Tampico, Monterrey and Mexico City geographic zones as open-access zones for distribution, which will be subject to a private-sector bidding process.

Employee Matters

At December 31, 1996, PEMEX had 120,945 employees (excluding employees of the PMI Group), as compared with 124,396 in 1995 (including those employed on a temporary basis). Of the total number of PEMEX employees at December 31, 1996, 43,961 (36.35%) were employed by Pemex-Refining, 35,096 (29.02%) by Pemex-Exploration and Production, 13,390 (11.07%) by Pemex-Petrochemicals, 11,793 (9.75%) by Pemex-Gas and Basic Petrochemicals and 16,705 (13.81%) by Petróleos Mexicanos. At December 31, 1996, the PMI Group had 283 employees. At September 30, 1997, preliminary sources indicate that PEMEX had approximately 130,000 employees (excluding employees of the PMI Group).

The Organic Law provides that workers of PEMEX may be reassigned to the Subsidiary Entities as necessary. In any case, all rights of employees will be fully recognized and the terms of the current Collective Bargaining Agreement (as defined below) will continue to apply. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Current Situation in Secondary Petrochemical Industry".

Approximately 77% of PEMEX's work force is represented by the *Sindicato de Trabajadores Petroleros de la República Mexicana* (Petroleum Workers' Union of the Mexican Republic, or the "Union"). The leaders of the Union are PEMEX employees and are elected by members of the Union. Since the Union's official establishment in 1938, PEMEX has not experienced any labor strikes. During this 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 19% in 1997, 23% in 1996, 16% in 1995, 7% in 1994, and 8% in 1993, in line with the Government's price and wage accords.

In accordance with the Collective Bargaining Agreement and Federal Labor Law, PEMEX is obligated 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 Public Credit and 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 of the estate of such 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 and Public Credit. PEMEX's annual budget and 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.

The formulas for crude oil export prices and for prices of products sold domestically are set by committees composed of PEMEX officials and representatives of various governmental agencies (including, among others, the Ministry of Finance and Public Credit, the Ministry of Energy, the General Comptroller's Office, Banco de México and the Ministry of Commerce and Industrial Development).

The formulas for determining crude oil export prices are based on international reference prices and a constant to be set according to specific market conditions. Export prices of derivatives 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) price-setting mechanisms should be transparent, lending themselves to the use of formulas; and (v) targets should be macro-economic. It is the policy of the Government and PEMEX to keep PEMEX's domestic prices generally in line with international prices.

The prices for PEMEX's domestic products are determined as follows: first international prices are used as reference prices, but are adjusted to reflect transportation expenses, opportunity costs and differences in the quality of PEMEX's products relative to the international benchmarks in order to arrive at Mexican producer prices; next, the VAT, the retailer's margin and freight costs are added to reach the consumer's (retail) price.

Special conditions prevail for setting the price formula for gasoline and diesel. In arriving at producer prices for gasoline and automotive diesel an extra charge, which is expected to be completely phased out by 1998, is added to the international reference price to compensate for efficiency differences in refining costs. In addition, the consumer prices for gasoline and diesel, which are determined by the Ministry of Finance and Public Credit, reflect the addition of the indirect IEPS tax (which PEMEX collects on behalf of the Government) and VAT. The IEPS tax is currently only charged on gasoline, diesel, and natural gas for automotive uses, but not on other products. For further discussion of the IEPS tax, see "—Federal Taxes and Duties" below.

Prices for domestic sale of natural gas are calculated according to directives published on March 20, 1996 by the *Comisión Reguladora de Energía* (the Energy Regulatory Commission of Mexico). They reflect gas opportunity costs, competitive conditions in international markets and the location where the sale is made.

Under the Organic Law, *Petróleos Mexicanos* is entrusted with the central planning and strategic management of Mexico's petroleum industry, and PEMEX 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 natural gas, used as basic industrial raw materials and considered Basic Petrochemicals. The entry into force on January 1, 1994 of 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. Over a ten-year period, 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.

Foreign investment in Secondary Petrochemicals is currently permitted under Mexican law and is being actively pursued through a privatization program announced on March 18, 1995 as a part of the process followed by the Government concerning the sale of non-strategic assets. However, on October 13, 1996, the Ministry of Energy announced that the privatization process would continue under a redesigned strategy that contemplates the creation of ten subsidiaries of Pemex-Petrochemicals (one subsidiary for each of Pemex-Petrochemicals' ten complexes) which would be 51% majority-owned by PEMEX. During 1997, seven of the ten complexes were created as independent corporations and PEMEX's assets thereby divested. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Current Situation in Secondary Petrochemical Industry" and "Business—Petrochemicals".

The following table compares the average prices in Mexico and in the United States of certain products indicated.

	1992		1993		1994	
	Mexico	U.S.	Mexico	U.S.	Mexico	U.S.
Oil Products						
Unleaded regular gasoline ⁽¹⁾	\$ 63.06	\$ 44.54	\$ 65.33	\$ 42.84	\$ 62.75	\$ 42.98
Premium gasoline ⁽¹⁾						
Jet Fuel ⁽²⁾	23.89	24.02	22.44	22.26	20.83	20.67
Kerosene ⁽³⁾	35.18	25.55	41.08	24.37	42.97	22.42
Natural Gas⁽⁴⁾						
Industrial	1.88	2.80	2.18	2.97	1.94	2.94
Residential	2.46	6.38	3.69	6.46	4.38	6.66
Selected Petrochemicals⁽⁵⁾						
Ammonia ⁽⁵⁾	78.64	110.78	114.35	129.14	157.47	188.61
Polyethylene L.D. ⁽⁶⁾	807.46	826.02	786.86	798.94	837.49	887.51
Polyethylene H.D. ⁽⁷⁾	682.25	737.25	644.20	712.60	787.23	838.78
Styrene ⁽⁸⁾	496.00	532.87	526.65	511.87	735.89	696.97

- (1) In U.S. dollars per barrel. Prices to final consumers, including taxes. Mexican prices do not consider prices in border zones and price applied to the rest of the country. Premium price in Mexico City. U.S. prices in Houston, Texas. Sources: *Pemex-Refining*
- (2) In U.S. dollars per barrel. Mexico prices at the gate of the refineries. U.S. spot prices in Houston, Texas (Jet Fuel Gulf Coast *Market Scan, McGraw-Hill Company*).
- (3) In U.S. dollars per barrel. In both countries, prices to final consumers. Mexico prices includes taxes, while U.S. prices exclude taxes. *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 reflect the specific cost of transportation and distribution in that area. U.S. prices are national average industrial prices and *Petrochemicals and Petroleum Marketing Monthly*.
- (5) In U.S. dollars per ton. Prices exclude taxes. Mexico prices to contract users at Cosoleacaque Petrochemical Plant. U.S. spot prices *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 prices *(since 1992 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 average prices *(since 1992 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. *(since 1992 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' 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, with the new indebtedness denominated in currencies other than pesos. In December 1990, the Government and Petróleos Mexicanos agreed to capitalize such amount into 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 in monthly advance payments during the year. During 1992, 1993, 1994, 1995 and 1996, Petróleos Mexicanos made advance payments to the Government in the aggregate of Ps. 1,417 million, Ps. 1,209 million, Ps. 1,661 million, Ps. 4,289 million and Ps. 6,782 million, respectively, as minimum guaranteed dividends. During the first nine months of 1997, Petróleos Mexicanos made advance payments to the Government of Ps. 4,230 million of such dividends. The total dividends paid by Petróleos Mexicanos to the Government in respect of the CAPs regarding 1992, 1993, 1994, 1995 and 1996 fiscal years amounted to Ps. 3,313 million, Ps. 2,982 million, Ps. 1,661 million, Ps. 4,289 million and Ps. 6,782 million, respectively.

In December 1997, the Issuer and the Government agreed to a reduction in the equity of Petróleos Mexicanos, and in connection therewith, the Board of Directors of Petróleos Mexicanos authorized a reduction in the CAPs by an amount of Ps. 12,118.05 million, and Petróleos Mexicanos paid the Government U.S. \$1,500 million in December 1997 as consideration for such reduction in the CAPs. Petróleos Mexicanos and the Government are currently negotiating a reduction in the minimum guaranteed dividend payable to the Government in respect of the CAPs, although no assurances can be made as to whether or when such reduction will be effected, and whether or to what extent the total dividends payable to the Government for 1998 and future years may be reduced.

Federal Taxes and Duties

Instead of paying a conventional tax on income, until 1992 PEMEX was subject to a special duty on hydrocarbon extraction imposed by the Government. This duty was meant to incorporate a royalty payment for the extraction of hydrocarbons, an oil income tax and a dividend to PEMEX's sole owner, the Government. For 1992, this duty was set at a rate of 58.4% of the value of the hydrocarbons exported (based on the weighted average price of crude oil exported) and 53.4% of the value of hydrocarbons sold in the domestic market in the form of natural gas, refined products and petrochemicals.

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

With a view towards providing PEMEX with more fiscal stability, starting in 1993 the Ministry of Finance and Public Credit established a new fiscal regime for PEMEX. For 1998, according to 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 and Public Credit (other than the corporate income tax and the assets 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 applicable 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. PEMEX may determine this tax on a consolidated basis.

IEPS Tax—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 fuel and natural gas for automotive use. The IEPS tax on the sale of gasolines and diesel fuel 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 and Public Credit. 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 as applied to 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 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 *Derecho sobre Hidrocarburos* (the "Hydrocarbon Duty"). This duty is calculated by applying a rate of 60.8% to the hydrocarbons sales revenues of PEMEX 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 Duty.

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 crude oil sales at prices in excess of U.S. \$13.50 per barrel, effective January 15, 1998.

Starting in 1994, interest payments by PEMEX on its external debt were no longer 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 substantial amounts in terms of the total PEMEX's total tax liabilities.

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

Environmental Regulation

PEMEX is subject to the provisions of the *Ley General de Equilibrio Ecológico y Protección al Ambiente* (the 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. The SEMARNAP is assisted in its charge 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 Navy) and the Ministry of Energy. In addition, PEMEX is subject to 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. In order to obtain authorization, SEMARNAP requires the submission of an environmental impact analysis based upon such analysis and other information it may request. SEMARNAP is entitled to grant or deny its authorization for any activity.

Since the enactment of the Environmental Law, several technical environmental regulations have been issued. These regulations are applicable to Mexican industry in general, including PEMEX, and specifically set forth, among others, permissible levels of emissions, water discharges and hazardous substances discharges as well as atmospheric pollution levels. Other technical regulations are issued for specific industries. Some have been issued in respect of the oil refining and petrochemical industry, 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 the petrochemical and oil refining industry. The Mexican environmental regulatory framework is generally updated and revised annually.

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 PEMEX's 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.

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

Prior to 1993, the identification of environmental matters was done by each 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 quantify restoration, dismantlement and abandonment costs. In connection with this new structure, PEMEX has contracted with external engineers for the performance of operational audits, which 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 term, 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 Office of the Federal Attorney General for Environmental Protection for the audited sites. The majority of the corrective actions have been directed to the remediation of surface and subsurface areas.

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 1995, PEMEX invested Ps. 3,654.8 million in environmental projects. During 1996, PEMEX invested Ps. 3,311.8 million in various environmental projects. During 1997, PEMEX budgeted Ps. 3,042.6 million for environmental projects. 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 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.

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 Petróleos Mexicanos as of February 1, 1998:

<u>Name</u>	<u>Position</u>	<u>Year Appointed</u>
PETROLEOS MEXICANOS		
Board of Directors		
Mr. Luis Tellez Kuenzler	Chairman of the Board of Petróleos Mexicanos and Secretary of the Ministry of Energy	1997
Mr. José Angel Gurría Treviño	Secretary of the Ministry of Finance and Public Credit	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 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
[Vacant]	Deputy Director of Financial Information Systems	--
Mr. Raúl Esquerra Castañeda	Deputy Director of the Assets Streamlining Unit	1995
Mr. Enrique Román Enríquez	Deputy Director of Finance and Treasury	1995
[Vacant]	Corporate Director of Administration	--
Mr. Julio Pindter González	Deputy Director of Labor Relations	1993
Mr. Luis Andaluz Carmona	Deputy Director of Services	1997
Mr. Rafael Fernández de la Garza	Deputy Director of Industrial Safety Systems	1997
Mr. Gerardo Rueda Rábago	Corporate Comptroller General	1997
Mr. Raúl Capdeviell 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

<u>Name</u>	<u>Position</u>	<u>Year Appointed</u>
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. Raúl Livas Elizondo	(refer to Pemex-Petrochemicals)	1997
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance and Public Credit	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
Mr. Rafael Vega Monter	Deputy Director—Northeastern Marine Region	1998
Mr. Maclovio Yañez 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 Helu	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. Ricardo Palacios Calva	Deputy Director—South Region	1995
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. Raúl Livas Elizondo	(refer to Pemex-Petrochemicals)	1997
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance and Public Credit	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of Environment, Natural Resources and Fishing	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

<u>Name</u>	<u>Position</u>	<u>Year Appointed</u>
Executive Officers		
Mr. Jaime Mario Willars Andrade	Director General	1995
Mr. Armando Leal Santana	Deputy Director of Production	1995
Mr. Emilio Aguado Calvet	Deputy Director of Trading	1995
Mr. Pedro Carlos Gómez Flores	Deputy Director of Distribution	1994
Mr. Rudy Omar Albertos Cámara	Deputy Director of Finance and Management	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. Raúl Livas Elizondo	(refer to Pemex-Petrochemicals)	1997
Mr. Santiago Levy Algazi	Undersecretary of Disbursements of the Ministry of Finance and Public Credit	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of the Environment, Natural Resources and Fishing	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. 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	1996
Mr. Armando Arenas Briones	Deputy Director of Production	1996
Mr. Claudio Urencio Castro	Deputy Director of Pipelines	1996

<u>Name</u>	<u>Position</u>	<u>Year Appointed</u>
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 and Public Credit	1994
Mr. Enrique Provencio Durazo	President of the National Ecology Institute of the Ministry of the Environment, Natural Resources and Fishing	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. Raúl Livas Elizondo	Director General	1997
[Vacant]	Deputy Director of Planning	--
Mr. Mario González Petrikowsky	Deputy Director of Management and Finance	1994

DESCRIPTION OF NOTES

General

The Notes are to be issued under a Fiscal Agency Agreement (the "Fiscal Agency Agreement"), dated as of June 16, 1993, as amended and restated on February 26, 1998, between the Issuer and Bankers Trust Company, as fiscal agent (the "Fiscal Agent"). The following summaries of certain provisions of the Fiscal Agency Agreement and the Notes do not purport to be complete and are subject to, and are qualified in their entirety by reference to, all of the provisions of the Fiscal Agency Agreement and the Notes, including the definitions therein of certain terms. Wherever particular defined terms of the Fiscal Agency Agreement are referred to, such defined terms are incorporated herein by reference. Capitalized terms not otherwise defined herein shall have the meanings given to them in the Fiscal Agency Agreement or the Notes.

The particular terms of each issue of Notes, including the purchase price, currency or currency unit of denomination and payment, Stated Maturity, form, interest rate, interest payment dates, and, if applicable, redemption, repayment and index provisions, will be set forth for each such issue in the Note and in the applicable Pricing Supplement. With respect to any particular Note, the description of the Notes herein is qualified in its entirety by reference to, and to the extent inconsistent therewith is superseded by, such Note and the applicable Pricing Supplement.

The Notes are limited to an aggregate initial offering price of \$1,500,000,000 or its equivalent in one or more currencies or currency units. The foregoing limit, however, may be increased by the Issuer if in the future it determines that it may wish to sell additional Notes.

The issuance of the Notes has been duly authorized by the Board of Directors of the Issuer; *provided, however*, that additional authorization by the Board of Directors of the Issuer will be necessary in order to issue Notes after December 31, 1998.

Unless previously redeemed, a Note will mature on the date (the "Stated Maturity") from 1 year to 30 years from its date of issue that is specified on the face thereof and in the applicable Pricing Supplement.

Each Note will be denominated in U.S. dollars or in one or more foreign currencies or currency units (each, a "Specified Currency") as shall be specified in such Note and the applicable Pricing Supplement. Unless otherwise specified in the Note and the applicable Pricing Supplement, payments on the Notes will be made in the applicable Specified Currency, except in the circumstances specified under "—Foreign Currency Notes and Indexed Notes" below. The Pricing Supplement for each issue of Foreign Currency Notes will include additional information with respect to exchange rates applicable to the currency or currency unit specified therein, any relevant foreign exchange controls and any relevant foreign currency risk.

Notes will be sold in individual issues of Notes having such interest rate or interest rate formula, if any, Stated Maturity, Specified Currency and date of issue as shall be selected by the initial investors and agreed to by the Issuer. Unless otherwise indicated in the applicable Pricing Supplement, each Note, except any Indexed Note, will bear interest at a fixed rate or at a rate determined by reference to the LIBOR or the Treasury Rate, as adjusted by the Spread and/or Spread Multiplier, if any, applicable to such Note. See "Interest Rate" below.

The Notes may be issued as Original Issue Discount Notes. "Original Issue Discount Note" means (i) a Note, including any Note having an interest rate of zero, that has a stated redemption price at maturity that exceeds its issue price (each as defined for U.S. federal income tax purposes) by at least 0.25% of such stated redemption price at maturity, multiplied by the number of complete

years from the issue date to the Stated Maturity for such Note and (ii) any other Note designated by the Issuer as issued with original issue discount for United States Federal income tax purposes.

The Notes may be issued as Indexed Notes (as defined below), the principal amount of which payable on or prior to Stated Maturity, the amount of interest payable on which and/or any premium payable with respect to which will be determined by reference to the difference in the price of crude oil on certain specified dates or by some other index or indices. See "Foreign Currency Notes and Indexed Notes" below.

The Fiscal Agency Agreement does not limit the aggregate amount of debt securities that may be issued thereunder and provides that debt securities may be issued thereunder from time to time in one or more series.

The Issuer has agreed to maintain Paying Agents and Transfer Agents in the Borough of Manhattan, The City of New York, and in the City of London. The Issuer has initially appointed the Fiscal Agent at its corporate trust office in New York as principal Paying Agent, Transfer Agent, Authenticating Agent and Registrar for all Registered Notes and the Fiscal Agent at its corporate trust office in London as principal Paying Agent and Authenticating Agent for all Bearer Notes. The Transfer Agent will keep a register in which, subject to such reasonable regulations as the Issuer may prescribe, the Issuer will provide for the registration of the Notes and the registration of transfers of the Notes. For so long as any Notes are outstanding, the Issuer shall maintain a Paying Agent and a Transfer Agent for the Notes in a city in Western Europe (which, for so long as any Notes are listed on the Luxembourg Stock Exchange and the rules of such Exchange so require, shall include a Paying Agent and Transfer Agent in Luxembourg), and, for so long as any Registered Notes are outstanding, the Issuer shall maintain a Paying Agent and Transfer Agent in The City of New York.

Ranking of Notes and Guaranties

The Notes 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 Notes 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 Notes 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 Notes and the Fiscal Agency Agreement as subject to the Guaranty Agreement. See "—Guaranties" below. The Guaranty of the Notes 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 Notes are not obligations of, or guaranteed by, Mexico.*

Form and Denomination

Notes may be issued in registered form without interest coupons ("Registered Notes") or in bearer form, with or without interest coupons ("Bearer Notes"), as specified in the applicable Pricing Supplement and as described below.

Unless otherwise specified in the applicable Pricing Supplement, Registered Notes will be issued in denominations of U.S. \$10,000 and integral multiples thereof and Bearer Notes will be issued in

denominations of U.S. \$10,000 and U.S. \$100,000 (or, in each case, the approximate equivalent thereof in a specified currency or currency unit).

Registered Notes will be issued in the following forms, unless otherwise specified in the applicable Pricing Supplement.

Registered Notes of the same tranche and tenor initially sold outside the United States in compliance with Regulation S will be represented by one or more Registered Notes in global form (collectively, a "Regulation S Global Note") which will be (a) deposited with the Fiscal Agent in New York as custodian for The Depository Trust Company ("DTC") and will be registered in the name of a nominee of DTC, for the accounts of Euroclear and Cedel Bank or (b) deposited with a common depository in London for Euroclear and Cedel Bank and registered in the name of such common depository or its nominee, for the accounts of Euroclear and Cedel Bank (DTC or such other depository, a "Depository"). On or prior to the 40th day after completion of the distribution (as certified to the Fiscal Agent by the relevant Agent) of all Notes of an identifiable tranche (the "Restricted Period"), beneficial interests in a Regulation S Global Note representing Notes of such tranche may be held only through Euroclear and Cedel Bank for the account of non-U.S. persons, unless delivery is made in the form of an interest in a Restricted Global Note (as defined below) of the same tranche in accordance with the certification requirements described below.

Registered Notes of the same tranche or tenor initially sold within the United States and eligible for resale in reliance on Rule 144A will be represented by one or more Registered Notes in global form (collectively, a "Restricted Global Note" and, together with the Regulation S Global Note, the "Global Notes") which will be deposited with the Fiscal Agent in New York as custodian for DTC and will be registered in the name of a nominee of DTC. The Restricted Global Notes (and any Certificated Notes (as defined herein) issued in exchange therefor) will be subject to certain restrictions on transfer set forth under "Notice to Investors".

On or prior to the last day of the Restricted Period, a beneficial interest in a Regulation S Global Note may be transferred to a person who takes delivery in the form of an interest in a Restricted Global Note of the same tranche and like tenor, but only upon receipt by the Fiscal Agent of a written certification from the transferor (in the form provided in the Fiscal Agency Agreement) to the effect that such transfer is being made to a person who the transferor reasonably believes is purchasing for its own account or accounts as to which it exercises sole investment discretion and that such person and each such account is a qualified institutional buyer within the meaning of Rule 144A, in each case in a transaction meeting the requirements of Rule 144A and in accordance with all applicable securities laws of the states of the United States (a "Restricted Global Note Certification"). After the last day of the Restricted Period, such certification requirement will no longer apply to such transfers. Beneficial interests in a Restricted Global Note may be transferred to a person in the form of an interest in a Regulation S Global Note of the same tranche and of like tenor, whether before, on or after the end of the Restricted Period, but only upon receipt by the Fiscal Agent of a written certification from the transferor (in the form(s) provided in the Fiscal Agency Agreement) to the effect that such transfer is being made in accordance with Rule 903 or Rule 904 of Regulation S or (if available) Rule 144 under the Securities Act (a "Regulation S Global Note Certificate") and that if (but only if) such transfer occurs on or prior to the last day of the Restricted Period, the interest transferred will be held immediately thereafter through Euroclear or Cedel Bank for the account of non-U.S. persons. Any beneficial interest in a Global Note that is transferred to a person who takes delivery in the form of an interest in another Global Note of the same tranche and of like tenor will, upon transfer, cease to be an interest in such Global Note and become an interest in such other Global Note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in such other Global Note for as long as it remains such an interest.

Unless otherwise specified in the applicable Pricing Supplement, Bearer Notes of the same tranche and tenor will initially be represented by a temporary global Bearer Note, without interest coupons, which will be deposited with a common depositary for Morgan Guaranty Trust Company of New York, Brussels Office, as operator of the Euroclear System ("Euroclear") and Cedel Bank, *société anonyme* ("Cedel Bank"). Such temporary global Bearer Note will be exchangeable for a permanent global Bearer Note (such permanent global Bearer Note, together with a temporary global Bearer Note, a "Global Bearer Note"), without interest coupons, or definitive Bearer Notes, with coupons, as specified in the applicable Pricing Supplement, on or after the 40th day after the completion of the distribution (as certified to the Fiscal Agent by the relevant Agent) of the identifiable tranche of which Notes constitute a part (the "Exchange Date"), as notified to the Fiscal Agent by the relevant Agents, *provided, however*, that with respect to each beneficial interest in the portion of such temporary global Bearer Note to be exchanged, (i) the participant in Euroclear or Cedel Bank, as the case may be, through which such beneficial interest is held has delivered to Euroclear or Cedel Bank, as the case may be, an Owner Tax Certification (as defined below), and (ii) Euroclear or Cedel Bank, as the case may be, has delivered to the Fiscal Agent a Depositary Tax Certification (as defined below) in the form required by the Fiscal Agency Agreement.

No interest or principal payable in respect of any beneficial interest in a temporary global Bearer Note will be paid until the certification requirements described above have been satisfied with respect to such beneficial interest. Delivery of an Owner Tax Certification by a participant in Euroclear or Cedel Bank shall constitute an irrevocable instruction by such participant to Euroclear or Cedel Bank, as the case may be, to exchange on the applicable Exchange Date, the beneficial interest covered by such certificate for such definitive Bearer Notes or interest in a permanent global Bearer Note as such participant may specify consistent with the Fiscal Agency Agreement and the applicable Pricing Supplement.

As described above, no payment will be made on any temporary global Bearer Note and no exchange of a beneficial interest in a temporary global Bearer Note for a definitive Bearer Note or an interest in a permanent global Bearer Note may occur until the person entitled to receive such interest or Bearer Note furnishes written certification (an "Owner Tax Certification"), in the form required by the Fiscal Agency Agreement, to the effect that such person (i) is not a United States person (as defined below under "Limitations on Issuance of Bearer Notes"), (ii) is a foreign branch of a United States financial institution purchasing for its own account or for resale, or is a United States person who acquired the Note through such a financial institution and who holds the Note through such financial institution on the date of certification, provided in either case that such financial institution certifies that it agrees to comply with the requirements of Section 165(j)(3)(A), (B) or (C) of the Internal Revenue Code of 1986, as amended (the "Code"), and the United States Treasury Regulations thereunder, or (iii) is a financial institution holding for purposes of resale during the restricted period (as defined in United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(7)). A financial institution described in clause (iii) of the preceding sentence (whether or not also described in clause (i) or (ii)) must certify that it has not acquired the Note for purposes of resale directly or indirectly to a United States person or to a person within the United States or its possessions.

The following legend will appear on all permanent global Bearer Notes and definitive Bearer Notes and any coupons with respect thereto: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code". The sections referred to in the legend provide that, with certain exceptions, a United States taxpayer will not be permitted to deduct any loss, and will not be eligible for capital gain treatment with respect to any gain, realized on a sale, exchange or redemption of a Bearer Note or coupon.

Global Notes

A Global Note may not be transferred except as a whole by its Depositary to a nominee of such Depositary or by a nominee of such Depositary to such Depositary or another nominee of such Depositary or by such Depositary or any such nominee to a successor of such Depositary or a nominee of such successor.

Upon the issuance of a Global Note or a Global Bearer Note, DTC, Euroclear or Cedel Bank, as the case may be, will credit, on its book-entry registration and transfer system, the respective principal amounts of the Notes represented by such Global Note or such Global Bearer Note to the accounts of institutions that have accounts with DTC, Euroclear or Cedel Bank, as the case may be ("participants"). The accounts to be credited shall be designated by the underwriters or agents of such Notes or by the Issuer, if such Notes are offered and sold directly by the Issuer. Ownership of beneficial interests in a Global Note or a Global Bearer Note, will be limited to participants or persons that may hold interests through participants. Ownership of beneficial interests in such Global Note or such Global Bearer Note will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC, Euroclear or Cedel Bank, as the case may be, (with respect to interests of participants) or by participants or persons that hold through participants (with respect to interests of persons other than participants). The laws of some states require that certain purchasers of securities take physical delivery of such securities in definitive form. Such limits and such laws may impair the ability to transfer beneficial interests in a Global Note or Global Bearer Note.

So long as a Depositary, or its nominee, is the holder of a Global Note or Global Bearer Note, such Depositary or its nominee, as the case may be, will be considered the sole registered owner or holder of the Notes represented by such Global Note or Global Bearer Note for all purposes under the Fiscal Agency Agreement. Except as set forth below under "—Certificated Notes and Definitive Bearer Notes", owners of beneficial interests in a Global Note or Global Bearer Note will not be entitled to have Notes represented by such Global Note or such Global Bearer Note registered in their names, will not receive or be entitled to receive physical delivery of Notes of such tranche in definitive form and will not be considered the owners or holders thereof under the Fiscal Agency Agreement.

Payments of principal, premium (if any) and interest on Notes registered in the name of or held by a Depositary or its nominee will be made to such Depositary or its nominee, as the case may be, as the registered owner or the holder of the Global Note or Global Bearer Note representing such Notes. Neither the Issuer nor the Fiscal Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in a Global Note or Global Bearer Note or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

The Issuer expects that DTC, Euroclear or Cedel Bank, as the case may be, upon receipt of any payment of principal, premium (if any) or interest in respect of a Global Note or Global Bearer Note, will credit immediately participants' accounts with payments in amounts proportionate to their respective beneficial ownership interests in the principal amount of such Global Note or Global Bearer Note as shown on the records of DTC, Euroclear or Cedel Bank, as the case may be. The Issuer also expects that payments by participants to owners of beneficial interests in such Global Note or Global Bearer Note held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such participants.

Certificated Notes and Definitive Bearer Notes

If DTC or any other Depositary is at any time unwilling or unable to continue as depositary 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 Notes in definitive, registered form ("Certificated Notes") in exchange for interests in the relevant Global Note or Notes. In addition, the Issuer may determine that any Global Note will be exchanged for Certificated Notes, upon 10 days' prior written notice to the relevant Depositary. In the case of Certificated Notes issued in exchange for a Restricted Global Note, such certificates will bear, and be subject to, the legend referred to under "Notice to Investors".

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

Certificated Notes may be presented for registration of transfer, or for exchange for new Certificated Notes of authorized denominations, at the corporate trust office of the Fiscal Agent in the Borough of Manhattan, The City of New York, or at the office of any Transfer Agent. Upon the transfer, exchange or replacement of Certificated Notes bearing a restrictive legend, or upon specific request for removal of such legend, the Issuer will deliver only Certificated Notes that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer such satisfactory evidence, which may include an opinion of New York counsel, as may reasonably be required by the Issuer, that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act. In the case of a transfer of less than the principal amount of any Certificated Note, a new Certificated Note will be issued to the transferee in respect of the amount transferred and another Certificated Note will be issued to the transferor in respect of the portion not transferred. Such new Notes will be available within three Business Days at the corporate trust office of the Fiscal Agent in New York or at the office of any Transfer Agent.

No service charge will be made for any registration of transfer or exchange of Notes, but the Issuer or the Fiscal Agent may require payment of a sum sufficient to cover any stamp tax or other governmental duty payable in connection therewith.

Unless otherwise specified in the applicable Pricing Supplement, if either Euroclear or Cedel Bank is closed for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention to cease business permanently, the Issuer will issue Bearer Notes in definitive form, with interest coupons ("Definitive Bearer Notes") in exchange for any Bearer Notes in global form, subject to the certification requirements set forth in such Notes. Definitive Bearer Notes of one denomination may be presented for exchange for definitive Bearer Notes of another authorized denomination against surrender of the relevant definitive Bearer Notes at the office of any Transfer Agent located outside the United States. New definitive Notes will be available for delivery within three Business Days at the offices of such Transfer Agent outside the United States.

Replacement of Notes

Notes that become mutilated, destroyed, stolen or lost will be replaced upon delivery to the Fiscal Agent of the Notes, or delivery to the Issuer and the Fiscal Agent of evidence of the loss, theft or destruction thereof satisfactory to the Issuer and the Fiscal Agent. In the case of a lost, stolen or destroyed Note, an indemnity satisfactory to the Fiscal Agent and the Issuer may be required at the expense of the holder of such Note before a replacement Note will be issued. Upon the issuance of any new Note, the Issuer may require the payment of a sum sufficient to cover any

tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and the expenses of the Fiscal Agent, its counsel and its agents) connected therewith.

Redemption

Redemption at the Option of the Issuer

Unless otherwise specified in the Notes and the applicable Pricing Supplement, the Notes will not be subject to any sinking fund. Unless a Redemption Commencement Date is specified in the Notes and the applicable Pricing Supplement, the Notes will not be redeemable prior to their Stated Maturity, except as specified under “—Tax Redemption” below. If a Redemption Commencement Date is so specified with respect to any Note, such Note and the applicable Pricing Supplement will also specify one or more redemption prices (expressed as a percentage of the principal or face amount of such Note) (“Redemption Prices”) and the redemption period or periods (“Redemption Periods”) during which such Redemption Prices shall apply. Unless otherwise specified in the Notes and the applicable Pricing Supplement, any such Note shall be redeemable at the option of the Issuer at any time in whole or from time to time in part in increments of U.S. \$10,000 (or the approximate equivalent thereof in a Specified Currency other than U.S. dollars) on or after such specified Redemption Commencement Date at the specified Redemption Price applicable to the Redemption Period during which such Note is to be redeemed, together with interest accrued to the redemption date, on notice given not less than 60 days prior to the redemption date.

Tax Redemption

An issue of Notes 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, except as specified in the applicable Pricing Supplement, or in the case of Notes issued with original issue discount, at an amount to be specified in the applicable Pricing Supplement, on giving not less than 30 nor more than 60 days’ notice to the holders of such Notes (which notice shall be irrevocable), if (i) the Issuer certifies to the Fiscal Agent 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 of interest on such Notes 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, rules or regulations of Mexico or any political subdivision or any taxing authority thereof or therein affecting taxation, or any change in, amendment to, an official interpretation or application of such laws, rules or regulations, which change or amendment becomes effective on or after the date of issuance of such Notes and (ii) prior to the publication of any notice of redemption, the Issuer shall deliver to the Fiscal Agent 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 Fiscal Agent 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 such Notes; *provided, however*, that no such notice of redemption shall 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 such Notes then due and, at the time such notice is given, such obligation to pay such Additional Amounts remains in effect.

Repayment at the Option of the Holder

Unless otherwise specified in the applicable Pricing Supplement and Notes, the Notes will not be subject to repayment at the option of the holder prior to the Stated Maturity. If so specified in the Pricing Supplement relating to any Note and such Note, such Note will be repayable at the option of

the holder on a date or dates specified prior to its Stated Maturity (each, an "Optional Repayment Date") at the price or prices set forth in such Note and in such Pricing Supplement, if any, together with accrued interest to the Optional Repayment Date. The Note and any applicable forms must be tendered to the Issuer at least 30 but not more than 45 days prior to an Optional Repayment Date. Any such tender for repayment is irrevocable. The repayment option may be exercised by the holder for less than the entire principal or face amount of the Note provided that the amount outstanding after repayment is an authorized denomination.

Interest Rate

Unless otherwise specified in the applicable Pricing Supplement and Note, each Note will bear interest from its date of issue or from the most recent Interest Payment Date (or, if such Note is a Floating Rate Note and the Interest Reset Period is daily or weekly, from the day following the most recent Regular Record Date) to which interest on such Note has been paid or duly provided for at the fixed rate per annum, or at the rate per annum determined pursuant to the interest rate formula stated therein and in the applicable Pricing Supplement, until the principal thereof is paid or made available for payment. Interest will be payable on each Interest Payment Date and at maturity as specified under "Payment of Principal and Interest" below.

Unless otherwise specified in the applicable Pricing Supplement and Note, each Note will bear interest at either (a) a fixed rate (such Note, a "Fixed Rate Note") or (b) a variable rate (such Note, a "Floating Rate Note") determined by reference to an interest rate basis, which may be adjusted by adding or subtracting the Spread and/or multiplying by the Spread Multiplier. The "Spread" is the number of basis points specified in the applicable Pricing Supplement and Note as being applicable to the interest rate for such Note and the "Spread Multiplier" is the percentage specified in the applicable Pricing Supplement and Note as being applicable to the interest rate for such Note. A Floating Rate Note may also have either or both of the following: (a) a maximum numerical interest rate limitation, or ceiling, on the rate of interest which may accrue during any interest period (a "Maximum Rate"); and (b) a minimum numerical interest rate limitation, or floor, on the rate of interest which may accrue during any interest period (a "Minimum Rate"). "Market Day" means (a) with respect to any Note (other than any LIBOR Note) denominated in U.S. dollars, any Business Day in The City of New York, (b) with respect to any Note denominated in a Specified Currency other than U.S. dollars, any day (i) that is a Business Day in the financial center of the country issuing the Specified Currency or, in the case of ECU (as defined below), a day on which banking institutions are not authorized or required by law or regulation to close in London and which is designated as an ECU settlement day by the ECU Banking Association, (ii) on which banking institutions in such financial center are carrying out transactions in such Specified Currency and (iii) that is a London Banking Day (as defined below) and (c) with respect to any LIBOR Note, a London Banking Day. "Business Day", when used with respect to any particular location, means each Monday, Tuesday, Wednesday, Thursday or Friday which is not a day on which banking institutions are authorized or obligated by law to close in such location. "London Banking Day" means any day on which dealings in deposits in U.S. dollars are transacted in the London interbank market. "Index Maturity" means, with respect to a Floating Rate Note, the period to maturity of the instrument or obligation on which the interest rate formula is based, as specified in the applicable Pricing Supplement and Note. Unless otherwise specified in the applicable Pricing Supplement, Bankers Trust Company will be the calculation agent (the "Calculation Agent") with respect to Floating Rate Notes.

The applicable Pricing Supplement relating to a Fixed Rate Note will designate a fixed rate of interest per annum payable on such Note and the Interest Payment Dates with respect to such Note.

The applicable Pricing Supplement relating to a Floating Rate Note will designate an interest rate basis (the "Interest Rate Basis") for such Floating Rate Note. The Interest Rate Basis for each Floating Rate Note will be: (a) LIBOR, in which case such Note will be a LIBOR Note; (b) the

Treasury Rate, in which case such Note will be a Treasury Rate Note; or (c) such other interest rate basis as is set forth in such Pricing Supplement. The Pricing Supplement for a Floating Rate Note will also specify, if applicable, the Calculation Agent, the Exchange Rate Agent, the Index Maturity, the Spread and/or Spread Multiplier, the Maximum Rate, the Minimum Rate, the Initial Interest Rate, the Interest Payment Dates, the Regular Record Dates, the Calculation Dates, the Interest Determination Dates, the Interest Reset Period and the Interest Reset Dates with respect to such Note.

The rate of interest on each Floating Rate Note will be reset and become effective daily, weekly, monthly, quarterly, semi-annually or annually or otherwise as specified in the applicable Pricing Supplement and Note (each, an "Interest Reset Period"); *provided, however*, that (a) if so specified in the Note and applicable Pricing Supplement, the interest rate in effect from the date of issue to the first Interest Reset Date with respect to a Floating Rate Note will be the Initial Interest Rate set forth in the Note and the applicable Pricing Supplement and (b) unless otherwise specified in the Note and the applicable Pricing Supplement, the interest rate in effect for the ten days immediately prior to maturity of a Note will be that in effect on the tenth day preceding such maturity. Unless otherwise specified in the applicable Pricing Supplement and Note, the interest reset date ("Interest Reset Date") will be, in the case of Floating Rate Notes which reset daily, each Market Day; in the case of Floating Rate Notes (other than Treasury Rate Notes) which reset weekly, the Wednesday of each week; in the case of Treasury Rate Notes which reset weekly, except as provided in the following paragraph, the Tuesday of each week; in the case of Floating Rate Notes which reset monthly, the third Wednesday of each month; in the case of Floating Rate Notes which reset quarterly, the third Wednesday of March, June, September and December; in the case of Floating Rate Notes which reset semi-annually, the third Wednesday of two months of each year as specified in the Note and the applicable Pricing Supplement; and in the case of Floating Rate Notes which reset annually, the third Wednesday of one month of each year as specified in the Note and the applicable Pricing Supplement. If any Interest Reset Date for any Floating Rate Note would otherwise be a day that is not a Market Day with respect to such Floating Rate Note, the Interest Reset Date for such Floating Rate Note shall be postponed to the next day that is a Market Day with respect to such Floating Rate Note, except that, in the case of a LIBOR Note, if such Market Date is in the next succeeding calendar month, such Interest Reset Date shall be the next preceding Market Day.

Unless otherwise specified in the applicable Pricing Supplement, Interest Determination Dates will be as set forth below. The Interest Determination Date pertaining to an Interest Reset Date for a LIBOR Note (the "LIBOR Interest Determination Date") will be the second Market Day preceding such Interest Reset Date. The Interest Determination Date pertaining to an Interest Reset Date for a Treasury Rate Note (the "Treasury Interest Determination Date") will be the day of the week in which such Interest Reset Date falls on which Treasury bills would normally be auctioned. Treasury bills are usually sold at auction on the Monday of each week, unless that day is a legal holiday, in which case the auction is usually held on the following Tuesday, except that such auction may be held on the preceding Friday. If, as the result of a legal holiday, an auction is so held on the preceding Friday, such Friday will be the Treasury Interest Determination Date pertaining to the Interest Reset Date occurring in the next succeeding week. If an auction date shall fall on any Interest Reset Date for a Treasury Rate Note, then such Interest Reset Date shall instead be the first Market Day immediately following such auction date.

All percentages resulting from any calculations referred to in this Offering Circular will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, with five one-millionths of a percentage point rounded upward (*e.g.*, 9.876545% (or .09876545) being rounded to 9.87655% (or .0987655)), and all Specified Currency amounts used in or resulting from such calculations will be rounded to the nearest cent (with one-half cent rounded upward) or nearest equivalent in Specified Currencies other than U.S. dollars.

In addition to any Maximum Rate which may be applicable to any Floating Rate Note pursuant to the above provisions, the interest rate on Floating Rate Notes will in no event be higher than the maximum interest rate permitted by New York law, as the same may be modified by United States law of general application. Under present New York law, the maximum rate of interest is 25% per annum on a simple interest basis, with certain exceptions. The limit may not apply to Floating Rate Notes in which U.S. \$2,500,000 or more has been invested.

Upon the request of the holder of any Floating Rate Note, the Calculation Agent will provide the interest rate then in effect, and, if determined, the interest rate which will become effective on the next Interest Reset Date with respect to such Floating Rate Note. The Calculation Agent's determination of any interest rate will be final and binding in the absence of manifest error.

The Fiscal Agent shall notify the Luxembourg Stock Exchange of the Interest Payment Dates, the applicable interest rate and the amount of interest payable on each Interest Payment Date for each issue of Floating Rate Notes listed on such Exchange by no later than the beginning of the relevant Interest Reset Date relating to such Notes.

LIBOR Notes

LIBOR Notes will bear interest at the interest rates (calculated with reference to LIBOR and the Spread and/or Spread Multiplier, if any), and will be payable on the dates, specified on the face of the LIBOR Note and in the applicable Pricing Supplement.

Unless otherwise indicated in the applicable Pricing Supplement and Note, LIBOR with respect to any Interest Reset Date will be determined by the Calculation Agent in accordance with the following provisions:

(i) On the relevant LIBOR Interest Determination Date, LIBOR will be determined on the basis of either:

(a) the offered rates for deposits in U.S. dollars having the specified Index Maturity, commencing on the second Market Day immediately following such LIBOR Interest Determination Date, which appear on the display designated as page "LIBO" on the Reuters Monitor Money Rates Service (or such other page as may replace the LIBO page on that service for the purpose of displaying London interbank offered rates of major banks) (the "Reuters Screen LIBO Page") as of 11:00 A.M., London time, on such LIBOR Interest Determination Date. If at least two such offered rates appear on the Reuters Screen LIBO Page, LIBOR with respect to such Interest Reset Date will be the arithmetic mean of such offered rates as determined by the Calculation Agent. If fewer than two offered rates appear, LIBOR with respect to such Interest Reset Date will be determined as described in (ii) below; or

(b) the offered rates for deposits in U.S. dollars having the specified Index Maturity, commencing on the second Market Day immediately following such LIBOR Interest Determination Date, which appear on the display designated as Page 3750 on the Telerate Service (or such other page as may replace Page 3750 on that service or such other service or services as may be nominated by the British Bankers' Association for the purpose of displaying London interbank offered rates for U.S. dollar deposits) ("Telerate Page 3750") as of 11:00 A.M., London time, on such LIBOR Interest Determination Date. If no such offered rate appears, LIBOR with respect to such Interest Reset Date will be determined as described in (ii) below.

(ii) With respect to a LIBOR Interest Determination Date on which fewer than two offered rates for the applicable Index Maturity appear on the Reuters Screen LIBO Page as described in (i)(a) above, or on which no rate appears on Telerate Page 3750, as described in (i)(b) above, as applicable, LIBOR will be determined on the basis of the rates at approximately 11:00 A.M., London time, on such LIBOR Interest Determination Date at which deposits in U.S. dollars having the specified Index Maturity are offered to prime banks in the London interbank market by four major banks in the London interbank market selected by the Calculation Agent (after consultation with the Issuer) commencing on the second Market Day immediately following such LIBOR Interest Determination Date and in a principal amount equal to an amount of not less than U.S. \$1,000,000 (or its approximate equivalent in a Specified Currency other than U.S. dollars) that in the Issuer's judgment is representative for a single transaction in such market at such time (a "Representative Amount"). The Calculation Agent will request the principal London office of each of such banks to provide a quotation of its rate. If at least two such quotations are provided, LIBOR with respect to such Interest Reset Date will be the arithmetic mean of such quotations. If fewer than two quotations are provided, LIBOR with respect to such Interest Reset Date will be the arithmetic mean of the rates quoted at approximately 11:00 A.M., New York City time, on such LIBOR Interest Determination Date by three major banks in The City of New York, selected by the Calculation Agent (after consultation with Issuer), for loans in U.S. dollars to leading European banks having the specified Index Maturity commencing on the Interest Reset Date and in a Representative Amount; *provided, however*, that if fewer than three banks selected as aforesaid by the Calculation Agent are quoting as mentioned in this sentence, LIBOR with respect to such Interest Reset Date will be the LIBOR in effect on such LIBOR Interest Determination Date.

Treasury Rate Notes

Treasury Rate Notes will bear interest at the interest rates (calculated with reference to the Treasury Rate and the Spread and/or Spread Multiplier, if any) and will be payable on the dates specified on the face of the Treasury Rate Note and in the applicable Pricing Supplement. Unless otherwise specified in the applicable Pricing Supplement and Note, the "Calculation Date" with respect to a Treasury Interest Determination Date will be the tenth day after such Treasury Interest Determination Date or, if such day is not a Market Day, the next succeeding Market Day.

Unless otherwise indicated in the applicable Pricing Supplement and Note, "Treasury Rate" means, with respect to any Interest Reset Date, the rate for the auction on the relevant Treasury Interest Determination Date of direct obligations of the United States ("Treasury Bills") having the specified Index Maturity as published in H.15(519) under the heading "U.S. Government Securities—Treasury Bills—auction average" or, if not so published by 3:00 P.M., New York City time, on the relevant Calculation Date, then the auction average rate (expressed as a bond equivalent yield, on the basis of a year of 365 or 366 days, as applicable, and applied on a daily basis) for such auction as otherwise announced by the United States Department of the Treasury. In the event that the results of such auction of Treasury bills having the specified Index Maturity are not published or reported as provided above by 3:00 P.M., New York City time, on such Calculation Date, or if no such auction is held during such week, then the Treasury Rate shall be the rate set forth in H.15(519) for the relevant Treasury Rate Interest Determination Date for the specified Index Maturity under the heading "U.S. Government Securities—Treasury Bills—Secondary Market". In the event such rate is not so published by 3:00 P.M., New York City time, on the relevant Calculation Date, the Treasury Rate with respect to such Interest Reset Date shall be calculated by the Calculation Agent and shall be a yield to maturity (expressed as a bond equivalent yield, on the basis of a year of 365 or 366 days, as applicable, and applied on a daily basis) of the arithmetic mean of the secondary market bid rates at approximately 3:30 P.M., New York City time, on such Treasury Interest Determination Date, of three primary United States government securities dealers in The City

of New York selected by the Calculation Agent (after consultation with the Issuer) for the issue of Treasury Bills with a remaining maturity closest to the specified Index Maturity; *provided, however*, that if fewer than three dealers selected as aforesaid by the Calculation Agent are quoting as mentioned in this sentence, the Treasury Rate with respect to such Interest Reset Date will be the Treasury Rate in effect on such Treasury Interest Determination Date.

Payment of Principal and Interest

Interest on Registered Notes will be payable to the person in whose name a Note is registered at the close of business on the Regular Record Date next preceding each Interest Payment Date; *provided, however*, that interest payable at maturity will be payable to the person to whom principal shall be payable; *provided further, however*, that any payment of interest on Global Notes shall be made to the applicable Depository or its nominee, as the registered owner of the Global Note representing such Notes. Unless otherwise specified in the Note or the applicable Pricing Supplement, the first payment of interest on any Note originally issued between a Regular Record Date and an Interest Payment Date will be made on the Interest Payment Date following the next succeeding Regular Record Date to the registered owner on such next succeeding Regular Record Date. Unless otherwise indicated in the applicable Pricing Supplement and Note, the "Regular Record Date" with respect to any Note shall be the date 15 calendar days prior to each Interest Payment Date, whether or not such date shall be a Business Day.

Payment of principal (and premium, if any) and any interest due with respect to any Registered Note at Stated Maturity will be made in immediately available funds upon surrender of such Note at the corporate trust office of Bankers Trust Company in the Borough of Manhattan, The City of New York, or at the specified office of any other Paying Agent, provided that the Registered Note is presented to the Paying Agent in time for the Paying Agent to make such payments in such funds in accordance with its normal procedures. Payments of principal (and premium, if any) and any interest in respect of Registered Notes to be made other than at Stated Maturity or upon redemption will be made by check mailed on or before the due date for such payments to the address of the person entitled thereto as it appears in the Security Register; *provided, however*, that (a) the applicable Depository, as holder of the Global Notes, shall be entitled to receive payments of interest by wire transfer of immediately available funds, (b) a holder of U.S. \$10,000,000 (or the approximate equivalent thereof in a Specified Currency other than U.S. dollars) in aggregate principal or face amount of Notes having the same Interest Payment Date shall be entitled to receive payments of interest by wire transfer to an account maintained by such holder at a bank located in the United States as may have been appropriately designated by such person to the Paying Agent in writing no later than the relevant Regular Record Date and (c) to the extent that the holder of a Registered Note issued and denominated in a Specified Currency other than U.S. dollars elects to receive payment of principal and interest at Stated Maturity in such Specified Currency, such payment, except in circumstances described in the applicable Pricing Supplement, shall be made by wire transfer of immediately available funds to an account specified in writing not less than 15 days prior to Stated Maturity by the holder to the Fiscal Agent. Unless such designation is revoked, any such designation made by such holder with respect to such Notes shall remain in effect with respect to any future payments with respect to such Notes payable to such holder.

Principal of (and premium, if any, on) a Bearer Note shall be payable by check or wire transfer upon presentation and surrender of such Note at an office of a Paying Agent located outside the United States and its possessions, as defined herein, or at such other offices or agencies located outside the United States and its possessions as the Issuer shall have appointed for the purpose pursuant to the Fiscal Agency Agreement. Such Paying Agents shall initially be Bankers Trust Company, London Office and Bankers Trust Luxembourg S.A. Interest on Bearer Notes shall be payable by check or wire transfer to the holder of each coupon appertaining to such Note in the amount determined in accordance with such coupon, on or after the due date of such payment as

set forth in such coupon, upon presentation and surrender thereof at the offices of the Paying Agents set forth on the reverse of such coupon or at such other offices or agencies located outside the United States and its possessions as the Issuer shall have appointed pursuant to the Fiscal Agency Agreement.

Unless otherwise indicated in the applicable Pricing Supplement and Note, and except as provided below, interest will be payable, in the case of Floating Rate Notes which reset daily, weekly or monthly, on the third Wednesday of each month or on the third Wednesday of March, June, September and December of each year (as indicated in the applicable Pricing Supplement and Note); in the case of Floating Rate Notes which reset quarterly, on the third Wednesday of March, June, September and December of each year; in the case of Floating Rate Notes which reset semi-annually, on the third Wednesday of the two months of each year specified in the applicable Pricing Supplement and Note; and in the case of Floating Rate Notes which reset annually, on the third Wednesday of the month specified in the applicable Pricing Supplement and Note (each, an "Interest Payment Date"), and in each case, at maturity.

Payments of interest on any Fixed Rate Note or Floating Rate Note with respect to any Interest Payment Date will include interest accrued to but excluding such Interest Payment Date; *provided, however,* that, unless otherwise specified in the applicable Pricing Supplement and Note, if the Interest Reset Dates with respect to any Floating Rate Note are daily or weekly, interest payable on such Note on any Interest Payment Date, other than interest payable on the date on which principal on any such Note is payable, will include interest accrued to but excluding the day following the next preceding Regular Record Date.

With respect to a Floating Rate Note, accrued interest from the date of issue or from the last date to which interest has been paid is calculated by multiplying the principal or face amount of such Floating Rate Note by an accrued interest factor. Such accrued interest factor is computed by adding the interest factor calculated for each day from the date of issue, or from the last date to which interest has been paid, to but excluding the date for which accrued interest is being calculated. Unless otherwise specified in the applicable Pricing Supplement and Note, the interest factor (expressed as a decimal) for each such day is computed by dividing the interest rate (expressed as a decimal) applicable to such date by 360, in the case of LIBOR Notes, or by the actual number of days in the year, in the case of Treasury Rate Notes. Unless otherwise specified in the applicable Pricing Supplement and Note, interest on Fixed Rate Notes will be computed on the basis of a 360-day year of twelve 30-day months.

If any Interest Payment Date (other than the Stated Maturity) for any Floating Rate Note would otherwise be a day that is not a Market Day, such Interest Payment Date shall be the succeeding Market Day, except that, in the case of a LIBOR Note, if such Market Day is in the next succeeding calendar month, such Interest Payment Date shall be the next preceding Market Day. If the Stated Maturity for any Fixed Rate Note or Floating Rate Note or the Interest Payment Date for any Fixed Rate Note falls on a day which is not a Business Day in the place of payment, payment of principal (and premium, if any) and interest with respect to such Note will be made on the next succeeding Business Day in the place of payment with the same force and effect as if made on the due date and no interest on such payment will accrue from and after such due date.

Foreign Currency Notes and Indexed Notes

If any Note is to be denominated in a Specified Currency other than U.S. dollars (each such Note, a "Foreign Currency Note"), certain provisions with respect thereto will be set forth in the applicable Note and in the related Pricing Supplement, which will specify the foreign currency or currency unit in which the principal, premium, if any, and interest with respect to such Note are to be paid, along with any other terms relating to the non-U.S. dollar denomination.

If the principal of or premium (if any), interest, Additional Amounts or other amounts on any Note is payable in a Specified Currency other than U.S. dollars and such Specified Currency is not available due to the imposition of exchange controls or other circumstances beyond the control of the Issuer, or is no longer used by the government of the country issuing such currency or for settlement of transactions by public institutions of or within the international banking community, the Issuer will be entitled to satisfy its obligations to the holder of such Notes by making such payment in U.S. dollars on the basis of the noon buying rate in The City of New York for cable transfers in such Specified Currency as certified for customs purposes by the Federal Reserve Bank of New York (the "Exchange Rate") for such Specified Currency on the second New York Business Day prior to the applicable payment date or, if the Exchange Rate is not then available, on the basis of the most recently available Exchange Rate. In the event no Exchange Rate is published for such currency, then the payment in U.S. dollars shall be made based on the rate given by the relevant central bank for buying such currency or, if no such rate is available, the rate shall be the average of rates given to the Fiscal Agent by internationally recognized commercial banks selected by the Fiscal Agent in consultation with the Issuer which regularly engage in foreign currency dealings for buying such currency. The Exchange Rate, or the rate as so determined, is referred to herein as the "Market Exchange Rate." Any payment made under such circumstances in U.S. dollars where the required payment is due in other than U.S. dollars will not constitute an Event of Default under the Notes.

If so specified in a Foreign Currency Note and the applicable Pricing Supplement, and except as provided in the next following paragraph, payments of principal and any premium, interest, Additional Amounts or other amounts with respect to such Note will be made in U.S. dollars if the holder of such Note on the relevant Regular Record Date or at Stated Maturity, as the case may be, has transmitted a written request for such payment in U.S. dollars to the Fiscal Agent and the applicable Paying Agent on or prior to such Regular Record Date or the date 15 days prior to Stated Maturity, as the case may be. Such request may be in writing (mailed or hand delivered) or by facsimile transmission. Any such request made with respect to any Registered Note by a holder will remain in effect with respect to any further payments of principal and any premium, interest, Additional Amounts or other amounts with respect to such Registered Note payable to such holder, unless such request is revoked on or prior to the relevant Regular Record Date or the date 15 days prior to Stated Maturity, as the case may be. Holders of Foreign Currency Notes that are registered in the name of a broker or nominee should contact such broker or nominee to determine whether and how an election to receive payments in U.S. dollars may be made.

The dollar amount to be received by a holder of a Foreign Currency Note who elects to receive payment in U.S. dollars will be based on the highest bid quotation in The City of New York received by the Exchange Rate Agent (as defined below) as of 11:00 A.M., New York City time, on the second Business Day in New York next preceding the applicable payment date from three recognized foreign exchange dealers (one of which may be the Exchange Rate Agent) for the purchase by the quoting dealer of the Specified Currency for U.S. dollars for settlement on such payment date in the aggregate amount of the Specified Currency payable to all holders of Notes electing to receive dollar payments and at which the applicable dealer commits to execute a contract. If three such bid quotations are not available on the second Business Day in New York preceding the date of payment of principal or any premium, interest, Additional Amounts or other amounts with respect to any Note, such payment will be made in the Specified Currency. All currency exchange costs associated with any payment in U.S. dollars on any such Foreign Currency Note will be borne by the holder thereof by deductions from such payment of such currency exchange being effected on behalf of the holder by the Exchange Rate Agent. Unless otherwise specified in the applicable Pricing Supplement, Bankers Trust Company will be the exchange rate agent (the "Exchange Rate Agent") with respect to Foreign Currency Notes.

Unless otherwise specified in the applicable Pricing Supplement and except as otherwise provided under "—Redenomination" below, Foreign Currency Notes will provide that, in the event of an official redenomination of the Specified Currency, the obligations of the Issuer with respect to payments on such Notes shall, in all cases, be deemed immediately following such redenomination to provide for payment of that amount of the redenominated Specified Currency representing the amount of such obligations immediately before such redenomination.

All determinations referred to above made by the Exchange Rate Agent shall, in the absence of manifest error, be conclusive for all purposes and binding on holders of the Notes and the Issuer, and the Exchange Rate Agent shall have no liability therefor.

The Issuer may from time to time offer Notes ("Indexed Notes"), the principal amount of which is payable on or prior to Stated Maturity, the amount of interest payable on which and/or any premium payment with respect to which will be determined with reference to an index or indices (e.g., the difference in price of crude oil on certain dates or any other index or indices). The Pricing Supplement relating to such Indexed Notes and such Indexed Notes will set forth the method by and the terms on which the amount of principal (payable on or prior to Stated Maturity), interest and/or any premium will be determined, any additional tax consequences to the holder of such Note, a description of certain risks associated with investment in such Note and other information relating to such Note.

Possible Introduction of a Single European Currency

The Treaty on European Union provides that a single European currency will be introduced and will replace certain of the currencies of the member states of the European Community. The process of European economic and monetary union is currently scheduled to begin on January 1, 1999 by irrevocably fixing the value of participating member state currencies against the European single currency, to be known as the euro, and is to be completed in 2002 by the withdrawal from legal tender of the national currencies of participating member states. As of the date hereof, it is not possible to predict whether the single European currency will be introduced in the form and according to the timetable currently proposed, which European Community member states will participate or how European economic and monetary union may affect the value of the Notes or the rights of holders of the Notes. Each prospective investor in the Notes that may be affected by European economic and monetary union is responsible for informing himself or herself about European economic and monetary union and the effects European economic and monetary union may have on his or her contemplated investment and assumes for himself or herself the associated investment risks.

In July 1997, the General Obligations Law of the State of New York was amended to provide that, subject to any specific agreement otherwise made between the parties to a contract, security or instrument governed by New York law, (1) if a currency of payment for any such contract, security or instrument is the ECU or a currency that is substituted or replaced by the euro, payments under such contract, security or instrument may instead be tendered in euro at the conversion rate specified in, and otherwise calculated in accordance with, regulations adopted by the Council of the European Union, (2) payments under such contract, security or instrument may also be made in the currency or currencies originally designated in the contract, security or instrument so long as such currency or currencies remain legal tender and (3) the introduction of the euro and the making of payments under a contract, security or instrument in accordance with the foregoing provisions will not have the effect of discharging or excusing performance under any such contract, security or instrument, or give a party the right to unilaterally alter or terminate any such contract, security or instrument.

Except as provided in an issue of Notes or in the Pricing Supplement with respect to the redenomination of such Notes into euros or the consolidation of such issue of Notes with other issues of Notes upon or subsequent to such conversion, to the extent permitted by applicable law, the occurrence or non-occurrence of an EMU Event (as defined below) or the entry into force of any law, regulation, directive or order requiring redenomination or consolidation to be undertaken on terms different than those described herein, will not have the effect of altering any term of, or discharging or excusing performance under, the Fiscal Agency Agreement or the Notes, nor give the Issuer, the Fiscal Agent, any other agent or any holder of such Notes the right unilaterally to alter or terminate the Fiscal Agency Agreement or such Notes or give rise to any Event of Default or otherwise be the basis for any acceleration, early redemption, rescission, notice, repudiation, adjustment or renegotiation of the terms of the Fiscal Agency Agreement or the Notes. For purposes hereof, "EMU Event" means any event associated with EMU in the European Community, including, without limitation, each (and any combination) of (i) the introduction of, changeover to or operation of the euro; (ii) the irrevocable fixing of exchange rates between the currency of a Participating Member State and the euro or between the currencies of Participating Member States; (iii) the substitution of the euro for the ECU; (iv) the introduction of the euro as lawful currency in a Participating Member State; (v) the withdrawal from legal tender of any currency that, before the introduction of the euro, was lawful currency in any of the Participating Member States; or (vi) the disappearance or replacement of a relevant rate option or other price source for the ECU or the national currency of any Participating Member State, or the failure of the agreed price or rate sponsor (or a successor sponsor) or screen provider to publish or display a relevant rate, index, price, page or screen.

Special Provisions related to Notes Denominated in ECU

ECU defined. The ECU is the same as the official ECU basket, as referred to in Article 109g of the Treaty establishing the European Community, as amended by the Treaty on European Union (as so amended, the "Treaty"), and as defined in Council Regulation (EC) No. 3320/94, that is from time to time used as the unit of account of the European Community. Under Article 109g of the Treaty, the currency composition of the ECU may not be changed. Other changes to the official ECU basket may be made by the European Community, in which case the ECU will change accordingly.

Payments in Euros; Business Days; Interest Accrual Basis. Under the Treaty, a single European currency, to be known as the euro (the "euro"), will be introduced on January 1, 1999. On June 17, 1997, the Council of the European Union adopted Council Regulation (EC) No 1103/97, which provides that, in accordance with the Treaty, from January 1, 1999 every reference in a legal instrument to the ECU shall be replaced by a reference to the euro at the rate of one euro for one ECU. Accordingly, following the replacement of the euro by the ECU, notwithstanding other terms and conditions applicable to the Notes, all payments in respect of Notes denominated in ECU will be paid solely in euros (including payments of interest in respect of periods commencing before the date of introduction of the euro) by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) at the rate of one euro for one ECU. In addition, from the date the euro replaces the ECU, (i) a Note or any coupon appertaining thereto may only be presented for payment on a day on which the TARGET system is operating; and (ii) if interest is required to be calculated for a period of less than one year, it will be calculated on the basis of the actual number of days elapsed divided by 365 (or, if any of the days elapsed fall in a leap year, the sum of (A) the number of those days falling in a leap year divided by 366 and (B) the number of those days in a non-leap year divided by 365). Replacement of the ECU by the euro will not result in payment in a substitute currency as discussed below.

Payments in a Substitute Currency. In the event that the ECU ceases to be the unit of account for the European Community and the ECU has not been replaced by the euro, the Exchange Rate Agent shall choose, in its discretion after consultation with the Issuer, taking into account applicable

European Community laws and regulations and market practices consistent therewith, a substitute currency (the "Chosen Currency") in which all payments due with respect to the Notes and any coupons appertaining thereto shall be made. The amount of each payment in such Chosen Currency shall be computed on the basis of the equivalent of the ECU in that currency, as determined by the Exchange Rate Agent, in its discretion after consultation with the Issuer, taking into account applicable European Community laws and regulations and market practices consistent therewith.

Determinations Made by the Exchange Rate Agent. All determinations made by the Exchange Rate Agent shall, in the absence of manifest error, be conclusive for all purposes and binding on the Issuer and all holders of Notes and coupons.

Redenomination

If the principal of and any interest and premium, if any, on any issue of Notes is payable in any Specified Currency other than U.S. dollars and the country in which such Specified Currency has been the legal currency (the "Currency Country") becomes a Participating Member State (as defined below), then the Issuer may at its option, and without the consent of the holders of such Notes or any coupons appertaining thereto or the need to amend the Notes or the Fiscal Agency Agreement, on any Interest Payment Date after the date on which such Currency Country has become a Participating Member State (such Interest Payment Date, a "Redenomination Date"), redenominate all of such Notes into euros upon the giving of not less than 30 days' notice thereof in accordance with the terms of such Notes, which notice shall set forth the manner in which such redenomination shall be effected. If the Issuer elects to so redenominate such Notes, such Notes shall be redenominated:

(i) in such manner and subject to compliance with all applicable requirements of relevant monetary, stock exchange or other authorities, applicable European Community national and governing laws and regulations and such existing or anticipated market practices consistent therewith with respect to debt obligations issued in the Euromarkets (whether denominated in such Specified Currency or otherwise) which are held in international clearing systems ("euromarket debt obligations"); or

(ii) if no such determination as set out in clause (i) above is made, the Issuer shall convert the nominal Specified Currency amount of each of such Notes into euros by using the Fixed Conversion Rate (as defined below) and rounding the resultant figure to the nearest cent (with 0.005 of a Euro being rounded upwards) (the "Redenominated Amount"), unless the international clearing systems in which such Notes are then cleared and settled do not then accept for clearance and settlement redenominated euromarket debt obligations, with a denomination of one cent, in which case the Redenominated Amount shall be rounded to the nearest euro (with 0.5 euro being rounded upwards). Any balance remaining from a redenomination shall be paid by way of cash adjustment. Such cash adjustment shall be payable in euros on the Redenomination Date to, or to the order of, the holders of such Notes in a manner substantially similar to that provided herein and in such Notes for the payment of interest on such Notes.

Exchange of Bearer Notes; Definitive Notes. With effect from the Redenomination Date, (i) all unmatured coupons, if any, relating to Bearer Notes redenominated in accordance with the provisions of this section (whether or not attached) shall become void and no payment shall be made in respect of them and (ii) all such coupons and the Notes to which they appertain may be exchanged for new coupons and Notes reflecting the redenomination, in such manner as the Exchange Rate Agent may specify and notify to the holders of the Notes.

Certificated Notes. If Certificated Notes are required to be issued, they shall be issued in the denominations determined as appropriate by the Fiscal Agent, after consultation with the relevant clearing systems, and notified to holders of the Notes. New certificates in respect of euro-denominated Notes will be issued in exchange for Notes and coupons appertaining thereto denominated in such Specified Currency in such manner as the Fiscal Agent may specify and notify to holders of the Notes.

Renominalization. Without prejudice to the foregoing, the Issuer may, without the consent of the holders of any issue of Notes or the holders of the coupons appertaining thereto or the need to amend the Notes or the Fiscal Agency Agreement, upon the giving of not less than 30 days' irrevocable notice thereof in accordance with the terms hereof (which notice shall set forth the manner in which such further redenomination shall be effected subject to applicable law), elect that, with effect from the Redenomination Date for such issue or such later Interest Payment Date as it may specify (the "Renominalization Date"), the nominal denominations of the euro-denominated Notes of such issue shall be changed to new specified nominal denominations as set forth in such notice; *provided, however*, that in no event shall the minimum denominations of such Notes after the Renominalization Date with respect thereto be lower than the minimum denominations of such Notes prior to the Renominalization Date with respect thereto. If the Issuer so elects, the then-existing euro-denominated Notes of a series ("Original Euro Notes") shall be exchangeable for Notes of such new denomination ("New Euro Notes"). Any balance remaining from a renominalization shall be paid by way of cash adjustment. Such cash adjustment shall be payable in euros on the Renominalization Date to, or to the order of, the holders of such Notes in a manner substantially similar to that provided herein and in such Notes for the payment of interest in such Notes.

Reconventioning. At the option of the Issuer, references in the terms and conditions of such Notes to any business day, day-count fraction or other convention (whether for the calculation of interest, determination of payment dates or otherwise) may be amended, with effect from (i) the Redenomination Date, (ii) the Interest Payment Date following the date that the Specified Currency is replaced by the euro pursuant to applicable law, or (iii) such later Interest Payment Date as the Issuer may specify, to comply with any conventions applicable to euro-denominated debt obligations pursuant to applicable requirements of relevant monetary, stock exchange or other authorities, applicable European Community, national and governing laws and regulations and such market practices consistent therewith as the Exchange Rate Agent, in its discretion after consultation with the Issuer, shall determine to be applicable for Eurobonds held in international clearing systems which have been redenominated into euro, and the terms of the Notes shall be deemed to be amended accordingly.

The Issuer may, with the consent of the Fiscal Agent and without the need to obtain the consent of the holder of any Note, make any changes or additions to the terms of an issue of Notes which (i) the Issuer or the Fiscal Agent reasonably believes are necessary or appropriate to facilitate the implementation of the practical aspects of this section as they relate to such Notes in the context of the introduction of the euro or (ii) correct any manifest error or any ambiguity or correct or supplement any defective provisions described herein; *provided* that such changes or additions are not materially prejudicial to the interests of the holders of such Notes. Any such change or addition shall be binding on the Issuer, the holders of such Notes, the Fiscal Agent, the Paying Agents and any other agent of the Issuer. The Issuer shall promptly give notice of any such change or addition in accordance with "—Notices" below.

Consolidation of Notes Denominated in Euro

Subject to the provisions below, the Issuer may, without the consent of the holders of an issue of Notes or the need to amend the Fiscal Agency Agreement or such Notes, on any Interest Payment Date after the EMU Date (as defined below) (or if that day is not a Business Day in any location(s)

which is or are determined by the Issuer to be necessary or appropriate for the consolidation of such Notes, the next following day which is a Business Day in such location(s)) (each, a "Consolidation Date"), and on the giving of not less than 30 days' prior notice thereof in accordance with the terms hereof (which notice shall detail the manner in which consolidation shall be effected, subject to applicable law), consolidate such Notes with one or more series of Other Securities, *provided, however*, (i) that such consolidation may only be carried out if such Notes and the Other Securities to be consolidated have been redenominated in euros (if not already so denominated) on or before the relevant Consolidation Date, and (ii) that no Event of Default under such Notes or other event which, with the giving of notice or the passage of time or both, would constitute an Event of Default under such Notes, or any similar event under the terms of such Other Securities, has occurred and is continuing.

"Other Securities" means, at any time, any one or more issues of other Notes or other notes or bonds of the Issuer which (i) are issued pursuant to the Fiscal Agency Agreement and have the same or substantially the same terms and conditions (as then in effect and which have not lapsed), and the benefit of the same rights (including the Guaranties), as such Notes (other than in relation to the currency of original denomination and/or the denomination and/or the terms and conditions of such Notes relating to business days or interest accrual bases and/or the stock exchange(s) (if any) on which such other Notes or other notes or bonds are listed and/or the clearing systems through which such other Notes or other notes or bonds are cleared and settled and/or redenomination into euros and/or notices) and (ii) have been designated by the Issuer as falling within clause (i) above and remain so designated.

Clearance and Settlement; Stock Exchange Listing. The Issuer may exercise its right referred to above if it determines that an issue of Notes and Other Securities which it proposes to consolidate (collectively, the "Consolidating Securities") will, with effect from the date of their consolidation, (i) be cleared and settled on an interchangeable basis with the same securities identification numbers through the main clearing systems through which such Notes and the relevant Other Securities were cleared and settled immediately prior to consolidation and (ii) if either such Notes or the relevant Other Securities were listed on any European stock exchange on which debt obligations issued in the Euromarkets are customarily listed immediately prior to the consolidation contemplated hereby, continue to be listed on at least one such exchange.

Renominalization/Reconventioning. With effect from the Consolidation Date of any issue of Notes or such later Interest Payment Date as the Issuer may specify, the Issuer may, without the need to obtain the consent of holders of the affected Notes, (i) alter the nominal amounts in which such Notes are denominated as a result of any previous redenomination of such Notes in accordance with the provisions described in "—Redenomination—Renominalization" above and/or (ii) alter the conventions applicable to such Notes in accordance with the provisions of "—Redenomination—Reconventioning" above.

Change of Common Depositary. Upon any consolidation of an issue of Notes represented by a Global Note with any series of Other Securities so represented, the Issuer may change the depositary or depositaries which hold the Notes of such series and/or the relevant Other Securities either physically or on behalf of the clearing system or clearing systems through which such Notes and/or the relevant Other Securities are held and/or issue a replacement Global Note or Global Notes representing such Notes.

Certificated Notes. Holders of Certificated Notes must exchange such Notes for Notes represented by a Global Note prior to any consolidation hereunder. If such exchange is not possible pursuant to the terms of such Notes, such Notes may not be consolidated with Other Securities represented by a Global Note.

The Issuer undertakes to the holders of an issue of Notes consolidated in accordance with the provisions of this section that, following a consolidation of such Notes with Other Securities, it shall, in dealing with the holders of such Notes, have regard to the interests of such holders and the holders of the relevant Other Securities, taken together as a class, and treat them alike.

The Issuer may, with the consent of the Fiscal Agent, and without the need to obtain the consent of the holders of any Notes, make any changes or additions to the terms of an issue of Notes which (i) the Issuer or the Fiscal Agent reasonably believes are necessary or appropriate to facilitate the implementation of the practical aspects of this section as they relate to such Notes in the context of the relevant consolidation or (ii) correct any manifest error or any ambiguity or correct or supplement any defective provisions described herein; *provided* that such changes or additions are not materially prejudicial to the interests of the holders of such Notes. Any such change or addition shall be binding on the Issuer, the holders of such Notes, the Fiscal Agent and any other agent of the Issuer. The Issuer shall promptly give notice of any such change or addition in accordance with "— Notices" below.

Definitions

For the purposes of this Offering Circular, the following terms shall have the meanings specified below:

"EMU" means economic and monetary union as contemplated by the Treaty of Rome;

"ECU" means the European Currency Unit as represented by the official ECU basket, as referred to in Article 109g of the Treaty of Rome, as amended by the Treaty on European Union (as so amended, the "Treaty"), and as defined in Council Regulation (EC) No. 3320/94, that is from time to time used as the unit of account of the European Community;

"EMU Date" means the day on which the euro has been introduced as the legal currency of certain Participating Member States of the European Community or events have occurred which have substantially the same effects and which result in substantially the same consequences as the effects and consequences of the start of the third stage of EMU as contemplated by the Treaty on European Union as of the date of this Offering Circular, whichever is earlier;

"euro" means the single or unified currency to be introduced in the Participating Member States, whether known as the euro or otherwise;

"Fixed Conversion Rate" with respect to any Specified Currency means the irrevocably fixed conversion rate between the Euro and such Specified Currency adopted by the Council of the European Union according to Article 109 1(4) first sentence of the Treaty of Rome;

"Participating Member State" means a member state of the European Community established by the Treaty of Rome which has adopted the euro as its legal currency in accordance with the Treaty of Rome;

"Relevant Financial Center" means (i) in the case of a Note denominated in U.S. dollars, The City of New York; (ii) in the case of a Note denominated in ECU or euro, Brussels; and (iii) in the case of a Note denominated or payable in any other currency or currencies, such financial center or centers as may be applicable to such currency or currencies under the definition of "Business Day" in the 1991 ISDA Definitions (as amended and updated from time to time) published by the International Swap and Derivatives Association, Inc. ("ISDA");

"Treaty of Rome" means the Treaty of Rome of March 25, 1957, establishing the European Community, as amended by the Single European Act of 1986 and the Treaty on European Union, as amended from time to time; and

"Treaty on European Union" means the treaty which was signed in Maastricht on February 1, 1992 and came into force on November 1, 1993.

Guaranties

Pursuant to a Guaranty Agreement dated July 29, 1996 (the "Guaranty Agreement"), among the Issuer and the Guarantors, each of the Guarantors will be 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 Fiscal Agency Agreement and the Notes will be designated by the Issuer in certificates of designation dated February 26, 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 Notes, 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 Notes. 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 Notes, 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 Notes and the Fiscal Agency Agreement) 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 Note such additional amounts ("Additional Amounts") as may be necessary in order that every net payment made by the Issuer or a Guarantor on such Note, 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 Notes. The foregoing obligation to pay Additional Amounts, however, will not apply to:

(a) any Mexican Withholding Taxes that would not have been imposed or levied on a holder of Notes but for the existence of any present or former connection between the holder of such Notes and Mexico or any political subdivision or territory or possession thereof or area subject to its jurisdiction, including, without limitation, such holder of Notes (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 Notes;

(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 Notes to comply with any certification, identification, information,

documentation, declaration or other reporting requirement that 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 Fiscal Agent, in writing that the holders of Notes 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 Note 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 Note 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 Note.

All references herein to principal and interest in respect of Notes 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 Note (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, as amended to date, 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 Guarantors cannot obtain such certification, identification, information, documentation, declaration or evidence, or satisfy any other reporting requirements, on its own through reasonable

diligence and the Issuer or the Guarantors 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 Note 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 Note register with the Ministry of Finance and Public Credit for the purpose of establishing eligibility for an exemption from or reduction of Mexican Withholding Taxes.

The Issuer or the applicable Guarantor, as the case may be, will, upon written request, provide the Fiscal Agent, the holders and the Paying Agents with a duly certified or authenticated copy of an original receipt of the payment of Mexican Withholding Taxes which the Issuer or the Guarantor has withheld or deducted in respect of any payments made under or with respect to the Notes or the Guaranty of the Notes, as the case may be.

In the event that Additional Amounts actually paid with respect to any Notes 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 Notes, 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 such Notes, 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.

Negative Pledge

So long as any Note 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 Notes equally and ratably therewith or providing such other Security Interest for the Notes as shall be approved by the holders of at least 66 2/3% in aggregate principal amount of the outstanding Notes; *provided, however*, 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 Fiscal Agent certifying that on the date of creation of such Security Interest there is no default

under any Financing Document (as defined in the Notes) resulting from a failure to pay principal or interest, as described more particularly in the Fiscal Agency Agreement.

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 by, 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 Notes (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 with respect to an issue of Notes, the Fiscal Agent, if so requested by holders of at least one-fifth in principal amount of the Notes of such issue then outstanding, shall give notice to the Issuer that such Notes 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 premium, if any, or any interest on, or any sinking fund payment with respect to, any of such Notes when due and such failure continues, in the case of non-payment of principal or any sinking fund payment for seven days, and of interest or premium 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 such Notes or (insofar as it concerns such Notes) the Fiscal Agency Agreement 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 Fiscal Agent; 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 such Notes, the Fiscal Agency Agreement 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 such Notes 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 such Notes, the Fiscal Agency Agreement 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 such Notes; 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 Offering Circular, 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 Fiscal Agent, the holders of a majority in aggregate principal amount of the Notes of such issue then outstanding may rescind and annul such acceleration if all Events of Default, other than the non-payment of the principal of such Notes that have become due solely by such declaration of acceleration, have been cured or waived as provided in the Fiscal Agency Agreement.

The holders of a majority in principal amount of the outstanding Notes of any issue may on behalf of the holders of such Notes 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 such Notes or in respect of a covenant or provision in the Fiscal Agency Agreement that cannot be modified or amended without the consent of the holder of each Note affected. Holders of at least 66 2/3% in principal amount of the outstanding Notes of any issue may on behalf of the holders of all Notes waive compliance with certain provisions of the Notes and (insofar as it concerns such Notes) the Fiscal Agency Agreement.

Purchase of Notes

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

Modification and Waiver

Modifications to and amendments of the Fiscal Agency Agreement and the Notes may be made by the Issuer and the Fiscal Agent with the consent of the holders of not less than a majority in aggregate principal or face amount of the Notes at the time Outstanding that are affected by such amendment, but no such modification or amendment may, without the consent of the holder of each Note affected thereby, (i) change the due date for the payment of principal of, premium (if any) or any installment of interest on any Note, (ii) reduce the principal or face amount of, the portion of such principal or face amount which is payable upon acceleration of the maturity of, the rate of interest on or the premium payable upon redemption of any Note, (iii) shorten the period during which the Issuer is not permitted to redeem any Note, or permit the Issuer to redeem any Note if, prior to such action, the Issuer is not permitted to do so, (iv) change the coin or currency in which or the required places at which any Note or the interest or premium thereon is payable, (v) modify the Guaranties in any manner adverse to the holders of any Note, (vi) change the obligation of the Issuer or any Guarantor to pay Additional Amounts or (vii) reduce the above-stated percentage of Notes necessary to modify, amend or supplement the Fiscal Agency Agreement or the Notes or for waiver of compliance with certain provisions thereof or for waiver of certain defaults.

The holders of not less than a majority in aggregate principal or face amount of the Outstanding Notes may waive compliance by the Issuer with certain restrictive provisions of the Notes and may waive any past default under the Notes, except a default in the payment of principal or interest or in respect of any covenant in or provision of the Fiscal Agency Agreement or the Notes which cannot be modified or amended without the consent of the holder of each affected Note.

The Issuer and the Fiscal Agent may, without the vote or consent of any holder of Notes, modify or amend the Fiscal Agency Agreement or the Notes for the purpose of (a) adding to the covenants of the Issuer, for the benefit of the holders of the Notes, (b) surrendering any right or power conferred upon the Issuer, (c) securing the Notes pursuant to the requirements of the Notes or otherwise, (d) 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 Notes and in the Fiscal Agency Agreement pursuant to any merger, consolidation or sale of assets, (e) correcting or supplementing any defective provision contained in the Fiscal Agency Agreement or in the Notes or (f) amending the Fiscal Agency Agreement or the Notes in any manner which the Fiscal Agent and the Issuer may determine and which shall not adversely affect the interests of any holder of the Notes.

Repayment of Moneys; Prescription

Any moneys paid by the Issuer or any Guarantor to the Fiscal Agent for the payment of the principal of or interest on any Notes and remaining unclaimed at the end of two years after such principal or interest shall have become due and payable and shall have been paid to the Fiscal Agent by the Issuer or any Guarantor, shall then be repaid to the Issuer upon its written request, and the holders of such Notes will thereafter look only to the Issuer and the Guarantors for payment thereof. The Notes will become void unless presented for payment within five years after the maturity date thereof.

Governing Law, Jurisdiction and Waiver of Immunity

The Fiscal Agency Agreement and the Notes will be governed by and construed in accordance with the laws of the State of New York, except that the authorization and execution of such documentation shall 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 each of the Guarantors will appoint the Consul General of Mexico in New York City and his successors as his authorized agent (the "Authorized Agent") upon whom process may be served in any action based upon the Notes or the Fiscal Agency Agreement which may be instituted in any federal court in the Borough of Manhattan, The City of New York, by the holder of any Note, and the Issuer and the Fiscal Agent will each irrevocably submit to the jurisdiction of any such court in respect of any such action and will irrevocably waive 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 it 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 United States Foreign Sovereign Immunities Act of 1976 (the "Immunities Act") with respect to actions brought against them under United States federal securities laws or any state securities laws, and the Issuer's and each of the Guarantors' appointment of the Consul General 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 United States judgment in such an action against the Issuer or such Guarantor unless a U.S. 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 a 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 the United Mexican States 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 with 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 attachment of its assets.*

Fiscal Agent, Paying Agent and Transfer Agent

Bankers Trust Company will be the Fiscal Agent under the Fiscal Agency Agreement. The corporate trust office of the Fiscal Agent is located at Four Albany Street, New York, New York 10006. Bankers Trust Company has also been appointed as Paying Agent and Transfer Agent under the Fiscal Agency Agreement, at its offices specified above. The Fiscal Agent, Paying Agents and Transfer Agents are agents of the Issuer and do not have the duties of a trustee with respect to the Noteholders.

The Fiscal Agent may resign at any time or may be removed by the Issuer. If the Fiscal Agent resigns, is removed or becomes incapable of acting as Fiscal Agent or if a vacancy occurs in the office of the Fiscal Agent for any cause, a successor Fiscal Agent shall be appointed in accordance with the provisions of the Fiscal Agency Agreement.

In the ordinary course of their respective businesses, Bankers Trust Company and its affiliates have engaged, and may in the future engage, in investment banking activities and commercial banking activities with PEMEX, and have provided, and may in the future provide, investment advisory and corporate trust services to PEMEX.

Notices

Notices to holders of Registered Notes will be given mail to their respective addresses appearing in the register maintained by the Fiscal Agent. In addition, if and for so long as the Notes 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 *Luxemburger 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. Any such notice shall be deemed to have been given on the later of the date of such publication and the fourth calendar day after the date of mailing.

Notices to holders of Bearer Notes will be valid if published in a daily newspaper having general circulation in London and (so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require) in a leading newspaper having general circulation in Luxembourg or, if any such publication is not practicable, in another leading daily English language newspaper having general circulation in Europe approved by the Fiscal Agent. It is expected that such publication will be made in the *Financial Times* in London and the *Luxemburger Wort* in Luxembourg. Notices will, if published more than once or on different dates, be deemed to have been given on the date of the first publication in both such newspapers as provided above. Holders of coupons shall be deemed for all purposes to have notice of the contents of any notice to the holders of the related Bearer Notes.

LIMITATIONS ON ISSUANCE OF BEARER NOTES

In compliance with United States federal tax laws and regulations, Bearer Notes (including temporary global Bearer Notes), other than Bearer Notes with a maturity not exceeding one year from the date of issue, may not be offered or sold during the restricted period (as defined in United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(7)) within the United States or its possessions or to United States persons (each as defined below) other than to an office located outside the United States or its possessions of a United States financial institution (as defined in Section 1.165-12(c)(1)(v) of the United States Regulations), purchasing for its own account or for resale or for the account of certain customers, that provides a certificate stating that it agrees to comply with the requirements of Section 165(j)(3)(A), (B) or (C) of the code, and the United States Treasury Regulations thereunder, or to certain other persons described in Section 1.163-

5(c)(2)(i)(D)(1)(iii)(B) of the United States Treasury Regulations. Moreover, such Bearer Notes may not be delivered within the United States or its possessions in connection with their sale during the restricted period. No Bearer Note (other than a temporary global Bearer Note) may be delivered, nor may interest be paid on any Bearer Note, until receipt by the Issuer of (i) a Depositary Tax Certification in the case of Temporary Global Bearer Notes or (ii) an Owner Tax Certification in all other cases as described above under "Description of Notes—Form and Denomination".

As used herein, "United States Person" means any citizen or resident of the United States, any corporation, partnership or other entity created or organized in or under the laws of the United States and any estate or trust the income of which is subject to United States federal income taxation regardless of its source, "United States" means the United States of America (including the States thereof and the District of Columbia) and "possessions" of the United States include Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, Wake Island and the Northern Mariana Islands.

IMPORTANT CURRENCY INFORMATION

Unless otherwise specified in the applicable Pricing Supplement, purchasers are required to pay for Notes in the Specified Currency in immediately available funds. Currently, there are limited facilities in the United States for conversion of U.S. dollars into foreign currencies or currency units and vice versa, and it is believed that only a limited number of U.S. banks offer foreign currency checking or savings account facilities in the United States. However, if requested by a prospective purchaser of Notes denominated in a Specified Currency other than U.S. dollars, an Agent soliciting the offer to purchase may at its discretion arrange for the conversion of U.S. dollars into such Specified Currency to enable the purchaser to pay for such Notes. Such request must be made on or before the fifth Business Day preceding the date of delivery of the Notes, or by such other date as determined by such Agent. Each such conversion will be made by such Agent on such terms and subject to such conditions, limitations and charges as such Agent may from time to time establish in accordance with its regular foreign exchange practice. All costs of exchange will be borne by purchasers of the Notes.

For purposes of determining whether the holders of the requisite principal amount of outstanding Notes have taken or authorized any action under the Fiscal Agency Agreement, the principal amount of a Note denominated in a Specified Currency other than U.S. dollars at any time outstanding shall be deemed to be in the U.S. dollar equivalent, determined on the basis of the Market Exchange Rate as of the Issue Date of such Note, of the principal amount of such Note.

CURRENCY RISKS AND RISKS ASSOCIATED WITH INDEXED NOTES

Exchange Rates and Exchange Controls

An investment in a Note denominated in a Specified Currency other than the currency of the country in which a purchaser is resident or the currency (including any currency unit) in which a purchaser conducts its primary business (the "home currency") or where principal or interest on Notes is payable by reference to a Specified Currency index other than an index relating to the home currency entails significant risks that are not associated with a similar investment in a security denominated in the home currency. Such risks include, without limitation, the possibility of significant changes in rates of exchange between the home currency and the Specified Currency and the possibility of the imposition or modification of foreign exchange controls by either the United States or foreign governments. Such risks generally depend on factors over which the particular country has no control, such as economic, financial, political and military events and the supply of and demand for the relevant currencies. In recent years, rates of exchange for certain currencies have been highly volatile, and such volatility may be expected in the future. Fluctuations in any particular exchange rate that have occurred in the past are not necessarily indicative, however, of

fluctuations in the exchange rate that may occur during the term of any Note. Depreciation of the Specified Currency in which a Note is denominated against the relevant home currency would result in a decrease in the effective home currency-equivalent yield of such Note below its interest rate, in the home currency-equivalent value of the principal payable at maturity of such Note and generally in the home currency-equivalent market value of such Note and could result in a loss to the investor on a home currency basis.

Foreign exchange rates can either be fixed by sovereign governments or float. Exchange rates of most economically developed nations are permitted to fluctuate in value relative to the U.S. dollar. National governments, however, rarely voluntarily allow their currencies to float freely in response to economic forces. Sovereign governments in fact use a variety of techniques, such as intervention by a country's central bank or imposition of regulatory controls or taxes, to affect the rate of exchange of their currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing Notes that are denominated in a foreign currency or currency unit is that the U.S. dollar equivalent yields of such Notes could be affected by governmental actions which could change or interfere with theretofore freely determined currency valuations, fluctuations in response to other market forces and the movement of the currencies across borders.

Governments have from time to time imposed, and may in the future impose, exchange controls that could affect the availability of a Specified Currency for making payments with respect to a Note. There can be no assurance that exchange controls will not restrict or prohibit payments in any currency or currency unit. Even if there are no actual exchange controls, it is possible that on a payment date with respect to any particular Note, the Specified Currency for such Note would not be available to the Issuer to make payments then due. In that event, the Issuer will make such payments in the manner set forth below under "Payment Currency".

THIS OFFERING CIRCULAR AND ANY PRICING SUPPLEMENT HERETO DO NOT DESCRIBE ALL THE RISKS OF AN INVESTMENT IN NOTES DENOMINATED IN A CURRENCY (INCLUDING ANY CURRENCY UNIT) OTHER THAN A PROSPECTIVE PURCHASER'S HOME CURRENCY AND THE ISSUER DISCLAIMS ANY RESPONSIBILITY TO ADVISE PROSPECTIVE PURCHASERS OF SUCH RISKS AS THEY EXIST AT THE DATE OF THIS OFFERING CIRCULAR AND AS SUCH RISKS MAY CHANGE FROM TIME TO TIME. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR OWN FINANCIAL AND LEGAL ADVISORS AS TO THE RISKS ENTAILED BY AN INVESTMENT IN NOTES DENOMINATED IN A CURRENCY (INCLUDING ANY CURRENCY UNIT) OTHER THAN THEIR PARTICULAR HOME CURRENCY. SUCH NOTES ARE NOT AN APPROPRIATE INVESTMENT FOR PERSONS WHO ARE UNSOPHISTICATED WITH RESPECT TO FOREIGN CURRENCY TRANSACTIONS.

Unless otherwise provided, Notes denominated in a Specified Currency other than the U.S. dollar or the ECU will not be sold in, or to residents of, the country of the Specified Currency in which such Notes are denominated. The information set forth in this Offering Circular and any Pricing Supplement is directed to prospective purchasers who are United States residents. The Issuer disclaims any responsibility to advise prospective purchasers who are residents of countries other than the United States with respect to any matters that may affect the purchase, holding or receipt of payments of principal of or interest on Notes. Such persons should consult their own legal and financial advisors with regard to such matters.

The Pricing Supplement relating to each Foreign Currency Note may contain information concerning relevant historical exchange rates for the applicable Specified Currency, a description of such currency or currencies and any exchange controls affecting such currency or currencies. The information therein concerning exchange rates and exchange controls, if any, is furnished as a

matter of information only and should not be regarded as indicative of the range of or trends in fluctuations in exchange rates or of exchange controls that may be imposed in the future. The Issuer disclaims any responsibility to advise prospective purchasers of changes in such exchange rates or exchange controls after the date of any such Offering Circular.

Payment Currency

Except as set forth below, if payment on a Note is required to be made in a Specified Currency other than U.S. dollars and on a payment date with respect to such Note such currency or currency unit is unavailable due to the imposition of exchange controls or other circumstances beyond the Issuer's control, or is no longer used by the government of the country issuing such currency or currency unit or for the settlement of transactions by public institutions of or within the international banking community, then all such payments due on such payment date shall be made in U.S. dollars. The amount so payable on any payment date in such foreign currency or currency unit shall be converted into U.S. dollars at a rate determined by the Exchange Rate Agent as of the second Business Day prior to the date on which such payment is due on the basis of the most recently available Market Exchange Rate for such currency or currency unit, or as otherwise specified in the applicable Pricing Supplement. Any payment made under such circumstances in U.S. dollars will not constitute an Event of Default under the Notes.

If payment on a Note is required to be made in ECU and on a payment date with respect to such Note ECU are unavailable due to the imposition of exchange controls or other circumstances beyond the Issuer's control, or no longer are used as the unit of account of the European Community or the European Central Bank, then all such payments due on such payment date shall be made in the manner specified under "Description of the Notes—Special Provisions related to Notes Denominated in ECU—Payments in a Substitute Currency". Any payment made in accordance with such provisions will not constitute an Event of Default under the Notes.

If the official unit of any component currency of the ECU is altered by way of combination or subdivision, the number of units of that currency as a Component shall be divided or multiplied in the same proportion. If two or more component currencies are consolidated into a single currency, the amounts of those currencies as Components shall be replaced by an amount in such single currency equal to the sum of the amounts of the consolidated component currencies expressed in such single currency. If any component currency is divided into two or more currencies, the amount of that currency as a Component shall be replaced by amounts of such two or more currencies, each of which shall have a value on the date of division equal to the amount of the former component currency divided by the number of currencies into which that currency was divided.

All determinations referred to above made by the Exchange Rate Agent shall be confirmed by the Issuer (except to the extent expressly provided herein or in the applicable Pricing Supplement) and, in the absence of manifest error, shall be conclusive for all purposes and binding on holders of the Notes, and the Exchange Rate Agent shall have no liability therefor.

Unless otherwise specified in the applicable Pricing Supplement, Notes denominated in a Specified Currency other than U.S. dollars will provide that, in the event of an official redenomination of the Specified Currency, the obligations of the Issuer with respect to payments on such Notes shall, in all cases, be deemed immediately following such redenomination to provide for payment of that amount of the redenominated Specified Currency representing the amount of such obligations immediately before such redenomination.

Foreign Currency Judgments; Immunity from Attachment

The Notes will be governed by and construed in accordance with the laws of the State of New York. See "Description of Notes—Governing Law, Jurisdiction and Waiver of Immunity". Courts in the United States customarily have not rendered judgments for money damages denominated in any currency other than U.S. dollars. New York statutory law provides, however, that in an action based on an obligation denominated in a currency other than U.S. dollars, a court shall render a judgment or decree in the foreign currency of the underlying obligation and that the judgment or decree shall be converted into U.S. dollars at the exchange rate prevailing on the date of entry of the judgment or decree. It is not known whether the foregoing New York statutory law would be applied (a) in any action based on an obligation denominated in a currency unit or (b) by a Federal court sitting in the State of New York.

Under the Mexican Monetary Law, payments which should be made in Mexico in foreign currency, whether by agreement or upon judgment of a Mexican court, may be discharged in pesos at a rate of exchange for pesos into the relevant foreign currency prevailing at the time of payment. 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 "Investment Considerations—Sovereign Immunity; Judgment Currency".

Risks Associated with Indexed Notes

An investment in Indexed Notes may entail significant risks that are not associated with a similar investment in a debt instrument that has a fixed principal amount, is denominated in U.S. dollars and bears interest at either a fixed rate or a floating rate determined by reference to nationally published interest rate references. The risks of a particular Indexed Note will depend on the terms of such Indexed Note, but may include, without limitation, the possibility of significant changes in the prices of securities, currencies, intangibles, goods, articles or commodities or of other objective price, economic or other measures making up the relevant index (the "Underlying Assets"). Such risks generally depend on factors over which the Issuer has no control, such as economic and political events and the supply of and demand for the Underlying Assets. In recent years, currency exchange rates and prices for various Underlying Assets have been highly volatile, and such volatility may be expected in the future. Fluctuations in any such rates or prices that have occurred in the past are not necessarily indicative, however, of fluctuations that may occur during the term of any Indexed Note.

In considering whether to purchase Indexed Notes, investors should be aware that the calculation of amounts payable in respect of Indexed Notes may involve reference to prices which are published solely by third parties or entities which are not subject to regulation under the laws of the United States.

THIS OFFERING CIRCULAR AND ANY PRICING SUPPLEMENT HERETO DO NOT DESCRIBE ALL THE RISKS OF AN INVESTMENT IN INDEXED NOTES AND THE ISSUER DISCLAIMS ANY RESPONSIBILITY TO ADVISE PROSPECTIVE PURCHASERS OF SUCH RISKS AS THEY EXIST AT THE DATE OF THIS OFFERING CIRCULAR OR AS SUCH RISKS MAY CHANGE FROM TIME TO TIME. THE RISK OF LOSS AS A RESULT OF THE LINKAGE OF PRINCIPAL OR INTEREST PAYMENTS ON INDEXED NOTES TO AN INDEX AND TO THE UNDERLYING ASSETS CAN BE SUBSTANTIAL. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR OWN FINANCIAL AND LEGAL ADVISORS AS TO THE RISKS ENTAILED BY AN INVESTMENT IN INDEXED NOTES. AN INDEXED NOTE IS NOT AN APPROPRIATE INVESTMENT FOR PERSONS WHO ARE UNSOPHISTICATED WITH RESPECT TO TRANSACTIONS IN THE UNDERLYING ASSETS OF ANY INDEX RELEVANT TO THAT INDEXED NOTE.

CLEARING AND SETTLEMENT

Arrangements will be made with each of DTC, Euroclear and Cedel Bank to facilitate initial issuance of Global Notes deposited with, or on behalf of, DTC ("DTC Global Notes"). See "Description of Notes—Form and Denomination". Transfers within DTC, Euroclear and Cedel Bank will be made in accordance with the usual rules and operating procedures of the relevant system. Cross-market transfers between investors who hold or who will hold DTC Global Notes through DTC and investors who hold or will hold DTC Global Notes through Euroclear and/or Cedel Bank will be effected in DTC through the respective depositaries of Euroclear and Cedel Bank. Each Regulation S Global Note and each Restricted Global Note deposited with DTC will have a different CUSIP or CINS number.

DTC

DTC has advised the Issuer as follows: DTC is a limited-purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of the New York Banking Law, 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 for its participating organizations ("DTC Participants") and to facilitate the clearance and settlement of securities transactions between DTC Participants through electronic book-entry changes in accounts of the DTC Participants, thereby eliminating the need for physical movement of certificates. DTC Participants include securities brokers and dealers, brokers, banks, trust companies and clearing corporations and may include certain other organizations. Indirect access to the DTC system is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly ("Indirect DTC Participants").

Under the rules, regulations and procedures creating and affecting DTC and its operations (the "Rules"), DTC is required to make book-entry transfers between DTC Participants on whose behalf it acts with respect to the Notes and is required to receive and transmit distributions of principal of and interest on the Notes. DTC Participants and Indirect DTC Participants with which investors have accounts with respect to the Notes similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective investors.

Because DTC can only act on behalf of DTC Participants, who in turn act on behalf of Indirect DTC Participants and certain banks, the ability of a person having a beneficial interest in a Note held in DTC to transfer or pledge such interest to persons or entities that do not participate in the DTC system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate of such interest. The laws of some states of the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer beneficial interests in a Note held in DTC to such persons may be limited.

DTC has advised the Issuer that it will take any action permitted to be taken by a holder of Notes (including, without limitation, the presentation of Notes for exchange as described above) only at the direction of one or more participants to whose account with DTC interests in the relevant Notes are credited, and only in respect of such portion of the aggregate principal amount of the Notes as to which such participant or participants has or have given such direction. However, in certain circumstances, DTC will exchange the DTC Global Notes held by it for Certificated Notes, which it will distribute to its participants and which, if representing interests in the Restricted Global Note, will be legended as set forth under "Notice to Investors". See "Description of Notes—Certificated Notes and Definitive Bearer Notes".

Euroclear

The Euroclear System was created in 1968 to hold securities for participants in Euroclear ("Euroclear Participants") and to effect transactions between Euroclear Participants through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates and any risk from lack of simultaneous transfer of securities and cash. Euroclear Participants include banks (including central banks), securities brokers and dealers and other professional financial intermediaries. Indirect access to Euroclear is also available to other firms that clear through or maintain a custodial relationship with a Euroclear Participant, either directly or indirectly.

Euroclear is operated by Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System (the "Euroclear Operator"), under contract with Euroclear Clearance System Société Coopérative, a Belgian cooperative corporation (the "Cooperative"). All operations are conducted by the Euroclear Operator, and all Euroclear securities clearance accounts and Euroclear cash accounts are accounts with the Euroclear Operator, not the Cooperative. The Cooperative establishes fundamental policies for Euroclear on behalf of Euroclear Participants. The Euroclear Operator is regulated and examined by the Board of Governors of the Federal Reserve System, the New York State Banking Department and the Belgian Banking Commission.

Securities clearance accounts and cash accounts with the Euroclear Operator are governed by the terms and conditions governing use of Euroclear, the related operating procedures of the Euroclear System and applicable Belgian law (collectively, the "Euroclear Terms and Conditions"). The Euroclear Terms and Conditions govern transactions of securities and cash within Euroclear, withdrawal of securities and cash from the system, and receipts of payments with respect to securities in the system. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Euroclear Terms and Conditions only on behalf of Euroclear Participants, and has no record of or relationship with persons holding through Euroclear Participants.

Distributions with respect to interests in temporary global Bearer Notes, permanent global Bearer Notes and Global Notes held through Euroclear will be credited to the Euroclear cash accounts of Euroclear Participants to the extent received by the Euroclear Operator's depository, in accordance with the Euroclear Terms and Conditions. The Euroclear Operator will take any other action permitted to be taken by a holder of any Notes on behalf of a Euroclear Participant only in accordance with the Euroclear Terms and Conditions, subject to the ability of the Euroclear Operator's depository to effect such actions on its behalf (through DTC in the case of DTC Global Notes).

Cedel Bank

Cedel Bank is incorporated under the laws of Luxembourg as a professional depository and provides, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities. As a professional depository, Cedel Bank is subject to regulation by Luxembourg Monetary Institute. Cedel Bank holds securities for its participating organizations ("Cedel Bank Participants") and facilitates the clearance and settlement of securities transactions through electronic book-entry changes in accounts of Cedel Bank Participants, thereby eliminating the need for physical movement of certificates. Cedel Bank Participants are recognized financial institutions around the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Indirect access to Cedel Bank is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Cedel Bank Participant, either directly or indirectly.

Initial Settlement in Relation to DTC Global Notes

Upon the issuance of a DTC Global Note, DTC or its custodian will credit, on its internal system, the respective principal amount of the individual beneficial interests represented by such DTC Global Note to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the relevant Agent or the Issuer, in the case of a Note sold directly by the Issuer. Ownership of beneficial interests in a DTC Global Note will be limited to DTC Participants, including Euroclear and Cedel Bank, or Indirect DTC Participants. Ownership of beneficial interests in DTC Global Notes will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC Participants) and the records of DTC Participants (with respect to interests of Indirect DTC Participants).

Euroclear and Cedel Bank will hold omnibus positions on behalf of their participants through customers' securities accounts for Euroclear and Cedel Bank on the books of their respective depositories, which in turn will hold such positions in customers' securities accounts in such depositories' names on the books of DTC.

Investors that hold their interests in a DTC Global Note through DTC will follow the settlement practices applicable to global bond issues. Investors' securities custody accounts will be credited with their holdings against payment in same-day funds on the settlement date.

Investors that hold their interests in a DTC Global Note through Euroclear or Cedel Bank accounts will follow the settlement procedures applicable to conventional eurobonds in registered form. The interests will be credited to the securities custody accounts on the settlement date against payment in same-day funds.

Secondary Market Trading in Relation to DTC Global Notes

Since the purchaser determines the place of delivery, it is important to establish at the time of the trade where both the purchaser's and the seller's accounts are located to ensure that settlement can be made on the desired value date. Although DTC, Euroclear and Cedel Bank have agreed to the following procedures in order to facilitate transfers of interests in a Regulation S Global Note and a Restricted Global Note among participants of DTC, Euroclear and Cedel Bank, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Issuer nor the Fiscal Agent, any Paying Agent or the Registrar will have any responsibility for the performance by DTC, Euroclear or Cedel Bank or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Trading between DTC Participants

Secondary market trading between DTC Participants will be settled using the procedures applicable to global bond issues in same-day funds.

Trading between Euroclear and/or Cedel Bank Participants

Secondary market trading between Euroclear Participants and/or Cedel Bank Participants will be settled using the procedures applicable to conventional eurobonds in same-day funds.

Trading between DTC Sellers and Euroclear or Cedel Bank Purchasers

When interests are to be transferred from the account of a DTC Participant to the account of a Euroclear Participant or a Cedel Bank Participant, the purchaser will send instructions to Euroclear or Cedel Bank through a Euroclear Participant or a Cedel Bank Participant, as the case may be, at least one business day prior to settlement. The Euroclear Operator or Cedel Bank will instruct its respective depository to receive such interest against payment. Payment will then be made by the depository to the DTC Participant's account against delivery of the interest in the relevant DTC Global Note. After settlement has been completed, the interest will be credited to the respective clearing system, and by the clearing system, in accordance with its usual procedures, to the Euroclear Participant's or Cedel Bank Participant's account. The securities credit will appear the next day (European time) and the cash debit will be back-valued to, and the interest on the DTC Global Note will accrue from, the value date (which would be the preceding day, when settlement occurred in New York). If settlement is not completed on the intended value date (*i.e.*, the trade fails), the Euroclear or Cedel Bank cash debit will be valued instead as of the actual settlement date.

Euroclear Participants and Cedel Bank Participants will need to make available to the relevant clearing system the funds necessary to process same-day funds settlement. The most direct means of doing so is to preposition funds for settlement, either from cash on-hand or existing lines of credit, as such Participants would for any settlement occurring with Euroclear or Cedel Bank. Under this approach, such Participants may take on credit exposure to the Euroclear Operator or Cedel Bank until the interests in the relevant DTC Global Note are credited to their accounts one day later.

As an alternative, if the Euroclear Operator or Cedel Bank has extended a line of credit to a Euroclear Participant or a Cedel Bank Participant, as the case may be, such Participant may elect not to preposition funds and allow the credit line to be drawn upon to finance settlement. Under this procedure, Euroclear Participants or Cedel Bank Participants purchasing interests in a DTC Global Note would incur overdraft charges for one day, assuming they cleared the overdraft when the interests in the relevant DTC Global Note were credited to their accounts. However, interest on the relevant DTC Global Note would accrue from the value date. Therefore, in many cases the investment income on the interest in the relevant DTC Global Note earned during that one-day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each participant's particular cost of funds.

Since settlement takes place during New York business hours, DTC Participants can employ their usual procedures for transferring global bonds to the respective depositories of Euroclear or Cedel Bank for the benefit of Euroclear Participants or Cedel Bank Participants. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to DTC Participants, a cross-market sale transaction will settle no differently from a trade between two DTC Participants.

Trading between Euroclear or Cedel Bank Sellers and DTC Purchasers

Due to time zone differences in their favor, Euroclear Participants and Cedel Bank Participants may employ their customary procedures for transactions in which interests in a DTC Global Note are to be transferred by the relevant clearing system, through its respective depository, to a DTC Participant at least one business day prior to settlement. In these cases, Euroclear or Cedel Bank will instruct its respective depository to deliver the interest in the relevant DTC Global Note to the DTC Participant's account against payment. The payment will then be reflected in the account of the Euroclear Participant or Cedel Bank Participant the following day, and receipt of the cash proceeds in the Euroclear Participant's or Cedel Bank Participant's account would be back-valued to the value date (which would be the preceding day, when settlement occurred in New York). Should the Euroclear Participant or Cedel Bank Participant have a line of credit in its respective clearing system and elect to be in debit in anticipation of receipt of the sale proceeds in its account, the

back-valuation will extinguish any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date (*i.e.*, the trade fails), receipt of the cash proceeds in the Euroclear Participant's or Cedel Bank Participant's account would instead be valued as of the actual settlement date.

Finally, day traders that use Euroclear or Cedel Bank to purchase interests in a DTC Global Note from DTC Participants for delivery to Euroclear Participants or Cedel Bank Participants should note that these trades will automatically fail on the sale side unless affirmative action is taken. At least three techniques should be readily available to eliminate this potential problem:

- borrowing through Euroclear or Cedel Bank for one day (until the purchase side of the day trade is reflected in their Euroclear or Cedel Bank accounts) in accordance with the clearing system's customary procedures;
- borrowing the interests in the DTC Global Note in the United States from a DTC Participant no later than one day prior to settlement, which would give sufficient time for the Notes to be reflected in their Euroclear or Cedel Bank account in order to settle the sale side of the trade; or
- staggering the value date for the buy and sell sides of the trade so that the value date for the purchase from the DTC Participant is at least one day prior to the value date for the sale to the Euroclear Participant or Cedel Bank Participant.

Initial Settlement and Secondary Market Trading in relation to Bearer Notes and Global Notes deposited with the Common Depositary

Initial settlement in Euroclear and Cedel Bank and secondary market trading between Euroclear Participants and/or Cedel Bank Participants will be settled using the procedures applicable to conventional eurobonds.

TAXATION

The following summary contains a description of the principal Mexican and U.S. federal income tax consequences of the ownership and disposition of Notes, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase or dispose of Notes. This summary is based on the federal tax laws in force on the date of this Offering Circular (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 prospective holder or beneficial owner of Notes should consult its tax advisor as to the Mexican, United States or other tax consequences of the ownership and disposition of the Notes, 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 Notes 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. 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 Notes 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 the Issuer or the Guarantors in respect of the Notes (including payments of principal in excess of the issue price of such Notes, 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 Notes 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 Notes are registered with the Special Section of the Registry. Under the Tax Treaty, Foreign Holders that are United States Holders, as defined below, may be eligible for reduced rates of withholding applicable to payments of interest (or amounts

deemed interest) made by the Issuer or any Guarantor (which are not currently lower than the Reduced Rate).

Pursuant to Rule 3.32.11 as amended (the "Reduced Rate Rule"), issued by the Ministry of Finance and Public Credit and expected to be effective through March 31, 1998, payments of interest made by the Issuer or the Guarantors in respect of the Notes to Foreign Holders will be subject to withholding taxes imposed at the Reduced Rate, regardless, generally, of the identity of the holder of the Notes, if (i) the Notes are registered with the Special Section of the Registry, (ii) the Issuer timely files with the Ministry of Finance and Public Credit certain information relating to the issuance of the Notes and this Offering Circular after completion of the transactions contemplated by this Offering Circular, (iii) the Issuer timely files with the Ministry of Finance and Public Credit quarterly information representing that no party related to the Issuer (as such terms are defined in the Reduced Rate Rule), 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 (iii) above. The Reduced Rate Rule is effective for only one year and hence is subject to an repeal or amendment on an annual basis. Although it is expected that a rule equivalent to the Reduced Rate Rule will be in effect for fiscal year 1998 and beyond, there can be no assurance that any such rule will be issued and become effective. In such event, higher rates may apply, as described herein.

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 Notes and to a non-Mexican pension or retirement fund will be exempt from Mexican withholding taxes, provided that (i) any such fund 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 and Public Credit 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 Notes 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 Notes 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 Notes—Additional Amounts".

Holders or beneficial owners of Notes 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 Notes—Additional Amounts".

Taxation of Dispositions. Capital gains resulting from the sale or other disposition of the Notes by a Foreign Holder 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 Notes. A Foreign Holder of Notes will not be liable for Mexican estate, gift, inheritance or similar tax with respect to the Notes.

United States Federal Income Taxation

The following is a summary of certain United States federal income tax considerations that may be relevant to a holder of a Note that is a "United States person" (as defined below) or that otherwise is subject to United States federal income taxation on a net income basis in respect of the Note (a "United States holder"). This summary is based on laws, regulations, rulings and decisions now in effect, all of which are subject to change. This summary deals only with United States holders that will hold Notes as capital assets, and does not address tax considerations applicable to investors that may be subject to special tax rules, such as banks, tax-exempt entities, insurance companies or dealers in securities or currencies, persons that will hold Notes as a position in a "straddle" or conversion transaction, or as part of a "synthetic security" or other integrated financial transaction or persons that have a "functional currency" other than the U.S. dollar. Any special United States federal income tax considerations relevant to a particular issue of Notes, including any Indexed Notes, will be provided in the applicable Pricing Supplement.

As used herein, the term "United States person" means a holder of a Note who is a citizen or resident of the United States, or that is a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, an estate the income of which is subject to United States federal income taxation regardless of its source or a trust if (i) a U.S. court is able to exercise primary supervision over the trust's administration and (ii) one or more United States persons have the authority to control all of the trust's substantial decisions, and the term "United States" means the United States of America (including the States and the District of Columbia).

Investors should consult their own tax advisors in determining the tax consequences to them of holding Notes, including the application to their particular situation of the United States federal income tax considerations discussed below, as well as the application of state, local, foreign or other tax laws.

Payments of Interest and Additional Amounts. A United States holder will be taxed on the gross amount of payments of "qualified stated interest" (as defined below under "Original Issue Discount") 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) on a Note as ordinary income at the time that such payments are accrued or are received (in accordance with the United States holder's method of tax accounting). If such payments are made with respect to a Foreign Currency Note, the amount of interest income realized by a United States holder that uses the cash method of tax accounting will be the U.S. dollar value of the Specified Currency payment based on the exchange rate in effect on the date of receipt regardless of whether the payment in fact is converted into U.S. dollars. A United States holder that uses the accrual method of accounting for tax purposes will accrue interest income on the Note in the relevant foreign currency and translate the amount accrued into U.S. dollars based on the average exchange rate in effect during the interest accrual period (or portion thereof within the United States holder's taxable year), or, at the accrual basis United States holder's election, at the spot rate of exchange on the last day of the accrual period (or the last day of the taxable year within such accrual period if the accrual period spans more than one taxable year), or at the spot rate of exchange on the date of receipt, if such date is within five business days of the last day of the accrual period. A United States holder that makes such election must apply it consistently to all debt instruments from year to year and cannot change the election without the consent of the Internal Revenue Service (the "IRS"). A

United States holder that uses the accrual method of accounting for tax purposes will recognize foreign currency gain or loss, as the case may be, on the receipt of an interest payment made with respect to a Foreign Currency Note if the exchange rate in effect on the date the payment is received differs from the rate applicable to a previous accrual of that interest income. This foreign currency gain or loss will be treated as ordinary income or loss but generally will not be treated as an adjustment to interest income received on the Note.

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.

Purchase, Sale and Retirement of Notes. A United States holder's tax basis in a Note generally will equal the cost of such Note to such holder, increased by any amounts includible in income by the holder as original issue discount and market discount and reduced by any amortized premium (each as described below) and any payments other than payments of qualified stated interest made on such Note. In the case of a Foreign Currency Note, the cost of such Note to a United States holder will be the U.S. dollar value of the foreign currency purchase price on the date of purchase. In the case of a Foreign Currency Note that is traded on an established securities market, a cash basis United States holder (and, if it so elects, an accrual basis United States holder) will determine the U.S. dollar value of the cost of such Note by translating the amount paid at the spot rate of exchange on the settlement date of the purchase. The amount of any subsequent adjustments to a United States holder's tax basis in a Note in respect of original issue discount, market discount and premium denominated in a Specified Currency will be determined in the manner described under "Original Issue Discount" and "Premium and Market Discount" below. The conversion of U.S. dollars to a Specified Currency and the immediate use of the Specified Currency to purchase a Foreign Currency Note generally will not result in taxable gain or loss for a United States holder.

Upon the sale, exchange or retirement of a Note, a United States holder generally will recognize gain or loss equal to the difference between the amount realized on the sale, exchange or retirement (less any accrued qualified stated interest, which will be taxable as such) and the United States holder's tax basis in such Note. If a United States holder receives a currency other than the U.S. dollar in respect of the sale, exchange or retirement of a Note, the amount realized will be the U.S. dollar value of the specified currency received calculated at the exchange rate in effect on the date the instrument is disposed of or retired. In the case of a Foreign Currency Note that is traded on an established securities market, a cash basis United States holder, and if it so elects, an accrual basis United States holder will determine the U.S. dollar value of the amount realized by translating such amount at the spot rate on the settlement date of the sale. The election available to accrual basis United States holders in respect of the purchase and sale of Foreign Currency Notes traded on an established securities market, discussed above, must be applied consistently to all debt instruments from year to year and cannot be changed without the consent of the IRS.

Except as discussed below with respect to market discount, Short-Term Notes (as defined below) and foreign currency gain or loss, gain or loss recognized by a United States holder generally will be long-term capital gain or loss if the United States holder has held the Note for more than one year at the time of disposition. Long-term capital gain recognized by an individual United States holder generally will be subject to a maximum tax rate of 28 percent in respect of Notes held for more than one year and to a maximum rate of 20 percent in respect of Notes held in excess of 18 months.

Gain or loss recognized by a United States holder on the sale, exchange or retirement of a Foreign Currency Note generally will be treated as ordinary income or loss to the extent that the gain or loss is attributable to changes in exchange rates during the period in which the holder held such Note. This foreign currency gain or loss will not be treated as an adjustment to interest income received on the Notes.

Original Issue Discount. United States holders of Original Issue Discount Notes generally will be subject to the special tax accounting rules for obligations issued with original issue discount ("OID") provided by the Internal Revenue Code of 1986, as amended (the "Code"), and certain regulations promulgated thereunder (the "OID Regulations"). United States holders of such Notes should be aware that, as described in greater detail below, they generally must include OID in ordinary gross income for United States federal income tax purposes as it accrues, in advance of the receipt of cash attributable to that income.

In general, each United States holder of an Original Issue Discount Note, whether such holder uses the cash or the accrual method of tax accounting, will be required to include in ordinary gross income the sum of the "daily portions" of OID on the Note for all days during the taxable year that the United States holder owns the Note. The daily portions of OID on an Original Issue Discount Note are determined by allocating to each day in any accrual period a ratable portion of the OID allocable to that accrual period. Accrual periods may be any length and may vary in length over the term of an Original Issue Discount Note, provided that no accrual period is longer than one year and each scheduled payment of principal or interest occurs on either the final day or the first day of an accrual period. In the case of an initial holder, the amount of OID on an Original Issue Discount Note allocable to each accrual period is determined by (a) multiplying the "adjusted issue price" (as defined below) of the Original Issue Discount Note at the beginning of the accrual period by the yield to maturity of such Original Issue Discount Note (appropriately adjusted to reflect the length of the accrual period) and (b) subtracting from that product the amount (if any) of qualified stated interest (as defined below) allocable to that accrual period. The yield to maturity of a Note is the discount rate that causes the present value of all payments on the Note as of its original issue date to equal the issue price of such Note. The "adjusted issue price" of an Original Issue Discount Note at the beginning of any accrual period will generally be the sum of its issue price (generally including accrued interest, if any) and the amount of OID allocable to all prior accrual periods, reduced by the amount of all payments other than payments of qualified stated interest (if any) made with respect to such Note in all prior accrual periods. The term "qualified stated interest" generally means stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually during the entire term of an Original Issue Discount Note at a single fixed rate of interest or, subject to certain conditions, based on one or more interest indices. In the case of an Original Issue Discount Note that is a Floating Rate Note, both the "yield to maturity" and "qualified stated interest" will generally be determined for these purposes as though the Original Issue Discount Note will bear interest in all periods at a fixed rate generally equal to the rate that would be applicable to the interest payments on the Note on its date of issue or, in the case of certain Floating Rate Notes, the rate that reflects the yield that is reasonably expected for the Note. (Additional rules may apply if interest on a Floating Rate Note is based on more than one interest index.) As a result of this "constant yield" method of including OID in income, the amounts includible in income by a United States holder in respect of an Original Issue Discount Note denominated in U.S. dollars

generally are lesser in the early years and greater in the later years than the amounts that would be includible on a straight-line basis.

A United States holder generally may make an irrevocable election to include in its income its entire return on a Note (i.e., the excess of all remaining payments to be received on the Note, including payments of qualified stated interest, over the amount paid by such United States holder for such Note) under the constant-yield method described above. For Notes purchased at a premium or bearing market discount in the hands of the United States holder, the United States holder making such election will also be deemed to have made the election (discussed below in "—Premium and Market Discount") to amortize premium or to accrue market discount in income currently on a constant-yield basis.

In the case of an Original Issue Discount Note that is also a Foreign Currency Note, a United States holder should determine the U.S. dollar amount includible in income as OID for each accrual period by (a) calculating the amount of OID allocable to each accrual period in the Specified Currency using the constant-yield method described above, and (b) translating the amount of the Specified Currency so derived at the average exchange rate in effect during that accrual period (or portion thereof within a United States holder's taxable year) or, at the United States holder's election (as described above under "—Payments of Interest"), at the spot rate of exchange on the last day of the accrual period (or the last day of the taxable year within such accrual period if the accrual period spans more than one taxable year), or at the spot rate of exchange on the date of receipt, if such date is within five business days of the last day of the accrual period. Because exchange rates may fluctuate, a United States holder of an Original Issue Discount Note that is also a Foreign Currency Note may recognize a different amount of OID income in each accrual period than would the holder of an otherwise similar Original Issue Discount Note denominated in U.S. dollars. All payments on an Original Issue Discount Note (other than payments of qualified stated interest) will generally be viewed first as payments of previously-accrued OID (to the extent thereof), with payments attributed first to the earliest-accrued OID, and then as payments of principal. Upon the receipt of an amount attributable to OID (whether in connection with a payment of an amount that is not qualified stated interest or the sale or retirement of the Original Issue Discount Note), a United States holder will recognize ordinary income or loss measured by the difference between the amount received (translated into U.S. dollars at the exchange rate in effect on the date of receipt or on the date of disposition of the Original Issue Discount Note, as the case may be) and the amount accrued (using the exchange rate applicable to such previous accrual).

A subsequent United States holder of an Original Issue Discount Note that purchases the Note at a cost less than its remaining redemption amount (as defined below), or an initial United States holder that purchases an Original Issue Discount Note at a price other than the Note's issue price, also generally will be required to include in gross income the daily portions of OID, calculated as described above. However, if the United States holder acquires the Original Issue Discount Note at a price greater than its adjusted issue price, such holder may reduce its periodic inclusions of OID income to reflect the premium paid over the adjusted issue price. The "remaining redemption amount" for a Note is the total of all future payments to be made on the Note other than payments of qualified stated interest.

Certain of the Notes may be subject to special redemption, repayment or interest rate reset features, as indicated in the applicable Pricing Supplement. Notes containing such features, in particular Original Issue Discount Notes, may be subject to special rules that differ from the general rules discussed above. Purchasers of Notes with such features should carefully examine the applicable Pricing Supplement and should consult their own tax advisors with respect to such Notes since the tax consequences with respect to such features, and especially with respect to OID, will depend, in part, on the particular terms of the purchased Notes.

Premium and Market Discount. A United States holder of a Note that purchases the Note at a cost greater than its remaining redemption amount (as defined in the second preceding paragraph) will be considered to have purchased the Note at a premium, and may elect to amortize such premium (as an offset to interest income), using a constant-yield method, over the remaining term of the Note. Such election, once made, generally applies to all bonds held or subsequently acquired by the United States holder on or after the first taxable year to which the election applies and may not be revoked without the consent of the IRS. A United States holder that elects to amortize such premium must reduce its tax basis in a Note by the amount of the premium amortized during its holding period. Original Issue Discount Notes purchased at a premium will not be subject to the OID rules described above. In the case of premium in respect of a Foreign Currency Note, a United States holder should calculate the amortization of such premium in the specified currency. Amortization deductions attributable to a period reduce interest payments in respect of that period and therefore are translated into U.S. dollars at the exchange rate used by the United States holder for such interest payments. Exchange gain or loss will be realized with respect to amortized bond premium on such a Note based on the difference between the exchange rate on the date or dates such premium is recovered through interest payments on the Note and the exchange rate on the date on which the United States holder acquired the Note. With respect to a United States holder that does not elect to amortize bond premium, the amount of bond premium will be included in the United States holder's tax basis when the Note matures or is disposed of by the United States holder. Therefore, a United States holder that does not elect to amortize such premium and that holds the Note to maturity generally will be required to treat the premium as capital loss when the Note matures.

If a United States holder of a Note purchases the Note at a price that is lower than its remaining redemption amount, or in the case of an Original Issue Discount Note, its adjusted issue price, by at least 0.25% of its remaining redemption amount multiplied by the number of remaining whole years to maturity, the Note will be considered to have "market discount" in the hands of such United States holder. In such case, gain realized by the United States holder on the disposition of the Note generally will be treated as ordinary income to the extent of the market discount that accrued on the Note while held by such United States holder. In addition, the United States holder could be required to defer the deduction of a portion of the interest paid on any indebtedness incurred or maintained to purchase or carry the Note. In general terms, market discount on a Note will be treated as accruing ratably over the term of such Note, or, at the election of the holder, under a constant yield method. Market discount on a Foreign Currency Note will be accrued by a United States holder in the Specified Currency. The amount includible in income by a United States holder in respect of such accrued market discount will be the U.S. dollar value of the amount accrued, generally calculated at the exchange rate in effect on the date that the Note is disposed of by the United States holder.

A United States holder may elect to include market discount in income on a current basis as it accrues (on either a ratable or constant-yield basis), in lieu of treating a portion of any gain realized on a sale of a Note as ordinary income. If a United States holder elects to include market discount on a current basis, the interest deduction deferral rule described above will not apply. Any accrued market discount on a Foreign Currency Note that is currently includible in income will be translated into U.S. dollars at the average exchange rate for the accrual period (or portion thereof within the United States holder's taxable year). Any such election, if made, applies to all market discount bonds acquired by the taxpayer on or after the first day of the first taxable year to which such election applies and is revocable only with the consent of the IRS.

Short-Term Notes. The rules set forth above will also generally apply to Notes having maturities of not more than one year ("Short-Term Notes"), but with certain modifications.

First, the OID Regulations treat *none* of the interest on a Short-Term Note as qualified stated interest (but instead treat such interest payments as part of the Short-Term Note's stated redemption price at maturity, thereby giving rise to OID). Thus, all Short-Term Notes will be Original Issue Discount Notes. OID will be treated as accruing on a Short-Term Note ratably, or at the election of a United States holder, under a constant yield method.

Second, a United States holder of a Short-Term Note that uses the cash method of tax accounting and is not a bank, securities dealer, regulated investment company or common trust fund, and does not identify the Short-Term Note as part of a hedging transaction, will generally not be required to include OID in income on a current basis. Such a United States holder may not be allowed to deduct all of the interest paid or accrued on any indebtedness incurred or maintained to purchase or carry such Note until the Stated Maturity of the Note or its earlier disposition in a taxable transaction. In addition, such a United States holder will be required to treat any gain realized on a sale, exchange or retirement of the Note as ordinary income to the extent such gain does not exceed the OID accrued with respect to the Note during the period the United States holder held the Note. Notwithstanding the foregoing, a cash-basis United States holder of a Short-Term Note may elect to accrue OID in income on a current basis (in which case the limitation on the deductibility of interest described above will not apply). A United States holder using the accrual method of tax accounting and certain cash-basis United States holders (including banks, securities dealers, regulated investment companies and common trust funds) generally will be required to include OID on a Short-Term Note in income on a current basis.

Third, any United States holder (whether cash or accrual basis) of a Short-Term Note can elect to accrue the "acquisition discount," if any, with respect to the Note on a current basis. If such an election is made, the OID rules will not apply to the Note. Acquisition discount is the excess of the remaining redemption amount of the Note at the time of acquisition over the purchase price. Acquisition discount will be treated as accruing ratably or, at the election of the United States holder, under a constant-yield method based on daily compounding.

Finally, the market discount rules will not apply to a Short-Term Note.

As described above, certain of the Notes may be subject to special redemption features. These features may affect the determination of whether a Note has a maturity of not more than one year and thus is a Short-Term Note. Purchasers of Notes with such features should carefully examine the applicable Pricing Supplement and should consult their own tax advisors with respect to such features.

Indexed Notes and Other Notes Providing for Contingent Payments. The IRS has issued final regulations (the "Contingent Payment Regulations") governing the tax treatment of debt obligations that provide for contingent payments ("contingent debt obligations"). The Contingent Payment Regulations generally require accrual of interest income on a constant-yield basis in respect of a contingent debt obligation at a yield determined at the time of issuance of the obligation, and may require adjustments to such accruals when any contingent payments are made. A detailed description of the tax considerations relevant to United States holders of any contingent debt obligations will be provided in the applicable Pricing Supplement.

Information Reporting and Backup Withholding. The Paying Agent will be required to file information returns with the IRS with respect to payments made to certain United States holders of Notes. 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 taxpayer identification numbers to the Paying Agent. Persons holding Notes who are not United States 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.

OFFERING AND SALE

The following is subject to change in the applicable Pricing Supplement. Further, the Agents who have agreed to purchase Notes from the Issuer will be specified in the applicable Pricing Supplement.

Subject to the terms and conditions set forth in the Distribution Agreement, dated as of June 16, 1993, as amended (the "Distribution Agreement"), the Notes are being offered on a continuing basis by PEMEX through Goldman, Sachs & Co., Goldman Sachs International, Credit Suisse First Boston Corporation, Credit Suisse First Boston (Europe) Limited, Lehman Brothers Inc., Lehman Brothers International (Europe), Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Merrill Lynch International, Salomon Brothers Inc and Salomon Brothers International Limited (the "Agents"), who have agreed to use reasonable efforts to solicit purchases of the Notes. The Issuer will have the sole right to accept offers to purchase Notes and may reject any proposed purchase of Notes as a whole or in part. The Agents shall have the right, in their discretion reasonably exercised, to reject any offer to purchase Notes, as a whole or in part. The Issuer will pay the Agents a commission in the amount agreed between the Agents and the Issuer for sales made through them as Agents.

The Issuer may also sell Notes to the Agents as principals for their own accounts at a discount to be agreed upon at the time of sale, or the purchasing Agents may receive from the Issuer a commission or discount equivalent to that set forth above in the case of any such principal transaction in which no other discount is agreed. Such Notes may be resold at prevailing market prices, or at prices related thereto, at the time of such resale, as determined by the Agents. The Issuer reserves the right to sell Notes directly on its own behalf or, subject to certain conditions set forth in the Distribution Agreement, through or to brokers or dealers (acting as principal or agent) other than the Agents. No commission will be payable to the Agents on any Notes sold directly by the Issuer. The commission schedule for agency sales through such other brokers or dealers will be the same as that set forth above; commissions or discounts for principal sales to such other brokers or dealers will be agreed upon at the time of sale.

Notes may also be sold by the Agents to or through dealers who may resell to investors. The Agents may pay all or part of their discount or commission to such dealers.

Notes in bearer form are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a U.S. person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code and regulations thereunder.

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act.

In connection with an offering of Notes, the Agents may purchase and sell the Notes in the open market. These transactions may include over-allotment and stabilizing transactions and purchases to cover short positions created by the Agents in connection with the offering. Stabilizing transactions consist of certain bids or purchases for the purpose of preventing or retarding a decline in the market price of the Notes; and short positions created by the Agents involve the sale by the Agents of a greater number of Notes than they are required to purchase from the Issuer in the offering. The Agents also may impose a penalty bid, whereby selling concessions allowed to broker-dealers in respect of the securities sold in the offering may be reclaimed by the Agents if such Notes are repurchased by the Agents in stabilizing or covering transactions. These activities may stabilize, maintain or otherwise affect the market price of the Notes, which may be higher than the price that

might otherwise prevail in the open market; and these activities, if commenced, may be discontinued at any time. These transactions may be effected in the over-the-counter market or otherwise.

The Issuer has been advised by each of the Agents that any offering or sale of Notes by such Agent will be (a) if such Notes are to be offered in the United States or to U.S. persons, only to institutions which such Agent reasonably believes are qualified institutional buyers in reliance on Rule 144A under the Securities Act and (b) if such Notes are to be offered outside of the United States, only to certain persons in offshore transactions in reliance on Regulation S under the Securities Act and in accordance with applicable law. Any offer or sale of Notes in reliance on Rule 144A will be made by broker-dealers who are registered as such under the Exchange Act.

With respect to Notes offered to non-U.S. persons in offshore transactions in reliance on Regulation S, each Agent has acknowledged and agreed that, except as permitted by the Distribution Agreement, it will not offer, sell or deliver any Notes (whether as principal or agent) (i) as part of their distribution at any time or (ii) otherwise, until 40 days after the completion of the distribution (as certified to the Fiscal Agent by the relevant Agent) of the identifiable tranche of which such Notes are a part, within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until the expiration of the 40-day period referred to above, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

Terms used in the four preceding paragraphs have the meanings given them by Regulation S and Rule 144A under the Securities Act.

The Issuer has agreed to restrictions similar to those described above with regard to sales made by it.

Each Agent has agreed, on behalf of itself and its respective selling agent, if any, that (a) it has not offered or sold and, prior to the date six months after the date of issue of any Notes, will not offer or sell any such Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purpose of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995, (b) it has complied, and will comply, with all applicable provisions of the Financial Services Act 1986 of Great Britain with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom and (c) it has only issued or passed on and will only issue or pass on in the United Kingdom any documentary received by it in connection with the issuance of the Notes to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 or is a person to whom the document may otherwise lawfully be issued or passed on.

The Notes may not be publicly offered or sold in Mexico.

Each Agent has acknowledged and agreed, on behalf of itself and its respective selling agent, if any, that (a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any other than to persons whose ordinary business it is to buy or sell shares or debentures, whether as principal or agent, or in circumstances, which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong and (b) it has not issued or had in its possession for the purpose of issue and will not issue or have in its possession for the purpose of issue any invitation or advertisement relating to the Notes in Hong Kong (except if permitted to do so by the securities laws of Hong Kong) other than with respect to Notes intended to be disposed of to persons outside Hong Kong or to be disposed of only to persons whose

business involves the acquisitions, disposal or holding of securities (whether as principal or as agent).

Each Agent has acknowledged and agreed that the Notes may not be offered or sold, nor may any document or other material in connection with the Notes be distributed, either directly or indirectly, to the public or any member of the public in Singapore other than (a) to an institutional investor or other person specified in section 106C of the Companies Act, Chapter 50 of Singapore (the "Singapore Companies Act"), (b) to a sophisticated investor, and in accordance with the conditions, specified in Section 106D of the Singapore Companies Act or (c) otherwise pursuant to, and in accordance with the conditions of, any other provision of the Singapore Companies Act.

No action has been or will be taken in any jurisdiction that would permit a public offering of the Notes, or the possession, circulation or distribution of this Offering Circular, any Pricing Supplement or any other material relating to the Issuer or the Notes, in any jurisdiction where action for such purpose is required. Accordingly, the Notes may not be offered or sold, directly or indirectly, nor may this Offering Circular, any Pricing Supplement or any other offering material or advertisements in connection with the Notes be distributed or published in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

Purchasers of Notes may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the offering price and accrued interest, if any, set forth in the Pricing Supplement with respect to such Notes.

Application has been made to list the Notes on the Luxembourg Stock Exchange. The Issuer has applied to have the Notes offered in the United States designated as PORTAL securities.

Each of the Agents may from time to time perform various investment banking services for the Issuer.

The Issuer and the Guarantors have agreed to indemnify the Agents against certain liabilities in connection with the offering of the Notes, including liabilities under the Securities Act.

VALIDITY OF THE NOTES

The validity under New York law of the Notes and the Guaranties will be passed upon by Cleary, Gottlieb, Steen & Hamilton, United States counsel for the Issuer, and by Sullivan & Cromwell or such other counsel as is specified in the applicable Pricing Supplement as United States counsel for the Agents. Certain legal matters governed by Mexican law will be passed upon by Francisco Javier Zenteno Barrios, General Counsel and Head of the Legal Department of Petróleos Mexicanos, and Ritch, Heather y Mueller, S.C., special Mexican counsel for the Agents.

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.

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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, 1996 and 1995, 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, 1996. 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 consolidated 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 consists of incorporating ten affiliated companies in a first stage, with a majority state interest. PEMEX will contribute the assets and liabilities required for operations to these ten 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 2 to the consolidated financial statements) which affect the equity caption titled revaluation surplus. The difference between this standard and Bulletin B-10 of accounting principles is disclosed in Note 13 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, 1996 and 1995, 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, 1996 in accordance with accounting principles generally accepted in Mexico and, as to the recognition of inflation, in accordance with NIF-06 BIS/A (see Notes 2 and 13 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, 1996, and total equity at December 31, 1996 and 1995 to the extent summarized in Note 15 to the consolidated financial statements.

COOPERS & LYBRAND

DESPACHO ROBERTO CASAS ALATRISTE

Manuel Alatríste
Contador Público

Mexico, D.F., Mexico
March 20, 1997 (except for Note 15
to the consolidated financial statements,
for which the date is June 26, 1997)

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 1996 and 1995
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3, and 13)

	1996	1996	1995
ASSETS:			
Current assets:			
Cash and cash equivalents	US\$ 2,292,688	Ps. 17,999,663	Ps. 11,787,227
Accounts and notes receivable, net (Note 4)	4,196,460	32,945,987	21,700,962
Investment fund for specific projects (Note 2o)	1,032,829	8,108,636	—
Inventories, net (Note 5)	1,944,586	15,266,749	10,198,414
Total current assets	9,466,563	74,321,035	43,686,603
Properties, net (Note 7)	26,323,784	206,665,398	182,583,061
Other assets (Notes 6 and 10)	3,956,572	31,062,654	18,168,460
Total assets	US\$39,746,919	Ps.312,049,087	Ps.244,438,124
LIABILITIES:			
Current liabilities:			
Short-term debt and current portion of long-term debt (Notes 8 and 9)	US\$ 4,695,903	Ps. 36,867,064	Ps. 26,084,849
Suppliers	995,538	7,815,868	4,087,808
Accounts payable and accrued expenses	420,476	3,301,118	3,069,062
Taxes payable	2,125,856	16,689,885	6,124,049
Total current liabilities	8,237,773	64,673,935	39,365,768
Long-term debt (Notes 8 and 9)	5,417,804	42,534,637	47,538,903
Reserve for sundry credits and others (Note 11)	438,160	3,439,949	2,218,010
Reserve for retirement payments, pensions and indemnities (Notes 2i and 10)	5,810,930	45,621,029	28,713,450
Commitments and contingencies (Note 11)	—	—	—
Total liabilities	US\$19,904,667	Ps.156,269,550	Ps.117,836,131
EQUITY:			
Certificates of Contribution "A" (Note 12)	2,845,599	22,340,513	22,340,513
Specific oil-field exploration and depletion reserve (Notes 2d, 2e and 12)	1,100,116	8,636,897	9,260,253
Revaluation surplus	12,638,718	99,225,314	82,008,530
Retained earnings:			
Prior years	1,156,837	9,082,212	3,184,059
Current year income	2,100,982	16,494,601	9,808,638
Total equity	19,842,252	155,779,537	126,601,993
Total liabilities and equity	US\$39,746,919	Ps.312,049,087	Ps.244,438,124

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 60,900 million barrels at December 31, 1996 (See note 15 I(a)) and 62,058 million barrels at December 31, 1995.

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

PETROLÉOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 and 1994
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3 and 13)

	1996	1996	1995	1994
Net sales:				
Domestic	US\$16,666,097	Ps. 130,843,862	Ps. 92,125,412	Ps. 64,116,414
Export	<u>12,883,755</u>	<u>101,149,072</u>	<u>65,184,186</u>	<u>31,043,367</u>
	29,549,852	231,992,934	157,309,598	95,159,781
Foreign exchange gain, net (Note 2h)	60,461	474,671	1,604,151	2,603,216
Other revenues	<u>426,998</u>	<u>3,352,319</u>	<u>2,636,276</u>	<u>2,536,728</u>
Total revenues	<u>30,037,311</u>	<u>235,819,924</u>	<u>161,547,025</u>	<u>100,299,725</u>
Costs and operating expenses:				
Cost of sales	7,227,072	56,739,019	45,723,632	30,391,383
Transportation and distribution expenses	621,660	4,880,592	4,497,313	4,082,006
Administrative expenses	1,485,479	11,662,348	8,510,409	6,070,574
Interest, net	(98,492)	(773,248)	(1,052,045)	851,505
Other expenses	234,923	1,844,354	1,472,113	726,593
Special tax on production and services (IEPS)	2,517,787	19,766,891	17,703,170	21,796,946
Hydrocarbon extraction duties and other	<u>15,947,900</u>	<u>125,205,367</u>	<u>77,883,795</u>	<u>33,054,459</u>
Total costs and operating expenses	<u>27,936,329</u>	<u>219,325,323</u>	<u>151,738,387</u>	<u>96,973,466</u>
Income for the year (Note 12)	<u>US\$ 2,100,982</u>	<u>Ps. 16,494,601</u>	<u>Ps. 9,808,638</u>	<u>Ps. 3,326,259</u>

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

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 and 1994
(In thousands of pesos)
(Notes 1, 2, and 13)

	Certificates of Contribution "A" (Note 12)	Reserve for Oil Field Exploration and Depletion (Notes 2d and 2e)	Revaluation Surplus	Retained Earnings (Note 12):	
				Prior Years	Current Year Income
Balances at December 31, 1993	Ps.22,340,513	Ps. 16,275,855	Ps. 66,360,712	Ps. (193,192)	Ps. 3,024,670
Dividends paid to the Federal Government approved by the Board of Directors on May 26, 1994 (Note 12)					(2,981,656)
Transfer to prior years' retained earnings				43,014	(43,014)
Transfer to prior years' retained earnings approved by the Board of Directors (Note 12)		(8,041,000)		8,041,000	
Offsetting of accounts receivable from the Federal Government against retained earnings, approved by the Board of Directors (Note 12)				(6,372,000)	
Increase in (allocations of) reserve for oil field exploration and depletion (Notes 2d and 2e):					
Increase charged to cost of sales		1,834,669			
Capitalized exploration and drilling cost of producing oil wells		2,357,232			
Exploration and drilling costs		(4,005,646)			
Effect of restatement in the year, net			16,264,150		
Income for the year					3,326,259
Balances at December 31, 1994	22,340,513	8,421,110	82,624,862	1,518,822	3,326,259
Dividends paid to the Federal Government approved by the Board of Directors on June 28, 1995 (Note 12)				(1,661,022)	
Transfer to prior years' retained earnings approved by the Board of Directors (Note 12)				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 2d and 2e):					
Increase charged to cost of sales		3,609,444			
Capitalized exploration and drilling cost of producing oil wells		4,458,827			
Exploration and drilling costs		(7,229,128)			
Effect of the restatement in the year, net			(616,332)		
Income for the year					9,808,638
Balances at December 31, 1995	22,340,513	9,260,253	82,008,530	3,184,059	9,808,638
Transfer to prior years' retained earnings approved by the Board of Directors (Note 12)				10,182,548	(10,182,548)
Transfer to prior years' retained earnings				(373,910)	373,910
Dividends paid to the Federal Government approved by the Board of Directors on May 29, 1996 (Note 12)				(4,289,362)	
Recognition of income related to prior years received from the Ministry of Finance and Public Credit (Note 12)				11,331,000	
Recognition of tax debts related to prior years payable to the Ministry of Finance and Public Credit (Note 12)				(10,952,123)	
Increase in (allocations of) reserve for oil field exploration and depletion (Notes 2d and 2e):					
Increase charged to cost of sales		4,397,509			
Capitalized exploration and drilling cost of producing oil wells		4,802,150			
Exploration and drilling costs		(9,823,015)			
Effect of restatement in the year, net			17,216,784		
Income for the year					16,494,601
Balances at December 31, 1996	<u>Ps.22,340,513</u>	<u>Ps. 8,636,897</u>	<u>Ps. 99,225,314</u>	<u>Ps. 9,082,212</u>	<u>Ps.16,494,601</u>

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

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES
STATEMENTS OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 and 1994
(In thousands of pesos and thousands of U.S. dollars)
(Notes 1, 2, 3 and 13)

	1996	1996	1995	1994
Funds provided by (applied in):				
Operations:				
Income for the year	US\$ 2,100,982	Ps. 16,494,601	Ps. 9,808,638	Ps. 3,326,259
Add charges to income not requiring the use of funds:				
Depreciation and amortization	1,324,476	10,398,324	9,385,382	6,618,095
Increase in the reserves for:				
Retirement payments, pensions and indemnities	1,022,869	8,030,441	6,999,057	4,033,982
Oil-field exploration and depletion	560,128	4,397,509	3,609,444	1,834,669
Environmental liabilities	57,811	453,871	1,674,852	—
	5,066,266	39,774,746	31,477,373	15,813,005
Decrease (increase) in:				
Accounts and notes receivable	(1,432,323)	(11,245,025)	(7,608,895)	4,696,890
Inventories	(642,103)	(5,041,083)	(3,192,699)	(296,461)
Other assets	(117,574)	(923,060)	(1,867,625)	(604,880)
Increase in:				
Accounts payable and accrued expenses	504,415	3,960,116	999,045	294,886
Taxes payable	1,345,812	10,565,836	2,496,398	1,539,415
Reserve for sundry credits	97,832	768,068	43,035	386,876
Payments for retirement, pensions and indemnities	(394,094)	(3,093,996)	(2,322,066)	(1,765,301)
Exploration and drilling expenses charged to the reserve for oil-field exploration and depletion (net)	(639,527)	(5,020,865)	(2,770,301)	(1,648,414)
Funds provided by operations	3,788,704	29,744,737	17,254,265	18,416,016
Financing:				
Increase in financing	735,960	5,777,949	23,560,193	21,834,113
Dividends paid to the Federal Government	(546,353)	(4,289,362)	(1,661,022)	(2,981,656)
Effect of settlements with the Ministry of Finance and Public Credit (Note 12)	48,259	378,877	—	—
Offsetting of accounts receivable from the Federal Government against retained earnings	—	—	—	(6,372,000)
Funds provided by financing activities	237,866	1,867,464	21,899,171	12,480,457
Investment:				
Net investment at cost in properties (includes capitalized interest and exchange loss)	(2,202,439)	(17,291,129)	(33,147,694)	(27,025,937)
Investment fund for specific projects	(1,032,829)	(8,108,636)	—	—
Funds applied in investment activities	(3,235,268)	(25,399,765)	(33,147,694)	(27,025,937)
Increase in cash and cash equivalents	791,302	6,212,436	6,005,742	3,870,536
Cash and cash equivalents at beginning of the year	1,501,386	11,787,227	5,781,485	1,910,949
Cash and cash equivalents at end of the year	US\$ 2,292,688	Ps. 17,999,663	Ps. 11,787,227	Ps. 5,781,485

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

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1996, 1995 and 1994

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

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;
Pemex-Refinación;
Pemex-Gas y Petroquímica Básica; and
Pemex-Petroquímica.

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

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1996, 1995 and 1994

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

On October 13, 1996, the Ministry of Energy disclosed a new strategy for the petrochemical industry. In its session held on December 13, 1996, the Board of Directors of Petróleos Mexicanos adopted the following resolutions related to the new strategy to be implemented during 1997:

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

b) PEMEX will transfer the related personnel and the corresponding liabilities to the new affiliated companies.

c) Once the affiliated companies are in operation, private investors will be invited to participate in up to 49% of their capital.

Because of the amendment to the Regulatory Law, in 1995 efforts to allow private participation in transportation, distribution, and storage of natural gas were started.

2. ACCOUNTING POLICIES:

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

a. Monetary Unit.

In January 1993, a new monetary unit temporarily named "new peso", equivalent to one thousand previous pesos, became effective. Starting January 1, 1996, the monetary unit is named "peso" without altering its equivalence and, accordingly, all amounts presented herein are stated in pesos.

b. Consolidation.

The consolidated financial statements include the accounts of Petróleos Mexicanos, of the Subsidiary Entities and 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., and Integrated Trade Systems, Inc.

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1996, 1995 and 1994

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

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.

Since January 1, 1995, when it began substantial operations, Integrated Trade Systems, Inc. has been included in the consolidated group; previously this company was accounted for as a cost basis investment. The effect of consolidating this entity in 1996 and 1995, after eliminations, increased income by Ps. 30,498 and Ps.14,777, respectively.

c. Effects of Inflation on the Financial Information.

The financial statements of PEMEX are prepared in conformity with generally accepted accounting principles in Mexico 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.

d. 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 budgeted exploration and drilling cost per barrel, with a corresponding amount charged to cost of sales. Actual exploration and drilling costs in turn are applied as reductions to the reserve. 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.2.92 to Ps.3.25 in 1996, Ps.1.47 to Ps.2.92 in 1995 and Ps.1.27 to Ps.1.47 in 1994. This increase

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1996, 1995 and 1994

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

resulted in an additional charge to cost of sales of Ps.447,000 in 1996, Ps.1,792,000 in 1995 and Ps.250,000 in 1994.

e. 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 2d. Geological and geophysical costs are expensed through the reserve.

f. 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 costs calculated based on realizable market prices.

Materials, spare parts and supplies are restated at the last purchase price. In 1994, the values of materials, spare parts, supplies and the related cost of sales were not restated for the effects of inflation, but were valued at an average price considering the 1993 base prices and 1994 purchases. The effect of the policy followed in 1994 did not differ materially from the use of the last purchase price.

g. 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.

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:

PETRÓLEOS MEXICANOS, SUBSIDIARY ENTITIES AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 1996, 1995 and 1994

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

	<u>%</u>
Buildings	3
Plant, wells and drilling equipment	3 - 5
Furniture and fixtures	10
Offshore platforms	4
Transportation equipment	4 - 20
Pipelines	2

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

h. Foreign Currency Balances and Transactions.

Transactions in foreign currency are recorded at the exchange rates in effect on the date the transactions are closed 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, generating net exchange gains of Ps.474,671, Ps.1,601,151 and Ps.2,603,216 in 1996, 1995 and 1994 respectively.

i. 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 Bulletin D-3 of Mexican Generally Accepted Accounting Principles ("Mexican GAAP").

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.

j. 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

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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.

k. 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 tax. 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\$13.25 per barrel for 1996). 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.

l. Special Tax on Production and Services.

The special tax on production and services is a tax on the sales of gasolines, 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 1996, 1995 and 1994.

m. Financial Statement Presentation.

The statement of changes in financial position discloses the sources and applications of funds derived from operating, financing and investing activities.

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n. 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 as Interest, net. See Note 9 for further disclosure regarding derivative instruments.

o. 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 intends to increase the investment in assets in 1997, mainly in oil extraction projects.

p. 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.

q. New Accounting Pronouncement.

The Mexican Institute of Public Accountants has issued Circular 50 for companies which reflect the effects of inflation on their financial statements utilizing Bulletin B-10. Effective January 1, 1997, companies will be required to utilize real (net of inflation) assumptions in the actuarial calculations of pension and seniority premium costs, and the related assets and liabilities. Circular 50 further defines these liabilities as non-monetary for the purposes of applying B-10. As PEMEX recognizes the effects of inflation in accordance with the guidelines established by the Financial Reporting Standard (NIF-06 BIS/A) issued by the Ministry of Finance and Public Credit and the Comptroller and Administrative Development Office, the provisions of Circular 50 will not be applicable.

r. 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 7.8509 pesos per U.S. dollar, which is the December 31, 1996 exchange rate for the settlement of obligations in foreign currencies provided by

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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.

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, 1996 and 1995:

Currency	Exchange Rates (stated in pesos) at December 31,		Amounts (thousands of pesos) at December 31,	
	1996	1995	1996	1995
<u>ASSETS</u>				
U.S. dollars	Ps.7.8509	Ps.7.6425	Ps.29,132,469	Ps.11,951,317
Dutch guilders	4.5394	4.7682	9,731	629
Other currencies	Various	Various	335	360
<u>LIABILITIES</u>				
U.S. dollars	Ps.7.8509	Ps.7.6425	Ps.72,967,813	Ps.66,246,037
Pounds sterling	13.4133	11.8612	710,458	635,535
Japanese yen	0.0675	0.0741	8,728,503	8,521,587
Deutsche marks	5.0929	5.3391	256,636	475,453
Austrian schillings	0.7168	0.7589	362,900	781,983
Other currencies	Various	Various	32,047	35,773

As of March 20, 1997, the Mexican peso/U.S. dollar exchange rate was Ps. 7.9233 = US\$1.00.

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4. ACCOUNTS AND NOTES RECEIVABLE:

Accounts and notes receivable are as follows:

	<u>1996</u>	<u>1995</u>
Trade:		
Domestic (a)	Ps. 11,569,460	Ps. 8,929,695
Foreign	9,451,794	5,843,864
Mexican Federal Government:		
Advance payments on minimum guaranteed dividends (Note 12)	6,781,517	4,289,362
Other accounts receivable	5,708,349	3,299,546
Less, allowance for doubtful accounts	<u>(565,133)</u>	<u>(661,505)</u>
	<u>Ps. 32,945,987</u>	<u>Ps. 21,700,962</u>

- (a) Balance includes 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, 1996 and 1995 the balance of such loans was Ps.1,081,000 and Ps.905,000, respectively.

5. INVENTORIES:

Inventories are as follows:

	<u>1996</u>	<u>1995</u>
Crude oil, refined products, derivatives and petrochemical products	<u>Ps. 11,635,761</u>	<u>Ps. 7,439,888</u>
Materials and supplies in stock	4,879,000	4,546,280
Less allowance for slow-moving inventory and obsolescence	<u>(2,141,644)</u>	<u>(2,245,754)</u>
	2,737,356	2,300,526
Materials in transit	<u>893,632</u>	<u>458,000</u>
	<u>Ps. 15,266,749</u>	<u>Ps. 10,198,414</u>

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6. OTHER ASSETS:

Other assets include long-term investments as follows:

	<u>1996</u>	<u>1995</u>
Shares of other non-consolidated subsidiaries and affiliates	<u>Ps.1,157,800</u>	<u>Ps.1,268,947</u>

In 1994, Petróleos Mexicanos sold its air transportation equipment to Servicios Aéreos Especializados Mexicanos, S.A. de C.V. ("SAEMSA"), from which it recorded a gain of Ps.340,969 (recorded in other income in the statements of income). In addition, PEMEX received a 49% interest in the capital of SAEMSA, which is being accounted for under the cost method and amounts to Ps.142,095 as of December 31, 1996 and 1995.

During 1993, PEMEX entered into a joint venture with Shell Oil Company, from which PEMEX obtained 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.570,281 as of December 31, 1996 (Ps.714,155 in 1995). During 1996, 1995 and 1994, PEMEX recorded Ps.152,597, Ps.549,017 and Ps.179,095, respectively, of its equity in the losses of the joint venture. During 1996, 1995 and 1994, PEMEX paid the joint venture Ps.1,448,059, Ps.677,813 and Ps.349,771, respectively, for the processing of petroleum. During 1996, 1995 and 1994, PEMEX, through its subsidiary, paid Ps.446,187, Ps.417,464 and Ps.104,118, respectively, to the joint venture under terms of the contract which call for contributions from PEMEX based on the refinery's operating margin.

During 1993, PEMEX made an investment in Mexicana de Lubricantes, S.A. de C.V. ("MexLub"). PEMEX invested Ps.176,204 to obtain a 49% investment in MexLub. Since January 1995, this investment is accounted for under the cost method (equity method until 1994), and amounts to Ps.238,093 as of December 31, 1996, and 1995. PEMEX accounts for this investment under the cost method due to the immateriality of amounts.

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 1996, 1995 and 1994 consolidated equity and earnings are 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

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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.

7. PROPERTIES:

a. The components of this caption are as follows:

	1996	1995	1994
Land	Ps. 13,028,077	Ps. 10,503,431	Ps. 10,449,897
Buildings	18,587,663	14,957,968	12,762,591
Wells and drilling equipment	75,160,539	66,758,271	56,868,922
Plants	114,734,935	105,776,324	92,492,536
Pipelines	85,014,635	69,096,828	62,663,911
Furniture and fixtures	8,898,848	7,206,030	6,944,786
Land and ocean transportation equipment	8,000,360	7,706,242	7,538,080
Offshore platforms	31,836,405	29,850,463	24,782,454
Leased equipment	<u>1,749,017</u>	<u>1,788,095</u>	<u>1,419,487</u>
	357,010,479	313,643,652	275,922,664
Less, accumulated depreciation and amortization	<u>178,288,536</u>	<u>153,410,961</u>	<u>134,404,573</u>
	178,721,943	160,232,691	141,518,091
Other	1,578,025	2,011,183	2,159,492
Construction in progress	<u>26,365,430</u>	<u>20,339,187</u>	<u>15,759,498</u>
	<u><u>Ps.206,665,398</u></u>	<u><u>Ps.182,583,061</u></u>	<u><u>Ps.159,437,081</u></u>

b. For 1996, 1995 and 1994, fixed assets, including accumulated depreciation, were restated for the effects of inflation and currency devaluation using appraisals made by IMP (except in 1996 for pipelines and other assets related to distribution, transportation and storage of natural gas). The appraisals were prepared using the specific price index method.

c. 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 made based on the regulation issued by the Energy Regulatory Commission in the matter of natural gas. The impact of the change in method was not significant.

d. Debt interest costs capitalized as part of construction in progress and wells were: Ps.2,285,784 in 1996, Ps.3,184,997 in 1995 and Ps.1,547,273 in 1994. Foreign currency losses associated with PEMEX's debt are capitalized as part of the cost of fixed assets. Foreign currency losses capitalized in 1996, 1995 and 1994 were Ps.1,043,296, Ps.20,951,523 and Ps.21,099,000, respectively.

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e. Depreciation and amortization expenses recorded for 1996, 1995 and 1994 were Ps.10,398,324, Ps.9,385,382 and Ps.6,612,675, respectively.

f. Leased equipment includes drilling and transportation equipment and offshore platforms.

8. BORROWINGS:

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 million), with maturities in the short term; Ps.2,364.1 million, (US\$308.7 million) was obtained via purchasing loans in the United States. During 1996 PEMEX issued bonds of Ps.6,090.4 million, (US\$792.6 million) in the European market. The bond issues were two Eurobond transactions for Ps.2,348.9 million and Ps.2,289.7 million, (US\$300 million) each and one issuance of bonds for 300 billion Italian Lira (US\$192.6 million) 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.1,451.8 million, (US\$192.6 million); thereby converting its foreign currency risk on the bonds from Lira to dollars.

During 1996, the lines of the commercial paper program with Bank of America were increased to US\$500 million and US\$175 million with short-term maturities at discount rates 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) of which Ps.7,437,519 (US\$947,346) are available.

At December 31, 1996 and 1995, the majority of short-term borrowings were denominated in foreign currencies. The weighted average interest rates for short-term borrowings was approximately 6.20% and 6.37% as of December 31, 1996 and 1995, respectively.

During 1995, PEMEX obtained several dollar denominated lines of credit totaling approximately US\$1,757,000 (Ps.11,406,444). Such lines of credit have various maturities ranging from one to five years. Also during 1995, PEMEX issued Swiss Francs 150 million (Ps. 996,885) of 9.255% fixed rate bonds maturing in two years. During the year PEMEX also increased by US\$65,000 (Ps.421,980) its commercial paper programs.

As of December 31, 1996 and 1995, long-term debt is as follows:

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			1996		1999			
	Rate of Interest	Maturity	pesos (thousands)	Foreign currency (thousands)	pesos (thousands)	Foreign currency (thousands)		
U.S. dollars (at Ps.7.8509 pesos per dollar in 1996 and Ps.7.6425 pesos in 1995):								
Unsecured loans (1)	Mainly LIBOR plus 0.8125%	Several to 2006	Ps. 7,419,909	US\$ 945,103	Ps. 7,717,129	US\$1,009,765		
Unsecured loans	LIBOR plus 1.2% and plus 1.7%	Several to 2006	1,903,971	242,510	3,308,657	432,770		
Acceptance lines	Acceptance rate plus 0.875% and plus 1%	In 1997	9,892,134	1,260,000	7,527,863	985,000		
Bonds	Several from 6.873% to 10.252% and LIBOR plus 0.05% and 0.8%	Several to 2023	25,289,123	3,221,175	20,853,005	2,728,558		
Purchasing loans	Several from 4.81% to 11.2 % and LIBOR plus 0.225% and plus 0.1875%	Several to 2006	3,995,558	508,930	2,829,818	370,274		
Leasing contracts	Several from 8.89% to 11.74% and LIBOR plus 1.1% to 2.25%	Several to 2011	3,599,708	458,509	3,156,498	413,019		
Commercial paper	Discount rate in force in the market plus 5 basis points	From 7 to 180 days, renewable	1,766,452	225,000	2,674,875	350,000		
Unsecured loan from the Mexican Government	LIBOR plus 0.8125%	Prepaid in 1996			5,148,080	673,612		
Sale of future accounts receivable	7.53%	In 2000	2,308,478	294,040	2,523,415	330,182		
External trade loans	LIBOR plus 0.5% and plus 1.0%	In 1997	12,365,167	1,575,000	4,990,553	653,000		
Syndicated loan (at \$7.7396 per dollar)	EURODOLLAR plus 0.625%	In 1996			1,350,977	174,554		
Revolving credit	LIBOR plus 1.0%	In 1996			611,400	80,000		
Total financing denominated in U.S. Dollars			<u>68,540,500</u>	<u>US\$8,730,267</u>	<u>62,692,270</u>	<u>US\$8,200,734</u>		
Japanese yen (at Ps.0.0675 per yen in 1996 and Ps.0.0741 in 1995):								
Purchasing Loans	Several from 2.9% to 6.1% and PRIME in yen from 3.8% to 6.6%	Several to 2015	8,654,331	128,212,310	8,346,738	112,641,529		
Leasing contracts	8.9%	In 1997	42,355	627,481	89,115	1,202,635		
Total financing denominated in Japanese yen			<u>8,696,686</u>	<u>128,839,791</u>	<u>8,435,853</u>	<u>113,844,164</u>		
Other currencies (2)		Several to 2016	1,326,227		1,877,729			
Total Principal(3)			<u>78,563,413</u>		<u>73,005,852</u>			
Plus: Accrued interest			<u>838,288</u>		<u>617,900</u>			
Total debt			<u>79,401,701</u>		<u>73,623,752</u>			
Less: Short-term debt and Short-term maturities			<u>36,867,064</u>		<u>26,084,849</u>			
Long-term debt			<u>Ps.42,534,637</u>		<u>Ps.47,538,903</u>			
	1997	1998	1999	2000	2001	2002	Over 6 years	Total principal amount of Debt
urities (in sands of Pesos)	<u>Ps. 36,028,776</u>	<u>Ps. 13,478,136</u>	<u>Ps. 8,088,290</u>	<u>Ps. 3,771,459</u>	<u>Ps. 3,063,084</u>	<u>Ps. 2,058,764</u>	<u>Ps. 12,074,904</u>	<u>Ps. 78,563,413</u>

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 projects financing in Pounds sterling, Deutsche marks, Swiss francs, Austrian schillings, French francs and Belgian francs at different rates.

(3) Includes foreign financing for Ps.68,870,159 and Ps.58,488,956 in 1996 and 1995, respectively.

(4) At December 31, 1996 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%.

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9. FINANCIAL INSTRUMENTS:

Risk management activities:

PEMEX uses derivative financial instruments to reduce the volatility of financing costs, and manage interest and currency risk. These instruments involve, to varying degrees, elements of market risk and credit risk which are not reflected in the consolidated balance sheet.

Market risk is defined as the exposure to potential loss through holding interest and exchange rate positions and commodities in the face of absolute and relative price movements and interest rate and currency volatility. Credit risk is defined as the possibility of sustaining a loss because the counterparty to a financial instrument fails to perform in accordance with the terms of the contract. Derivative instruments which are held by PEMEX, with the exception of foreign currency swaps, are commonly bought and sold in notional amounts which do not represent the actual amounts of cash flows to be exchanged by the parties. The amounts exchanged are based on the notional amounts and other terms of the contract. PEMEX's maximum exposure to credit loss in the event of nonperformance by the counterparty is represented by the premium paid for the instrument and any unrealized gains on the instrument.

For financial derivatives, the counterparty's default risk is monitored on an ongoing basis and the credit risk is minimized by dealing with major financial institutions as counterparties, maintaining a diversified portfolio of counterparties and requiring credit information for new counterparties.

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

PEMEX's risk management portfolio includes instruments used for hedging and non-hedging activities. The classes of instruments used by PEMEX in these two categories are described in the following sections.

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Hedging Activities:

Interest rate instruments: PEMEX enters into various types of interest rate contracts in managing its interest rate risk. Approximately 73% of the aggregate of PEMEX's debt and the minimum guaranteed dividend rate on the Certificates of Contribution "A" have floating interest rate terms that re-price approximately every three months based on LIBOR. PEMEX's management and its risk management committee have 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 their liabilities in a cost-efficient manner. At December 31, 1996, the interest rate on approximately 75% of PEMEX's debt was at fixed rates as either stipulated in the debt agreements or through the use of derivatives. Approximately 95% of such derivatives were interest rate swaps.

An interest rate swap is an agreement in which two parties agree to exchange, at specified intervals, interest payment streams calculated on an agreed-upon notional principal amount. Under these agreements PEMEX is obligated to make payments based on the fixed interest rate and entitled to receive payments generally based on the three month LIBOR interest rate, thereby reducing PEMEX's exposure to floating interest rate payments due on the related debt and Certificates of Contribution "A".

PEMEX has also 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 be protected if they rise.

Foreign currency instruments: A significant portion of PEMEX's revenues is derived from exports of crude oil and oil products, which are denominated and payable in U.S. dollars. In addition, the domestic revenues that PEMEX retains (i.e., does not pay to the government in the form of IEPS taxes) in respect of its sales of oil products and petrochemicals are related to the international prices of these products, which are denominated in U.S. dollars. 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 exchange rates. Substantially all of PEMEX's cross currency swaps are entered into with its creditors on the underlying debt. Cross-currency swaps are agreements to exchange one currency for another at an agreed upon exchange rate. In a cross-currency swap, the holder of one currency exchanges with a receiver an equivalent amount of another currency. During the life of the swap it involves the

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exchange of a fixed or floating rate obligation in one currency for a floating or fixed rate obligation in the other one. At maturity, the swap is reversed at the same agreed exchange rate. These swaps are technically borrowings, but unlike bank loans they are not ordinarily recorded on the balance sheet.

In addition, since a significant portion of PEMEX's revenues are dollar-denominated while hydrocarbon duties paid to the federal government are peso-denominated, PEMEX from time to time enters into forward contracts with Mexican banks for the sale of dollars in exchange for pesos. All such contracts expired in 1995.

Non-Hedging Activities:

To achieve its desired interest rate mix, PEMEX's risk management committee determined that it would remove some of the protection provided by its interest rate swaps by writing interest rate caps. As the writer of these caps, in exchange for receiving a premium, PEMEX is obligated to pay the holder 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 only writes interest rate caps to synthetically terminate the protection provided by existing interest rate swaps.

During 1995, PEMEX sold swaptions which, in exchange for a premium, provide the holder the right to enter into an interest rate swap agreement, on an agreed future exercise date, which would obligate PEMEX to make fixed interest rate payments. The swaptions are a means to synthetically extend the life of PEMEX's existing interest rate swaps. However, the underlying debt and Certificates of Contribution "A" funding are in place during the maturities of the swaptions so they do not create an additional funding risk.

During 1994, PEMEX also purchased interest rate floors to synthetically remove the fixed rate leg of the swaps once market interest rates decrease below the swap fixed rate. The interest rate floor entitles the holder to receive the amount, if any, by which the three month LIBOR rate is less than the rate specified in the floor agreement on the exercise date of the floor.

PEMEX sold interest rate floors during December 1996 in order to reverse the previous strategy to synthetically remove the fixed rate leg of the swaps.

Mexican GAAP accounting policies:

Through December 31, 1994, for accounting purposes, premiums paid or received with respect to financial derivatives were reported in income on a cash basis.

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PEMEX also records the amounts paid or received pursuant to the terms of derivative contracts on a cash basis on each contractual payment date. Effective January 1, 1995, PEMEX changed its method of accounting for interest rate swaps from a cash basis to an accrual basis. The effect of this change was recognized prospectively, and the cumulative effect of the change was not material.

The instruments utilized by PEMEX to achieve its risk management objectives are noted in the following table along with their notional amounts, average maturities, average rates and fair values.

	(1) Notional amounts at December 31, 1996	Weighted average maturity (years)	Weighted average pay rate	Weighted average receive rate	(2) Fair values at December 31, <u>Gain/(Loss)</u>	
					1996	1995
Hedging instruments: (3)						
Interest rate swaps	Ps.52,208,485	2.6	6.82%	6.13%	Ps.(937,216)	Ps.(2,058,645)
Interest rate caps (purchased)	3,140,360	1.7	7.67%	5.97%	2,261	5,819
Cross currency exchange swaps(4)	8,213,414	2.1	N/A	N/A	481,528	771,827
Non-Hedging instruments: (3)						
Interest rate caps (sold)	7,850,900	2.3	6.17%	8.70%	(12,148)	(17,536)
Interest rate floors (purchased)	5,495,630	1.9	6.01%	5.60%	21,875	98,404
Interest rate floors (sold)	5,495,630	1.6	5.50%	5.99%	(15,720)	(43,911)

(1) 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.

(2) 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.

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

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(4) Cross currency swaps are denominated in the currency of the underlying debt. At December 31, 1996, open contract amounts were as follows: 299,386,256 Swiss franc, 1,095,087,500 Austrian schilling, 743,625,000 French franc, 75,000,000 Pound sterling, 98,852,500 Canadian dollars, 19,886,000,000 Japanese yen and 297.8 billion Italian lira. Such amounts have been converted to a U.S. dollar denominated liability of US\$61,334. These cross currency swaps mature between 1997 and 2003.

10. 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 2i). In 1996, the calculation of the labor obligations of active personnel was made on the basis of the new salary scheme applied as of this year, due to the effect of the Employee Income Tax (Note 12). 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.

As of December 31, 1996 and 1995, the amount of the benefits projected for pensions and seniority premiums, determined by independent actuaries according to Bulletin D-3, is as follows:

	<u>1996</u>	<u>1995</u>
Obligations for current benefits	Ps. 48,487,257	Ps. 30,914,282
Additional amount for projected benefits	<u>19,994,037</u>	<u>10,157,739</u>
Obligations for projected benefits	68,481,294	41,072,021
Less plan assets (trust fund)	<u>2,866,370</u>	<u>2,537,308</u>
	65,614,924	38,534,713
Transition liability to be amortized over 15 years, for retirement payment and seniority premium and other effects of the actuarial calculations	<u>44,732,854</u>	<u>22,589,088</u>
Net projected liability	20,882,070	15,945,625
Additional liability derived from the excess of obligations for current benefits over plan assets and net projected liability	<u>24,738,959</u>	<u>12,767,825</u>
Accumulated obligation	<u>Ps. 45,621,029</u>	<u>Ps. 28,713,450</u>

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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.8,030,441, Ps.6,992,412 and Ps.4,033,982 in 1996, 1995 and 1994, respectively.

11. COMMITMENTS AND CONTINGENCIES:

Economic Stabilization Agreement

Under the Economic Stabilization Agreements (the "Agreements") entered into in 1995 between the Government of the United States of America and México providing the latter with financial resources, Petróleos Mexicanos and certain of its affiliates had 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. Although 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, any amounts due and unpaid from Mexico to the United States under the Agreements, which do not confer upon the United States any right over PEMEX's assets and do 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 has reached agreement with the Federal Agency of Environmental Protection ("PROFEPA") to implement remediation plans.

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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, 1996 and 1995 of Ps.2,128,723 and Ps.1,674,852, 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, 1996, PEP has potential obligations for these contracts amounting to approximately Ps.93,000, which will be paid during 1997, provided that the terms set forth in the contracts are met.

12. 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 which is not to be diminished. 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.

On May 29, 1996, the Board of Directors approved the financial statements for the year ended December 31, 1995, and the payment made in 1995 to the Mexican Government of the minimum guaranteed dividend of Ps. 4,289,362.

During 1996, Petróleos Mexicanos paid Ps.6,781,517 (Ps.4,289,362 during 1995) 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 1996.

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

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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 - 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.

On June 28, 1995, the Board of Directors approved the financial statements for the year ended December 31, 1994, and the payment made in 1994 to the Mexican Government of the minimum guaranteed dividend of Ps.1,661,022.

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

13. 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 requires them to be reflected in the income statement caption: "integral cost of financing".
- (c) NIF-06 BIS/A does not require the restatement of the equity accounts; Bulletin B-10 requires such restatement.
- (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".

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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.

The balance sheets as of December 31, 1996 and 1995 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, and prepared in accordance with NIF-06 BIS/A (Note 2c).

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.

	1996	1995
	Basic Financial Statements	Restated Amounts
EQUITY		
Certificates of Contribution "A"	Ps. 22,340,513	Ps. 22,340,513
Reserve for oil field exploration and depletion	8,636,897	9,260,253
Revaluation surplus	99,225,314	—
Accumulated earnings (deficit):		
Prior years	9,082,212	(11,692,386)
Income for the year	16,494,601	27,759,889
	25,576,813	16,067,497
Restatement of equity	—	362,684,368
Loss from accumulated monetary position	—	(44,237,068)
Equity monetary result	—	5,015,862
Accumulated deficit from holding non-monetary assets	—	(214,728,532)
	—	(253,949,738)
	Ps. 155,779,537	Ps. 155,779,537
		Ps. 126,601,993

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	<u>1996</u>	<u>1995</u>	<u>1994</u>
<u>EFFECT ON INCOME</u>			
Integral cost of financing:			
Interest and exchange loss capitalized			
in fixed assets	Ps. (3,329,080)	Ps.(24,709,314)	Ps. (23,044,501)
Gain from monetary position net	14,594,362	20,543,669	1,446,690
	<u>Ps. 11,265,282</u>	<u>Ps. (4,165,645)</u>	<u>Ps. (21,597,811)</u>

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 such 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, including 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 2c, to the result from applying indexes to them (by comparison with the general level of inflation).

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14. SUBSEQUENT EVENT:

As of March 20, 1997, the date of issuance of the December 31, 1996 financial statements, the average prices of Mexican crude oil exports had decreased approximately 19% compared to the average prices as of the closing date of 1996, and 8% compared to the average prices prevailing during 1996.

15. 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.

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:

	1996	1995	1994
Annual income reported under Mexican GAAP	Ps. 16,494,601	Ps. 9,882,638	Ps. 3,326,259
Approximate U.S. GAAP adjustments:			
Exploration and drilling costs (a)	803,677	1,782,782	774,671
Units of production amortization (b)	(472,607)	—	—
Pensions and seniority premiums(c)	(13,565)	(1,121,045)	(780,905)
Post retirement benefits (c)	(1,731,615)	(574,298)	—
Accrued vacation (d)	(8,065)	(14,660)	(9,085)
Fixed asset depreciation (f)	3,367,153	2,421,193	—
Foreign currency exchange losses (g)	(1,043,296)	(20,951,523)	(21,099,000)
Capitalization of interest (h)	(73,887)	(1,447,595)	(1,071,825)
Environmental matters (i)	—	1,535,286	(1,535,286)
Accounting for derivatives (j)	(44,159)	244,398	(124,667)
Sale of shares of Repsol (k)	—	—	(242,408)
Sale of air transport assets (l)	110,808	41,113	(322,406)
Fixed asset impairment (n)	(7,157,949)	—	—
Total approximate U.S. GAAP adjustments, net	(6,263,505)	(18,084,259)	(24,410,911)
Approximate annual (loss) income under U.S. GAAP	Ps. 10,231,096	Ps. (8,275,621)	Ps. (21,084,652)

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Equity is reconciled as follows:

Equity under Mexican GAAP	<u>Ps. 155,779,537</u>	<u>Ps. 126,601,993</u>
Approximate U.S. GAAP adjustments:		
Advanced payments on minimum guaranteed dividend (m)	(6,781,517)	(4,289,362)
Exploration and drilling costs (a)	2,959,085	1,532,052
Units of production amortization (b)	(472,607)	—
Pensions and seniority premiums (c)	(2,741,608)	(2,728,043)
Postretirement benefits (c)	(2,305,823)	(574,208)
Accrued vacation (d)	(70,171)	(62,106)
Inflation accounting - fixed assets valuation (e)	(28,012,386)	(10,795,602)
Fixed asset depreciation (f)	5,788,346	2,421,193
Foreign currency exchange losses (g)	(43,214,605)	(42,171,309)
Capitalization of interest (h)	(7,244,278)	(7,170,391)
Environmental matters (i)	(68,500)	(68,500)
Accounting for derivatives (j)	75,572	119,731
Sale of shares of Repsol (k)	(242,408)	(242,408)
Sale of air transport assets (l)	(170,485)	(281,293)
Fixed asset impairment (n)	(7,157,949)	—
Accounting for investment securities (o)	<u>3,136,586</u>	<u>2,388,500</u>
Total approximate U.S. GAAP adjustments, net	<u>(86,522,748)</u>	<u>(61,921,746)</u>
Approximate equity under U.S. GAAP	<u>Ps. 69,256,789</u>	<u>Ps. 64,680,247</u>

Explanation of Reconciling Items:

a) Exploration and Drilling Costs

As discussed in Notes 2d and 2e, 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

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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 15 I (n)). PEMEX has accordingly adjusted income and equity to reflect the impact of U.S. GAAP on exploration and drilling costs.

In 1996, PEMEX revised its procedures for estimating reserves to meet the standards of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers. Effective December 31, 1996, adjustments were applied to estimates of Mexico's proved reserves for offshore reservoirs in the two marine regions of the Campeche Sound in the Gulf of Mexico - the Northeast and the Southwest -, resulting in a revision of the proved reserves. PEMEX is in the process of reviewing the methodology for estimates of Mexico's other remaining proved reserves in the Southern and Northern regions, which is expected to be completed by 1998 and 1999, respectively. An estimate of the amount of the potential revision, if any, on the currently estimated proved developed reserves for these remaining regions cannot be determined as of this date, and consequently, no adjustment has been made to the units-of-production amortization for all the fields during 1996.

(b) Units of Production Amortization

For Mexican GAAP purposes PEMEX amortizes its well and platform costs 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, 1996 the units of production method generated Ps.472,607 more in amortization expense than the straight line method and PEMEX has accordingly adjusted income and equity for such effect.

(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 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.

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Under U.S. GAAP, effective January 1, 1995 PEMEX adopted 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, prior to January 1, 1995, PEMEX recorded all such benefits on a pay-as-you-go basis. Effective January 1, 1995, PEMEX began accruing for supplemental payments under its Bulletin D-3 calculations. PEMEX continues, however, to account 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. PEMEX has accordingly adjusted income and equity for each year presented.

(e) Inflation Accounting

U.S. GAAP does not require the recognition of the effects of inflation on the financial statements. As mentioned in Note 2c, 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 13), 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 prior year fixed asset revaluation 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 Asset Depreciation

Under Mexican GAAP, PEMEX amortizes 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

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to restatements for inflation and foreign exchange losses which are included in the basis of fixed assets.

(g) Foreign Currency Exchange Losses

Under Mexican GAAP, exchange losses arising from debt are capitalized; the net amount of the remaining exchange differences is either debited to costs and operating expenses or credited to revenues.

To conform with U.S. GAAP, all exchange losses have been recognized in results of operations for 1996, 1995 and 1994 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) 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, 1996, 1995 and 1994, for Mexican GAAP and U.S. GAAP purposes were allocated as follows:

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	<u>1996</u>	<u>1995</u>	<u>1994</u>
Under Mexican GAAP:			
Interest capitalized in fixed assets	Ps. 2,285,784	Ps.3,184,997	Ps.1,547,223
Interest in the specific reserve for exploration and depletion	779,928	572,794	400,197
Interest expense	3,767,215	2,626,338	1,786,189
Total interest cost	<u>Ps. 6,832,927</u>	<u>Ps.6,384,129</u>	<u>Ps.3,733,609</u>
Under U.S. GAAP:			
Interest capitalized in fixed assets	Ps.2,013,415	Ps.1,264,196	Ps. 475,398
Interest expense	4,819,512	5,119,933	3,258,211
Total interest cost	<u>Ps. 6,832,927</u>	<u>Ps.6,384,129</u>	<u>Ps.3,733,609</u>

(i) Environmental Matters

In 1993, partly as a result of the enactment of new environmental laws by the Mexican Government, PEMEX began to develop an internal structure to better identify and quantify restoration, dismantlement and abandonment costs. In connection with the new structure, in 1994 under the direction of the Mexican Government PEMEX contracted with external engineers for the performance of 33 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. Once such audits are completed, they are 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.

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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.

At December 31, 1994, under U.S. GAAP, PEMEX established accruals for restoration and removal costs identified in the 33 operational audits completed in 1994 and early 1995. 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.

For Mexican GAAP purposes, prior to 1995, PEMEX recorded environmental expenditures, including restoration, dismantlement and abandonment costs, on a pay-as-you-go basis and classified such expenses in its cost of sales. During 1995, under Mexican GAAP, PEMEX established a reserve for remediation costs identified through ongoing environmental audits.

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 9). 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.

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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

In 1994, 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 has been reversed and the transfer of the shares treated as a financing transaction.

(l) Sale of Air Transport Assets

As discussed in Note 6, under Mexican GAAP, during 1994, PEMEX recorded a gain of Ps.340,969 on the sale of its air transport division to the 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, and the realized gain is deferred. The amortization of the deferred gain during 1996, 1995 and 1994 amounted to Ps.110,808, Ps.41,113 and Ps.18,563 respectively.

(m) Advanced Payments on Minimum Guaranteed Dividend

Under Mexican GAAP, advanced payments on the minimum guaranteed dividend, derived from the capitalization of debt as described in Note 12, 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.

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The effective rate used to calculate the minimum guaranteed dividend is LIBOR plus 0.8125% (which was 5.932% and 6.453% for 1996 and 1995, respectively). The scheduled maturities on the original principal amount of the capitalized debt over the next five years is as follows:

<u>Year</u>	<u>Amount</u>
1997	992,371
1998	1,413,637
1999	1,631,881
2000	1,952,610
2001	2,397,012
Thereafter	11,896,332
	<u>20,283,843</u>

(n) *Fixed asset impairment*

Effective January 1, 1996, PEMEX adopted Statement of Financial Accounting Standards (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.

The impact of the adoption of the new standard as of January 1, 1996, was to reduce long-term assets by Ps.7,157,949 (with a corresponding charge to income). The expense relates primarily to producing fields, refineries and other plants with capitalized costs deemed to be impaired under SFAS No. 121. Expected cash flows and fair values were estimated internally using Company methodology and practices for valuing similar properties to be acquired or sold.

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(o) Accounting for investment securities

In 1996, PEMEX adopted SFAS No.115 "Accounting for Certain Investments in Debt and Equity Securities", and has recorder 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, 1996 and 1995 is as follows:

	1996			1995		
	Cost	Fair value	Unrealized Gain (Loss)	Cost	Fair value	Unrealized Gain (Loss)
Investment securities	Ps.1,354,592	Ps.4,491,178	Ps.3,136,586	Ps.1,354,592	Ps.3,743,092	Ps.2,388,500

Under Mexican GAAP, the held-for-investment securities are carried at cost. The unrealized gain for US 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.19,766,891, Ps.17,703,170, Ps.21,796,946, for the years ended December 31, 1996, 1995 and 1994, respectively.

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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.

The following table details the effects discussed above using Mexican GAAP measurement methods and U.S. GAAP presentation:

	1996	1995	1994
Income for the year plus or less charges or credits not requiring the use of cash:			
Under Mexican GAAP	Ps. 39,774,746	Ps. 31,477,373	Ps. 15,813,005
Under U.S. GAAP	40,571,929	30,460,176	4,873,225
Difference(1)	Ps. (797,183)	Ps. 1,017,197	Ps. 10,939,780
Operations:			
Accounts receivable:			
Under Mexican GAAP	Ps. (11,245,025)	Ps. (7,608,895)	Ps. 4,696,890
Under U.S. GAAP	(8,575,502)	(4,902,349)	525,323
Difference (3)	(2,669,523)	(2,706,546)	4,171,567

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	<u>1996</u>	<u>1995</u>	<u>1994</u>
Financing:			
New long-term financing	Ps. 25,074,736	Ps. 18,332,100	Ps. 18,060,341
Interest payable (Interest payments), net	220,388	155,426	98,212
Financing payments	<u>(20,253,789)</u>	<u>(16,955,333)</u>	<u>(17,423,440)</u>
Net (decrease) increase in financing under U.S. GAAP	5,041,335	1,532,193	735,113
Foreign currency exchange loss	<u>736,614</u>	<u>22,028,000</u>	<u>21,099,000</u>
Net increase in financing under Mexican GAAP	<u>Ps. 5,777,949</u>	<u>Ps. 23,560,193</u>	<u>Ps. 21,834,113</u>
Dividends paid to the Federal Government Under Mexican GAAP	Ps. (4,289,362)	Ps. (1,661,022)	Ps. (2,981,656)
Under U.S. GAAP	<u>(6,781,517)</u>	<u>(4,289,362)</u>	<u>(1,661,022)</u>
Difference (4)	<u>2,492,155</u>	<u>2,628,340</u>	<u>(1,320,634)</u>
Investment:			
Acquisition of fixed assets	Ps. 18,094,915	Ps. 14,366,084	Ps. 8,027,485
Disposal of fixed assets (2)	<u>(1,847,081)</u>	<u>(2,169,913)</u>	<u>(2,100,548)</u>
Net investment at cost in property, wells, plants and transportation equipment under U.S. GAAP	16,247,834	12,196,171	5,926,937
Capitalized exchange loss	<u>1,043,295</u>	<u>20,951,523</u>	<u>21,099,000</u>
Net investment at cost in property, wells, plants and transportation equipment under Mexican GAAP (including capitalized exchange loss and interest)	<u>Ps. 17,291,129</u>	<u>Ps. 33,147,694</u>	<u>Ps. 27,025,937</u>

- (1) The items that are excluded from the determination of cash flows under SFAS No. 95 are: the foreign currency translation gain on accounts receivable, 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 increase in the allowances 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, the net exchange variation and the increase (decrease) in the allowance for doubtful accounts.
- (4) The difference is because for Mexican GAAP purposes the dividends paid to the Federal Government are those approved by the Board of Directors in the year and for US GAAP purposes it is considered the actual cash flow on such dividends.

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Supplemental information for the Statement of Cash Flows:

	1996	1995	1994
Cash payments for interest:	<u>Ps. 6,332,827</u>	<u>Ps. 6,228,703</u>	<u>Ps. 3,635,396</u>

(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 calculation of seniority premium 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 the 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.

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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.47,848,630.

The components of net seniority premium and pension plan cost, calculated in accordance with SFAS No. 87, consist of the following:

	1996	1995	1994
Service cost: benefits earned during the year	Ps.1,094,970	Ps. 937,690	Ps. 894,452
Interest cost on projected benefit obligation	4,632,643	3,778,963	2,800,732
Expected return on plan assets	(380,596)	(303,733)	(216,263)
Net amortization and deferral	189,337	177,664	213,806
Amortization of net transition obligation	1,122,160	1,122,160	1,122,160
Net cost under U.S. GAAP	6,658,514	5,712,744	4,814,887
Net cost under Mexican GAAP	6,644,949	4,591,699	4,033,982
Additional expense that would be recognized under U.S. GAAP	Ps. 13,565	Ps.1,121,045	Ps. 780,905

Actuarial assumptions used in the calculation of net seniority premium and pension plan cost under U.S. GAAP as of December 31 are:

	1996	1995	1994
Discount rate	14.00%	14.00%	13.00%
Rates of increase in compensation levels	11.00%	11.00%	9.00%
Expected long-term rate of return on assets	15.00%	15.00%	13.00%

The combined seniority premium and pension plan liability as of December 31, 1996 and 1995 under SFAS No. 87 is as follows:

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	<u>1996</u>	<u>1995</u>
Actuarial present value of benefit obligations:		
Vested benefit obligation	<u>Ps. 31,358,145</u>	<u>Ps. 23,019,087</u>
Accumulated benefit obligation	<u>Ps. 36,018,219</u>	<u>Ps. 25,478,639</u>
Projected benefit obligation	Ps. 52,284,180	Ps. 34,421,540
Plan assets at fair value	<u>2,866,370</u>	<u>2,537,308</u>
Projected benefit obligation in excess of plan assets	49,417,810	31,884,232
Unrecognized net loss	(10,218,904)	(5,104,952)
Unrecognized transition obligation	(8,977,290)	(10,099,451)
Prior service cost	<u>(9,072,883)</u>	<u>93,834</u>
Accrued liability under U.S. GAAP	21,148,733	16,773,663
Accrued costs recognized in the consolidated balance sheet under Mexican GAAP	<u>18,407,125</u>	<u>14,045,620</u>
Net U.S. GAAP adjustment to seniority premium and pension plan liability	<u>Ps. 2,741,608</u>	<u>Ps. 2,728,043</u>
Additional minimum liability	<u>Ps. 12,003,117</u>	<u>Ps. 6,167,668</u>

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

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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, 1996 and 1995:

	1996			1995		
	<u>Supplemental Payments</u>	<u>Health Services</u>	<u>Total</u>	<u>Supplemental Payments</u>	<u>Health Services</u>	<u>Total</u>
Service cost	Ps.144,372	Ps. 199,294	Ps. 343,666	Ps.145,334	Ps. 189,968	Ps.335,302
Interest cost	1,064,379	1,507,806	2,572,185	966,252	1,199,843	2,166,095
Amortization of actuarial gains	(33,879)	(3,935)	(37,814)	—	—	—
Amortization of transition obligation	<u>418,020</u>	<u>518,346</u>	<u>936,366</u>	<u>418,019</u>	<u>518,346</u>	<u>936,365</u>
Net expense under U.S. GAAP	1,592,892	2,221,511	3,814,403	1,529,605	1,908,157	3,437,762
Expense under Mexican GAAP	<u>1,385,492</u>	<u>697,296</u>	<u>2,082,788</u>	<u>2,400,692</u>	<u>462,862</u>	<u>2,863,554</u>
Additional (less) expense under U.S. GAAP	<u>Ps. 207,400</u>	<u>Ps.1,524,215</u>	<u>Ps.1,731,615</u>	<u>Ps.(871,087)</u>	<u>Ps.1,445,295</u>	<u>Ps.574,208</u>

Actuarial assumptions used in the calculation of other post retirement benefits under U.S. GAAP as of December 31 were:

	<u>1996</u>	<u>1995</u>
Discount rate	14.00%	14.00%
Health Care Cost Trend Rate	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

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benefits by Ps.483,821 and increase the accumulated post retirement benefit obligation by Ps.2,434,110.

The other post retirement benefit liability as of December 31, 1996 and 1995 is as follows:

	1996			1995		
	Supplemental Payments	Health Services	Total	Supplemental Payments	Health Services	Total
Accumulated unfunded post retirement benefit obligation:						
Retirees	Ps.10,171,219	Ps.11,825,611	Ps.21,996,830	Ps.5,604,972	Ps. 8,022,205	Ps.13,627,177
Fully eligible active participants	416,592	249,975	666,567	163,407	195,949	359,356
Other active plan participants	5,609,006	4,529,564	10,138,570	1,834,327	2,551,887	4,386,214
Total	<u>16,196,817</u>	<u>16,605,150</u>	<u>32,801,967</u>	<u>7,602,706</u>	<u>10,770,041</u>	<u>18,372,747</u>
Unrecognized actuarial losses	(1,768,627)	(5,008,245)	(6,776,872)	440,891	(613,532)	(172,641)
Prior service cost and plan amendments	(6,020,265)	(434,527)	(6,454,792)	—	—	—
Unamortized transition obligation	<u>(6,596,667)</u>	<u>(8,192,868)</u>	<u>(14,789,535)</u>	<u>(7,014,687)</u>	<u>(8,711,214)</u>	<u>(15,725,901)</u>
Net post retirement benefit liability: U.S. GAAP	1,811,258	2,969,510	4,780,768	1,028,910	1,445,295	2,474,205
Mexican GAAP	2,474,945	—	2,474,945	1,899,997	—	1,899,997
Net U.S. GAAP adjustment	<u>Ps. (663,687)</u>	<u>Ps. 2,969,510</u>	<u>Ps.2,305,823</u>	<u>Ps.(871,087)</u>	<u>Ps. 1,445,295</u>	<u>Ps. 574,208</u>

d) Leases

During 1996, 1995 and 1994 PEMEX's rent expense under operating leases amounted to Ps.186,902, Ps.333,944, and Ps.152,808, 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, 1996:

	Capital Leases (a)	Operating Leases
1997	Ps.553,993	Ps.130,652
1998	404,391	57,565
1999	369,146	57,565
2000	323,544	40,500
2001	305,744	11,175
Thereafter	2,376,996	1,395
(a) includes Ps.1,718,248 of imputed interest		

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(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, 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
Year ended December 31, 1994:						
Sales:						
Trade	Ps.22,077,722	Ps. 52,168,804	Ps.15,087,506	Ps.5,825,749	Ps. —	Ps. 95,159,781
Intersegment	31,189,834	2,321,090	7,832,679	29,400,252	(70,743,855)	—
Total net sales	53,267,556	54,489,894	22,920,185	35,226,001	(70,743,855)	95,159,781
Income (loss)	5,914,485	(3,703,223)	805,247	241,154	68,596	3,326,259
Depreciation and amortization	3,270,696	1,344,510	1,715,468	287,421		6,618,095
Acquisition of fixed assets	3,408,450	3,359,058	1,150,679	109,298		8,027,485
Total assets	99,604,737	48,222,305	47,358,965	188,490,129	(182,158,069)	201,518,067

(1) The Gas and Petrochemicals segment includes the balances and operations of Pemex - Gas y Petroquímica Básica and Pemex-Petroquímica.

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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:

	1996	1995	1994
United States	Ps. 75,952,838	Ps. 51,273,881	Ps. 22,754,788
Canada, Central and South America	14,019,261	4,693,261	2,455,530
Europe	6,119,519	6,114,277	4,193,959
Far East	5,057,454	3,102,767	1,639,090
TOTAL	Ps. 101,149,072	Ps. 65,184,186	Ps. 31,043,367

(g) Fair Value of Financial Instruments:

In accordance with the requirements of SFAS No. 107 "Disclosures about the Fair Value of Financial Instruments", the following is the disclosure of the estimated fair value of financial instruments, for which it is practicable to estimate that value, as of December 31, 1996 and 1995:

	1996		1995	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Assets:				
Cash and cash equivalents	Ps. 17,999,663	Ps. 17,999,663	Ps. 11,787,227	Ps. 11,787,227
Accounts receivable	32,945,487	32,945,487	21,700,962	21,700,962
Liabilities:				
Accounts payable	11,116,986	11,116,986	7,156,870	7,156,870
Short-term debt	36,028,775	36,015,404	25,555,638	25,409,146
Long-term debt	42,534,638	42,187,719	47,450,214	45,176,316

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

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quotes and, in many cases, the estimated fair values would not necessarily be realized in an immediate sale or settlement of the instrument.

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.

(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, 1994				
Reserves deducted in the balance sheet from the assets to which they apply				
Allowance for uncollectible trade accounts	Ps. 400,726	Ps. 251,921	Ps. —	Ps. 652,647
Allowance for slow-moving inventory and obsolescence	Ps. 1,957,101	Ps. 414,549	Ps. 82,668	Ps. 2,288,982
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	Ps. 24,530	Ps. 15,672	Ps. 661,505
Allowance for slow-moving inventory and obsolescence	Ps. 2,288,982	Ps. 19,775	Ps. 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	Ps. 72,164	Ps. 168,536	Ps. 565,133
Allowance for slow-moving inventory and obsolescence	Ps. 2,245,754	Ps. 3,980	Ps. 108,090	Ps. 2,141,644

(i) Significant Risks and Uncertainties

Environment

The ultimate costs to be incurred in relation to PEMEX's environmental contingencies may exceed the total amounts reserved, since some of the sites are relatively early in the stages of remedial investigation or feasibility. Additional liabilities may be accrued as the assessment work is completed and formal remedial plans are formulated.

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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 has employees that belong to the Union of Petroleum Workers of the Mexican Republic which 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 50% 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 financial condition or liquidity.

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(j) Concentration of Credit Risk

PEMEX is subject to credit risk through trade receivables and short-term cash investments. 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.

16. 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 Statement of Financial Accounting Standards 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.

The supplemental data presented herein reflects information for all of the Company's oil and gas producing activities. Capitalized costs and results of operation presented herein have been prepared in accordance with Mexican GAAP.

Capitalized costs for oil and gas producing activities:

	As of December 31,		
	1996	1995	1994
Proved properties	Ps.156,703,714	Ps.143,129,983	Ps.122,878,079
Construction in progress	7,993,900	5,459,372	4,616,238
Accumulated depreciation and amortization	(66,618,063)	(64,125,769)	(55,815,273)
Net capitalized costs	<u>Ps. 98,079,551</u>	<u>Ps. 84,463,586</u>	<u>Ps. 71,679,044</u>

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Costs incurred for oil and gas property acquisition, exploration and development activities:

	Year Ended December 31		
	1996	1995	1994
Exploration	Ps. 534,373	Ps. 346,808	Ps. 753,695
Development	7,736,793	4,960,684	2,746,362
Total costs incurred	<u>Ps.8,271,166</u>	<u>Ps.5,307,492</u>	<u>Ps.3,500,057</u>

There are no property acquisitions 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.565,379, Ps.964,190 and Ps.846,768 for 1996, 1995, 1994, respectively, that are expensed, under successful efforts, as geological and geophysical exploration expense.

Results of operations for oil and gas producing activities:

	Year Ended December 31,		
	1996	1995	1994
Revenues	<u>Ps.168,586,566</u>	<u>Ps.101,897,278</u>	<u>Ps.53,267,556</u>
Production taxes	114,852,728	71,298,300	32,215,630
Excess-gains taxes	9,559,634	2,898,000	452,455
Production costs (excluding taxes)	19,300,807	13,282,441	9,468,626
Exploration expenses	1,135,302	1,048,147	846,768
Depreciation, depletion and amortization	4,717,994	4,305,436	3,197,645
	<u>149,566,465</u>	<u>92,832,324</u>	<u>46,181,124</u>
Results of operations for oil and gas producing activities	<u>Ps. 19,020,101</u>	<u>Ps. 9,064,954</u>	<u>Ps. 7,086,432</u>

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

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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. Mexico's proved reserves are estimated by PEMEX and IMP, a decentralized public entity, which is, like PEMEX, controlled by the Government.

PEMEX and IMP estimate 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.

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 of offshore reservoirs relating to PEMEX's current review of reserve estimates, as further described after the oil and gas reserves table below.

¹ The reserve estimates are published in PEMEX's *1995 Statistical Yearbook and Memoria de Labores*.

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Crude oil and condensate reserves (including natural gas liquids)^a
(millions of barrels)

	<u>1996</u>	<u>1995</u>	<u>1994</u>
Proved developed and undeveloped reserves			
At January 1	48,796	49,775	50,776
Revisions	702	(129)	1
Extensions and discoveries ^b	176	243	120
Production	(1,201)	(1,093)	(1,122)
At December 31	<u>48,473</u>	<u>48,796</u>	<u>49,775</u>
Proved developed reserves at December 31^c	29,664	30,044	30,158

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 1994 were estimated to be 30,890 million barrels.

Dry natural gas reserves
(billion of cubic feet)

	<u>1996</u>	<u>1995</u>	<u>1994</u>
Proved developed and undeveloped reserves			
At January 1	67,668	68,413	69,675
Revisions	(2,979)	(363)	(228)
Extensions and discoveries ^a	353	666	32
Production ^b	(1,129)	(1,048)	(1,066)
At December 31	<u>63,913</u>	<u>67,668</u>	<u>68,413</u>
Proved developed reserves at December 31^c	30,907	34,734	35,334

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- Descriptions 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 1994 were estimated to be 36,304 billion cubic feet.

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PEMEX is in the process of reviewing its estimates of Mexico's proved reserves, which are being audited by international experts in the field. Beginning in 1996, PEMEX has revised its procedures for estimating reserves to meet the reserve definitions and standards of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers (SPE/SPEE). For Mexico's reserves, the SPE/SPEE proved reserve definition is similar to the proved reserve definition used for U.S. financial reporting. These adjustments were applied to estimates for offshore reservoirs in the two production regions of Campeche Sound in the Gulf of Mexico – the Northeast and the Southwest. The results were audited, and the auditor's February, 1997 letter stated that the revised estimates of oil and gas reserves 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 are reasonable in the aggregate. Based on these same standards, PEMEX is estimating reserves in the remaining production regions of Mexico – the Southern and the Northern regions – which are expected to be published in 1998 and 1999, respectively. 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 Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers, proved reserves for the Northeast and Southwest marine regions, as of December 31, 1996, are estimated to be 17,110 million barrels of oil equivalent. Using other criteria and previous information, PEMEX had estimated its proved reserves for these regions at 27,923 million barrels of oil equivalent.

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 (ii) excluding approximately 17 billion boe of proved undeveloped reserves of the Northern area², and (iii) excluding proved reserves scheduled to be produced after the year 2021.

² Current priorities in PEMEX's investments portfolio will not soon allow development of the reserves of this area.

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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. Futures 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 1996 equaled 39.2% of its revenues in respect of crude oil export sales at prices in excess of US\$13.25 per barrel. For 1997, the excess gains tax applies to prices in excess of US\$14.50 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 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. Furthermore, probable and possible reserves, which may become proved in the future, are excluded from the calculation. To comply with SFAS 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.

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Standardized measure of discounted future net cash flows
(millions of dollars)

	1996	December 31, 1995	1994
Future cash inflows	US\$414,071	US\$384,287	US\$374,967
Future production costs (excluding taxes)	(50,866)	(52,606)	(53,533)
Future development costs	(45,619)	(46,745)	(47,039)
Future cash flows before taxes	317,586	284,936	274,395
Future production-and-excess-gains taxes	(267,183)	(242,884)	(236,188)
Future net cash flows	50,403	42,052	38,207
Effect of discounting net cash flows at 10%	(23,607)	(21,388)	(19,365)
Standardized measure of discounted future net cash flows	<u>US\$ 26,796</u>	<u>US\$ 20,664</u>	<u>US\$ 18,842</u>

Oil and gas prices have declined approximately 23% and 46%, respectively, since December 31, 1996 through May 1997. Had the standardized measure at December 31, 1996 been calculated using oil and gas prices at May 30, 1997, that standardized measure would have approximated 16,573 million dollars.

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To comply with SFAS 69, the next table presents the aggregate standardized measure change for each year and significant sources of variance:

Change in standardized measure of discounted net cash flows
(millions of dollars)

	1996	1995	1994
Sales of oil and gas produced, net of production costs	US\$(20,558)	US\$(15,423)	US\$(13,773)
Net changes in prices and production costs	87,698	10,473	30,903
Extensions and discoveries	1,850	1,555	480
Development cost incurred during the year	2,047	1,228	1,697
Changes in estimated development costs	(2,237)	(2,211)	(2,117)
Reserve revisions, and timing changes	(45,863)	(1,183)	8,540
Accretion of discounted pre-tax cash flows	12,689	11,891	8,621
Net changes in production-and-excess-gains taxes	(29,494)	(6,874)	(28,637)
Aggregate change in standardized measure	<u>US\$ 6,132</u>	<u>US\$ 1,822</u>	<u>US\$ 5,714</u>
Standardized measure			
As of January 1	US\$ 20,664	US\$18,842	US\$ 13,128
As of December 31	26,796	20,664	18,842
Change	<u>US\$ (6,132)</u>	<u>US\$ (1,822)</u>	<u>US\$ (5,714)</u>

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, changes in reserves are calculated at December prices and costs. 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

Area, Population and Society

The United Mexican States ("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* ("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 1.6% in 1997.

Mexico is generally classified as a middle-income developing country and had a per capita GNP (adjusted for purchasing power parity) in 1995 of U.S. \$6,400, compared with U.S. \$26,980 in the United States, U.S. \$7,900 in Venezuela, U.S. \$9,520 in Chile and U.S. \$5,400 in Brazil. Life expectancy at birth in Mexico was 72 years in 1995, compared with 77 years in the United States, 71 years in Venezuela, 72 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 1995 was 33 deaths per 1,000 live births in Mexico, compared with 8 in the United States, 12 in Chile, 23 in Venezuela and 44 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 may never be reelected. 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 camera. 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 six state governorships.

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 *Partido de la Revolución Democrática* (Democratic Revolution Party or "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 (collectively, the "Accords" and 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. On the one hand, the U.S. monetary authorities took measures to increase interest rates in the United States in order to control inflationary pressures in that country. The 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 that resulted from certain of the above-mentioned events 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. Even though the Government was aware of the large current account deficit and the unease of investors, it believed throughout much of 1994 that the real exchange rate remained competitive, particularly given the continued robust growth of exports of manufactured goods and the continued diversification of Mexican exports, and that the factors that had provoked uncertainty among investors were transitory. 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. Demand for foreign

currency resulting from the above factors and the conversion by certain investors of the peso proceeds of maturing Tesobonos increased the pressure on the exchange rate. The value of the peso continued to deteriorate during early 1995, with the peso/dollar exchange rate announced by Banco de México falling to Ps. 7.588 = U.S. \$1.00 on March 13, 1995, a 29.8% decline from its value on December 31, 1994. 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. However, the Mexican Stock Market Index subsequently recovered. See "Financial System—The Securities Markets".

Lower- and middle-income members of society have been especially affected by the economic developments since the end of 1995, 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

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 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.

On May 31, 1995, President Zedillo announced the *Plan Nacional de Desarrollo 1995-2000* (1995-2000 National Development Plan, or the "Development Plan"). The Development Plan addresses five topics: sovereignty, the rule of law, democratic development, social development and economic growth. The objective of the Development Plan is to promote vigorous and sustainable economic growth. Among other things, the Development Plan calls for steps to increase domestic savings, preferences for channeling foreign investment into direct productive investment, the elimination of unnecessary regulatory obstacles to foreign participation in productive activities and further deregulation of the economy. The Development Plan also states that the Government must maintain fiscal discipline over the medium-term and that exchange rate policy should systematically avoid overvaluation of the real exchange rate and should, in concert with other policy instruments, seek to ensure that the evolution of the exchange rate is conducive to price stability. In addition, the Development Plan contemplates various steps to strengthen the rule of law in Mexico, including consolidating and coordinating the activities of various security organizations and police forces in Mexico and intensifying efforts to combat organized crime.

In furtherance of the Development Plan, the Government has promoted increased private investment in electricity generation in order to increase productivity and secure financing for the expansion of generating capacity. Moreover, private investment should contribute to the expansion of the facilities for the transportation, storage and distribution of natural gas and the expansion of the secondary petrochemical industry, while public investment by *Petróleos Mexicanos*, a decentralized public entity of the Government of Mexico, has been concentrated in areas of exploration and production of crude oil, natural gas and refined products.

In September 1995, the Government created the *Fondo de Inversión en Infraestructura* (Infrastructure Investment Fund or the "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. The FINFRA has participated with private investors in over 40 such infrastructure development projects in several states, including Guanajuato, México, Sonora, Tamaulipas and Veracruz.. The FINFRA has a Ps. 1.7 billion capitalization, 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").

On October 29, 1995, the Zedillo Administration announced the establishment of the *Alianza para la Recuperación Económica* (Alliance for Economic Recovery or "ARE"), a new Accord among the Government and the business, labor and agricultural sectors of the economy. The chief objectives of the ARE, which was replaced by the ACE (as defined below), were to stimulate economic recovery and job creation and to strengthen the basis for gradual and sustainable economic growth. These general objectives were intended to be accomplished through (i) the establishment of tax incentives for business aimed at increasing employment and investment in productive activities, (ii) a gradual increase in the prices of public-sector goods and services, (iii) the promotion of consumer spending resulting from increases in employment and private and public investment, (iv) increased exports and (v) the reform of Mexico's pension system, in order to encourage private domestic savings. Key elements of the ARE included: (i) maintenance of the floating exchange rate policy announced in December 1994; (ii) an inflation target for 1996 (December 1995 to December 1996) of 20.5% and a targeted increase in real GDP during 1996 of 3.0%; (iii) a commitment in principle by business to absorb as much as possible cost increases stemming from the raising of prices and fees charged by the public sector within the ARE; (iv) a commitment by representatives of the agricultural sector to improve productivity, profitability and reduce the food trade deficit; (v) a commitment by the government to balance the tax incentives to be given to productive activities and employment with gradual increases in the prices of public-sector goods and

services and a reduction in real terms of 4.7% in public current expenditure with a view to achieving a balanced fiscal budget and (vi) an increase in the minimum wage of 22% (10% in December 1995 and the remaining 12% in April 1996), with other salaries to be negotiated between employers and workers.

As another 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 the most recent 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 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 will increase at monthly rates of 1.03% and 1.2%, respectively, in 1997. The price of electricity for domestic use and agricultural irrigation will increase at a monthly rate of 1.2% in 1997. The price of electricity for industrial use will increase 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. The Government further intends under the ACE to maintain the existing floating exchange rate system. The Government's 1997 economic policy targets embodied in the ACE include a 4% increase in real GDP, a reduction in the rate of inflation to approximately 15%, a public-sector deficit of 0.5% of GDP and a current account deficit of less than 2% of GDP.

On December 31, 1997, the ACE expired. For 1998, the Government has not announced an Accord to replace the ACE; however, on January 1, 1998, the minimum wage was increased by 14.7%. In addition, the Government has 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.

The specific components of the 1995 Economic Plan and subsequent economic initiatives are as follows:

Foreign Exchange Policy. The Government has maintained, and intends to continue to maintain, a floating exchange rate policy, with Banco de México intervening in the foreign exchange market from time to time to minimize volatility and maintain order in the market. From March 1995 through October 1995, Banco de México did not intervene in the foreign exchange market to support the value of the peso. In November 1995, however, 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. The Government has also 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 also intends to introduce futures on the peso/dollar exchange rate, and amendments to its internal rules have already been introduced to permit spot peso-dollar trading. These initiatives are designed to contribute to the Government's efforts to restore confidence in the Mexican economy by providing an important currency risk-management tools for investors. 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).

Fiscal Reform. Fiscal measures have been undertaken to increase the Government's primary balance and promote private-sector savings. The Government increased (effective as of April 1, 1995) the general value-added tax ("VAT") rate from 10% to 15% (except in the Mexico-United States border region and in duty-free zones, where the VAT rate remains at 10%, and except with respect to pharmaceutical products and food, which continue to be subject to a VAT rate of 0%). The Government also increased the amount that could be deducted in respect of depreciation in 1995, a measure which was designed to provide an enhanced incentive for investment. See "Public Finance—Revenues, Taxation and Expenditures".

On July 3, 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 were allowed to restructure such past-due taxes over four years, provided that they joined the support program by October 31, 1996. Restructured amounts were to bear interest at a fixed 30% interest rate until July 1997. 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.

The Government made certain modifications, effective on February 1, 1997, to the taxpayer support program. Under the modified program, all past due amounts may be restructured for a period of up to six years. The effective financing cost on restructured amounts will fluctuate according to an UDI (as defined below) derived index, with a maximum effective financing cost equal to 25% of past due amounts on an annualized nominal basis during the first three years. The period of time given to taxpayers who are in arrears to participate in the support program is being extended to 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 will be entitled to a 5% discount in the amount of taxes owed with respect to the last payment made. The Government anticipates that the cost of the support program, as modified, in lost revenues for 1997 will not exceed Ps. 1.9 billion, which revenue loss is contemplated in Mexico's Federal Revenue Law for 1997.

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. Banco de México's tightening of its monetary policy resulted in a decline in the monetary base from Ps. 56.9 billion at December 31, 1994 to Ps. 50.39 billion at November 24, 1995. Due to seasonal factors, the monetary base increased to Ps. 66.8 billion at December 31, 1995. Nevertheless, net domestic credit decreased by Ps. 77.7 billion from December 31, 1994 to December 31, 1995, which was 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. 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. See "External Sector of the Economy—Balance of International Payments".

An important element of the 1995 Economic Plan was the moderation of the inflationary pressures created by the devaluation of the peso. The Government's restrictive monetary policy was designed to help control inflation. In addition, the Government hoped that businesses would increase prices only in the proportion that products sold in Mexico were comprised of imported components. Nonetheless, the inflation rate (December 1994-December 1995) was 52% during 1995, as compared to 7.1% during 1994.

A 7% nominal increase in the minimum wage took effect on January 1, 1995, and a further 12% nominal increase took effect on April 1, 1995, as compared with the 4% increase agreed in December 1994. Wage increases for workers earning more than the minimum wage have been negotiated between employers and their employees. Under the PARASEE, productivity bonuses were maintained and tax benefits for workers were extended to those earning less than four times the minimum wage (as opposed to twice the minimum wage under the AUSEE). Furthermore, pursuant to the ARE, the Government increased the minimum wage by 22% (10% in December 1995 and 12% in April 1996). Under the ACE, the Government increased the minimum wage by 17% in December 1996. In January 1998, the Government increased the minimum wage by 14.7%.

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. The Government is committed to ensuring depositor safety and, to that end, took a number of interrelated steps. First, the Government established the *Programa de Capitalización Temporal* (Temporary Capitalization Program, or "PROCAPTE"), administered by the *Fondo Bancario de Protección al Ahorro* (Banking Fund for the Protection of Savings, or "FOBAPROA"). PROCAPTE is a voluntary program designed to assist banks with capitalization levels below 8% of risk-weighted assets, and is intended for use by viable banks that are currently or are expected to be facing short-term capital needs. Under PROCAPTE, FOBAPROA advances funds to participating banks in exchange for five-year mandatorily convertible subordinated bonds. Participating banks must deposit with Banco de México the funds raised from the issuance of the bonds, thereby neutralizing any monetary impact. If a participating bank's capital falls below a specified level while the bonds are outstanding, or if the bonds are not repaid prior to their five-year maturity, the bonds will 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 have an incentive to repay the bonds prior to maturity. In the event that FOBAPROA exercises its conversion right, FOBAPROA will sell the shares it receives to the public. Banks benefiting from PROCAPTE must maintain capitalization levels at least equal to 9.0% of their risk-weighted assets (which may decline to 8.5% if the decrease is caused by the creation of general reserves). See "Financial System—Banking Supervision and Support". Second, 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 outstanding as of January 28, 1998.

Amendments to Mexican law have broadened 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. See "Financial System—Banking System". These amendments also grant the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission, or "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.

To reduce the risk of lower asset quality, the CNBV has increased the amount of required loan-loss reserves. The updated CNBV guidelines require minimum loan-loss reserves equal to the greater of 60% of past-due loans and 4% of total loans. The increased reserve requirements are estimated to require an additional Ps. 4.4 billion of reserves. Other measures to strengthen the financial sector include a significant enhancement of the CNBV's supervisory activities through closer and more frequent inspections and heightened reporting requirements. For example, the Mexican accounting treatment of past-due loans has changed in connection with broader revisions to Mexican generally accepted accounting principles, which were aimed at bringing Mexican financial accounting more in line with international practice.

On March 30, 1995, the Government put in place a debt-restructuring support program, designed to help restructure past-due loans of borrowers facing cash-flow constraints. The restructuring program covers five types of 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 are converted into new financial units known as *Unidades de Inversión* (inflation-indexed units of account or "UDIs"), with maturities ranging from five to 12 years. 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. UDIs are designed to mitigate the short-term effect of inflation on borrowers and improve asset quality of banks, although banks retain the asset quality risk associated with restructured loans. Under a UDI-based loan, the borrower's nominal peso principal balance is converted to a 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 are made by special trusts set up by commercial banks for this purpose and are funded through long-term UDI bonds purchased by the Government through Banco de México. The outflow of money to commercial banks is in turn neutralized by the purchase by such banks of Government bonds. The maximum size of the restructuring program was estimated as of October 3, 1997 to be approximately Ps. 274. billion, representing approximately 25% of the total loan portfolio of commercial banks at December 31, 1996.

On April 25, 1997, the Government and commercial banks agreed to modify the UDI program for states and municipalities in order to improve the financial benefits of state and municipal debt restructuring. The changes include an increase in the term, which may be extended up to 12 years longer, lower interest rates and added benefits for prepayments.

Furthermore, 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 covers 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. The subsidized interest rates for existing debt are 38.5% for credit card loans (up to the first Ps. 5,000 of such loans), 34% for personal and consumer loans (up to the first Ps. 30,000 of such loans) and 25% for business loans (up to the first Ps. 200,000 of such loans). Interest rates in respect of the first Ps. 200,000 of mortgage loans which have previously been converted into UDIs are 6.5% in the first year and 8.75% thereafter, and amounts exceeding Ps. 200,000 in respect of mortgage loans are subject to a 10% interest rate. Pursuant to the ADE program, most borrowers with existing loans in good standing will 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 are required to convert their loans into UDIs. In addition, holders of past-due loans are required to sign special agreements to restructure their debts.

Under the ADE program, borrowers in the agriculture sector with existing business loans may 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. 15.0 billion.

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 covers loans restructured through September 30, 1996. Second, payments by mortgage debtors over a 10-year period will be 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 will be allowed to prepay their loans free of penalties and subject to 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 may elect to transfer their mortgaged properties to a trust fund and to pay rent to such trust fund with a repurchase option within a six-year period. The monthly rent will be adjusted according to changes in the value of UDIs and will not exceed 0.9% of the property value. Fourth, loans for the construction or purchase of public housing granted by banks or by the Housing Fund ("FOVI") will be 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 will 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. Payments on loans for the construction or purchase of public housing will be modified according to changes in the minimum wage. The net present value of the fiscal cost of this additional debt restructuring program is estimated to be approximately Ps. 39.2 billion (1.2% of projected GDP for 1997).

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 designed to help borrowers in the agriculture and fishing sector restructure their payment obligations to Mexican banks. The FINAPE program, which took effect on September 1, 1996 and covered loans restructured through December 30, 1996, has three principal features. First, the program covers 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 can elect to convert their loans into UDIs or restructure their debts under the terms and conditions agreed to 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. Buyers who are 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 balances 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 fiscal cost of this program will be approximately Ps. 15.8 billion (0.5% of projected GDP for 1997).

Mechanisms to Strengthen the Micro-, Small- and Medium-Size Business Sector. 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 firms with indebtedness of up to Ps. 6 million. Borrowers from commercial or development banks whose credits were opened before July 31, 1996 will benefit from this program, as will those holders of credits 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. These benefits will last up to 10 years. In the case of revolving credit lines, a program to reduce the interest rate for a maximum period of two years will be implemented. This reduction in interest rates will be between 5% and 22%, depending on the outstanding credit amount. In order to promote micro-, small- and medium-size firms, banking institutions have offered new financing in an amount of Ps. 13 billion; this new financing will supplement the support programs for micro-, small- and medium-size firms sponsored by development banks, which continue in effect.

The Government believes that the fiscal cost of FOPYME will be approximately Ps. 7.8 billion (0.2% of projected GDP for 1997). The banking system will absorb a similar amount.

Structural Reform. The Government expects that increased productivity and competitiveness of the economy will be achieved through deregulation and increased private-sector investment. Constitutional amendments that permit the Government to privatize railways and satellite communications have become effective. Pursuant to those amendments, Congress has enacted legislation that contemplates the auction of 50-year private concessions to operate parts of Mexico's railway system and has, as part of the telecommunications liberalization described below, enacted legislation to provide for the auction of private concessions to operate satellite telecommunications systems. In addition, the Government has announced plans to privatize power-generating plants and secondary petrochemical plants, airports, ports and highways. Congress has also approved amendments to the law applicable to the natural gas industry, which will allow 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. Congress has also enacted 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 would permit foreign and Mexican private-sector investors to purchase up to 49% of existing operations.

As noted above, Congress approved a telecommunications liberalization law on June 7, 1995. Pursuant to this law, upon the expiration in August 1996 of the concession granting a monopoly to Teléfonos de México, S.A. de C.V. ("Telmex") in domestic and international long-distance telephone services in Mexico, 30-year concessions would be granted for the establishment of public telecommunications networks, without payment of a licensing fee. In addition, 20-year concessions for use of portions of the radio spectrum for telecommunications purposes would be auctioned. From October 1, 1995 through May 31, 1997, eight new 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: Avantel, Iusatel, Alestra, Unicom, Investcom, Cableados y Sistemas, and Miditel. See "—The Role of the Government in the Economy; Privatization" below.

Through these measures, as well as the proposed sale by the Government of its 15.7% interest in *Grupo Financiero Bancomer, S.A. de C.V.* ("Bancomer"), one of Mexico's largest financial holding companies, and certain other state-owned institutions, the Government hopes to encourage private investment and to generate substantial privatization revenues.

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").

Pursuant to the Oil Agreement, Petróleos Mexicanos and its sales affiliates instructed their foreign buyers of crude oil and oil derivatives (with certain exceptions) to make payments to designated accounts of Petróleos Mexicanos and its affiliates with a bank in New York and instructed that bank to credit the amounts received to an account of Banco de México at the Federal Reserve Bank of New York ("FRBNY"). Banco de México had the right to withdraw the funds deposited in the FRBNY account so long as there was no payment default by Mexico under the February 21 Agreements or the NAFA. In the event of any such payment default, FRBNY had the right to debit and set-off the funds in the account to repay any amounts due and payable by Mexico under the February 21 Agreements and 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 October 1995, Banco de México repaid U.S. \$700 million to the U.S. Government and U.S. \$83 million to the Canadian Government in respect of short-term swaps under the NAFA that were scheduled to mature on November 1, 1995. On January 29, 1996, Banco de México repaid U.S. \$1.3 billion to the U.S. Government and U.S. \$158 million to the Canadian Government in respect of short-term swaps under the NAFA that matured on that date, and on August 5, 1996, the Government prepaid U.S. \$7 billion of medium-term swaps under the February 21 Agreements. These payments were financed primarily through new capital markets financings by Mexico, including the placement of U.S. \$6 billion of U.S. dollar denominated Floating Rate Notes due 2001 issued by Mexico on August 5, 1996, and by the release of U.S. \$780 million of collateral as a result of the exchange of Mexico's U.S. dollar Collateralized Floating Rate Bonds due 2019 and U.S. dollar Collateralized Fixed Rate Bonds due 2019 for Global Bonds due 2026. The Floating Rate Notes due 2001 were prepaid in full by Mexico on August 6, 1997.

On January 16, 1997, the Government prepaid U.S. \$3.5 billion of medium-term swaps to the U.S. Government, thus extinguishing all obligations of Mexico under the U.S. \$20 billion support facility established by the United States in February 1995.

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 on August 1, 1996.

On January 17, 1997, Banco de México prepaid U.S. \$1.5 billion to the IMF, which had been disbursed under the stand-by program for Mexico established by the IMF in February 1995, to be applied to the amortization schedule for 1998 for repurchase obligations under such program. Neither of these prepayments affected international reserves, primarily because Mexico borrowed sufficient funds in the

international capital markets to refinance such prepayments. However, net international assets increased by U.S. \$1.5 billion as a result of the IMF prepayment. From February through May 1997, Banco de México prepaid an aggregate of U.S. \$1.0 billion disbursed under the IMF stand-by program.

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 October 31, 1997, the Government had borrowed U.S. \$1.41 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. \$90 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. \$16.2 billion at the end of the first quarter of 1995, U.S. \$10.0 billion at the end of the second quarter, U.S. \$2.5 billion at the end of the third quarter and U.S. \$246 million at the end of the fourth quarter. 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 1996, 95.0% of Mexico's external public-sector debt consisted of long-term (i.e., one year or more) maturities, as compared with 69.0% 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 reinstate an intense dialogue and negotiation among the federal and state governments, political parties, 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.

Recent Developments

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, (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 and (v) avoid an economic crisis of the type suffered by Mexico during the past 20 years.

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.

The PRONAFIDE's macroeconomic and fiscal goals are to achieve an average of 5% real GDP growth per year for 1997-2000, to continue to decrease gradually the rate of inflation, to a estimated 7.5% in the year 2000, and to achieve a public-sector economic balance that is close to equilibrium by the year 2000.

On November 7, 1997, the Government arranged a U.S. \$2.5 billion liquidity facility with the international banking community. The facility will permit Mexico to use these funds to meet certain needs in the case of external shocks and the presence of volatility in international capital markets. The term of the liquidity facility is one year, renewable for another year.

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, 1996, the number of Government-owned businesses had been reduced to 185. Between 1982 and December 31, 1996, the Government divested itself of 1,050 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 23.3% in 1996. The importance of subsidies also diminished significantly. See "Public Finance—Government Agencies and Enterprises".

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. This program is to be implemented within a three-year period.

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. See "Principal Sectors of the Economy—Electric Power.

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 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. See "—The Government's Response—Structural Reform" above. 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.

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 September 1997, the Government had granted five 12-year concessions for the construction, ownership and operation of natural gas distribution centers in Chihuahua, Mexicali, Hermosillo, Toluca and Río Pánuco.

Railways and Aviation. 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. On September 30, 1996, the rules for the privatization of each of these new companies were published in the *Diario Oficial de la Federación* (the Official Gazette of the Federation). 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 Ferrovial 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.

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.

Secondary Petrochemicals. On December 13, 1996, *Petróleos Mexicanos* authorized its subsidiary entity, *Pemex—Petroquímica* ("Pemex-Petrochemicals"), to create ten petrochemical companies, which will own the non-basic petrochemical assets of the petrochemical complexes of Cosoleacaque, La Cangrejera, Morelos, Pajaritos, Independencia, Salamanca, 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.

On January 31, 1997, Pemex-Petrochemicals established the first four petrochemical companies at Camargo, Tula, Cosoleacaque and Escolín, on February 28, 1997 it established two additional companies at La Cangrejera and Morelos and on June 25, 1997, it established one additional company at Pajaritos. Pemex-Petrochemicals intends to establish three additional petrochemical companies later this year.

Gross Domestic Product

From 1992 through 1994 real GDP grew at the rates of 3.6%, 2.0% and 4.4%, 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 5.1% in 1996 as compared with 1995. Construction; manufacturing; transportation, storage and communications; and mining, petroleum and gas were the most dynamic sectors of the economy during 1996, growing by 11.4%, 10.9%, 8.7% and 8.3%, respectively, followed by the electricity, gas and water and the commerce, hotels and restaurants sectors, which grew by 4.5% and 4.1% respectively. The financial services, insurance, real estate, community, social and personal services and the agriculture, livestock, fishing and forestry sectors showed lower growth rates, both growing by 1.2% 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 during 1997, growing by 10.2%, 9.9%, 9.8%, and 9.5% in real terms, respectively, followed by the sectors of electricity, gas and water, which grew by 5.8%, financial services, insurance, real estate, community, social and personal services, which grew by 4.6%, 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.

The Government currently projects a 5.0% increase in GDP (in real terms) for 1998.

Prices and Wages

Since 1987, the Government reached a series of Accords with labor and business representatives, each of which continued to stress the moderation of inflation, fiscal discipline and a gradual devaluation of the peso. There was a gradual reduction in the number of goods and services whose prices were covered by such Accords. The two Accords immediately preceding the ACE also incorporated a reduction in the income tax rate applicable to corporations and certain self-employed individuals from 35% to 34% and a reduction in the withholding tax applicable to interest payments on publicly issued external debt and external debt payable to certain financial institutions from 15% to 4.9%. Under the later of these two Accords, tax benefits were proposed for workers receiving salaries not exceeding twice the minimum wage and asset taxes were to be reduced to 1.8%. These policies contributed to lower consumer inflation rates of 51.7% in 1988 to 7.1% in 1994.

The PARASEE and the ARE contained, and the ACE contains, provisions aimed at reducing inflationary forces through wage and price controls. See "—The Government's Response" above.

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. Nonetheless, 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. Inflation during 1997 was 15.7%, as compared with 27.7% during 1996.

Inflation during the first month of 1998 was 2.2%, as compared with 2.6% during the same period of 1997.

The following table shows in percentage terms the changes in price index and the annual increase in the minimum wage for the periods indicated.

Changes in Price Index

	National Producer Price Index(1)	National Consumer Price Index	Increase in Minimum Wage
1992.....	10.6%	11.9%	—
1993.....	4.6	8.0	8.1%
1994.....	9.1	7.1	7.0
1995.....	59.5	52.0	30.8
1996.....	25.5	27.7	31.8
1997.....	10.6	15.7	—
January 1998.....	2.0	2.2	14.7

(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. 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. See "—Events during 1994 and 1995" above. 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 a favorable perception of foreign and domestic investors. However at the end of October 1997, certain external events translated into an increase in volatility in the international scenario, altering temporarily the stability of the national financial markets and provoking fluctuations in 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 52.5% respectively during 1996. On February 24, 1998, the 28-day Cetes rate was 20.06% and the 91-day Cetes rate was 20.58%.

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 <i>Cetes</i>	91-Day <i>Cetes</i>	CPP	TIIP	TIIE
1992:					
January-June	13.8%	13.8%	16.9%	—	—
July-December	17.4	18.0	20.7	—	—
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	44.5
1996:					
January-June	35.4	37.2	34.5	37.3	37.2
July-December	27.4	28.6	26.9	30.2	30.1
1997:					
January-June	20.8	22.1	20.8	23.2	23.2
July-December	18.8	20.3	17.4	20.3	20.6
1998:					
January	18.0	19.4	17.0	19.5	19.7

(1) February-June average.

(2) Average for the last two weeks of March.

Source: Banco de México.

Employment and Labor

Between 1990 and 1994, the growth of the Mexican economy created new jobs in the industrial and commercial sectors at an estimated compound annual rate of 0.7%, but the even more rapid growth of the population entering the labor force and lower employment growth rates in certain other sectors of the economy have precluded a significant reduction in unemployment and underemployment. Over the past five years, the number of workers enrolled in the Government's social security system increased by approximately 0.7 million. (Since workers are required by law to enroll in the social security system upon becoming newly employed, this statistic is a measure of employment growth.)

A significant number of Mexican workers were unemployed as a result of the economic events during 1994 and 1995. See "—The Economy—Events During 1994 and 1995." Mexico's entry into GATT and, more recently, the implementation of 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.

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. Nevertheless, unemployment is particularly widespread in rural areas, where approximately 26.5% of the population resides. 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% of total working days were lost due to strikes during 1995 and 1996.

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 10% in December 1995 and 12% in April 1996. Under the ACE, the minimum wage increased 17% in December 1996.

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 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 will have the right to solicit individual Mexican workers to deposit savings in their licensed funds but will not collect money until July, when the new Social Security law takes effect. Beginning on July 1, 1997, the AFORES will commence operations and will be permitted to invest contributions in SIEFORES. Voluntary contributions will be invested through the AFORES beginning July 1, 1997, and mandatory contributions will be invested through the AFORES beginning 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 December 31, 1997, funds totaling approximately Ps. 115.0 billion had been deposited in the new pension and housing funds, with Ps. 47.9 billion of such amount corresponding to deposits in workers' retirement sub-accounts and Ps. 67.1 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 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, 1996, had assets of Ps. 275.4 billion (U.S. \$35.1 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 strengthens 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,						
	1992	1993	1994	1995	1996	1997(1)
	(in millions of nominal pesos)					
M1						
Notes and coins	Ps. 38,012	Ps. 43,228	Ps. 51,870	Ps. 60,655	Ps. 74,091	Ps. 94,585
Checking deposits in domestic currency	84,478	101,214	94,163	88,951	134,731	180,790
in foreign currency	3,981	4,469	8,486	15,762	23,856	32,916
Total M1	Ps. 126,471	Ps. 148,911	Ps. 154,519	Ps. 165,367	Ps. 232,678	Ps. 308,291
M4	Ps. 464,472	Ps. 587,735	Ps. 729,091	Ps. 880,053	Ps. 1,166,200	Ps. 1,505,883

Note: Totals may differ due to rounding.

(1) Preliminary.

Source: Banco de México.

1995 Monetary Program. As a result of the strict control over the money supply, the monetary aggregate M1 registered a real annual contraction of 29.7% at the end of 1995. This decrease followed the real annual decrease of 38% 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, the M4 monetary aggregate showed a reduction of 20.6% in real terms. As a proportion of GDP, M4 fell from 58.2% in 1994 to 55.7% in 1995. This 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 nominal growth rate of M4 (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), after eliminating the impact of exchange rate variations on dollar-denominated stocks, was 15.1% in 1995. The stock of government securities decreased by 55.7%.

1996 Monetary Program. The aggregate amount of the M1 money supply at December 31, 1996 was Ps. 232,678 million an increase in real terms of 10.2% over the 1995 level. Of this amount, Ps. 74,091 million corresponded to notes and coins, Ps. 134,731 million to checking deposits in domestic currency and Ps. 23,856 million to checking deposits in foreign currency. As of the same date, the aggregate amount of the M4 money supply was Ps. 1.166 billion, an increase in real terms of 3.8% 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 such amount was zero, monetary policy would achieve neutrality. If such amount was negative, it was said that Banco de México had left the monetary system "short". By leaving the system in a "short" monetary position, the central bank exercised a certain upward influence on interest rates. If such amount was positive, it was said that Banco de México had left the monetary system "long", which promoted a decline in interest rates and implied that the central bank was operating with an objective of negative accumulated balances. In this case, the central bank could adopt this stance in order to combat disorderly conditions in the money and foreign exchange markets, or to help ensure that the evolution of the monetary base would not show undesirable deviations in relation to a path consistent with the assumed inflation rate. The application of the foregoing monetary program (the "1997 Monetary Program") led to a decrease in the inflation rate, from 27.7% in 1996 to 15.7% in 1997.

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% over the amount registered at the end of 1996. The *Junta de Gobierno* (the "Governing Council") of the Banco de México believes that such 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. As of 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 the 1997 Monetary Program. This significant accumulation resulted from the application of a program for the purchase of foreign currencies through an options mechanism that entitles banking institutions to sell U.S. dollars to the Banco de México, when certain conditions are met.

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 monetary restriction.

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.

At December 31, 1997 the monetary base totaled Ps. 108.891 billion, representing a real increase of 12.0% as compared to December 31, 1996. As a result of the improvement in economic activity and the decrease in inflationary expectations, the monetary aggregate M1 showed positive growth in real terms. M1 grew at an annual rate of 14.5% in real terms in 1997, an increase of 4.3% with respect to the level at December 31, 1996. As of the same date, the aggregate amount of the M4 money supply was Ps. 1,505 billion, an increase in real terms of 11.6% over the 1996 level.

1998 Monetary Program. Banco de México's 1998 monetary program (the "1998 Monetary Program") has been 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. Under these circumstances, the 1998 Monetary Program relies on three basic elements:

Banco de México will adjust the supply of primary money on a daily basis, such that this supply satisfies the demand for monetary base, 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, taking into consideration an 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.

Banco de Mexico will continue making efforts to facilitate the continuing operation of its programs, the communication of its objectives in an efficient and timely manner, the use of its available instruments and the achievement of the 1998 Monetary Program in general. Additionally, the Banco de México shall remain responsive to any sudden changes in the economic environment that may have adverse effects on the Mexican economy.

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 public service of banking and credit. 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.

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.) At December 31, 1996, the foreign currency-denominated liabilities of Mexican commercial banks totaled approximately U.S. \$19.4 billion, of which U.S. \$12.0 billion had a maturity of 365 days or longer. The peso-denominated equity of Mexican banks is now a proportionately smaller percentage of their total assets by comparison to the period immediately preceding the devaluation of the peso, and, as a result, certain banks have had difficulty meeting required capital adequacy levels.

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.

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, 1996, (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, 18 commercial banking institutions, 15 securities firms, 18 insurance companies, 11 limited-scope financial institutions, 12 financial leasing companies, five factoring companies, two bonding companies and one 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 and one commercial bank; and (d) the Ministry of Finance and Public Credit had announced the receipt of, but had not yet acted upon, applications for the establishment of one financial leasing company, one insurance company and two foreign exchange houses.

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, 1996, the Ministry of Finance and Public Credit had approved applications for the establishment of 17 new banks, and had issued "favorable opinions" with respect to two additional applications for the establishment of 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, 1996, twenty-five 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, Banobras and *Banco Nacional de Comercio Interior, S.N.C.* ("Banci"). 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. The principal activities of Banci include the promotion and financing of national and regional economic development, particularly in the areas of commerce and the distribution and supply of goods.

Under the laws establishing NAFIN, Bancomext, Banobras and Banci, 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.

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.

In February 1995, Banco de México adopted PROCAPTE, a voluntary program for strengthening the capital of commercial banks that, by virtue of conditions prevailing in the financial markets, were unable to comply with regulatory capitalization requirements. See "The Economy—The Government's Response—Mechanisms to Strengthen the Stability of the Banking Sector". PROCAPTE consists principally of an undertaking by the trust that handles Mexico's bank insurance fund, FOBAPROA, to purchase subordinated debt instruments of commercial banks that qualify for PROCAPTE. The instruments will mature on March 31, 2000, and will be mandatorily convertible at the option of FOBAPROA into Series "A" or Series "B" shares of the issuing institution in the circumstances described below. During the term of PROCAPTE, each participating bank is required to maintain a capitalization coefficient of 9%, which may decline to 8.5% if the decrease is caused by the creation of general reserves. FOBAPROA may not exercise the conversion right before March 31, 2000, unless the basic net capital of the institution (apart from amounts corresponding to the subordinated obligations) falls below 2% of risk-weighted assets. After March 31, 2000, FOBAPROA may exercise the conversion right at its discretion. In deciding whether to exercise its conversion right, FOBAPROA is required to take into account the financial situation of the institution, including the rating of its portfolio, the amount of its reserves and provisions, the risks it may have incurred, the amount of its capital apart from amounts corresponding to the subordinated obligations, and its adherence to the program established to recapitalize it. If, during the term of the obligation, the financial situation of the bank is healthy, FOBAPROA undertakes not to exercise its conversion right. If it does exercise the conversion right, FOBAPROA will sell the shares it receives to the public. The issuing institution may at any time during the term of the subordinated debt instruments purchase all or any portion of them back from FOBAPROA, as long as it does so by raising capital to effect the purchase, through the issuance either of new shares or other mandatorily convertible subordinated obligations, such that the institution will maintain 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 loans reached Ps. 7,008 million. In February of 1997, Banco del Centro S.A., the last bank participating in PROCAPTE, liquidated its total participation that equaled Ps. 810.1 million. Such liquidation concludes the Program.

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 acknowledgment 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.

In the third quarter of 1997, and in accordance with the new accounting criteria applicable to credit institutions as of the beginning of 1997, the level of past-due loans of commercial banks (without banks under Government intervention or those in special situation) was of Ps. 98,776 million. Nevertheless, past-due loans decreased in certain credit institutions, primarily due to the write-offs or loans, the progress made in restructurings, and the continued effort to recover them. The past-due loans ratio of commercial banks was 12.8% in the third quarter, 20 basis points lower than the level of the second quarter of 1997.

The amount of loan loss reserves created by commercial banks (excluding intervened banks and those in special situation) reached a total of Ps 57,511 million. With this level, the commercial banks have reserves covering 58.2% of their past-due loans, figure greater than 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(2)		March 31, 1997	
	(% of total)		(% of total)		(% of total)		(% of total)		(% of total)	
					(in billions of pesos)					
Agriculture, mining, forestry and fishing....	Ps. 44.1	8%	Ps. 56.5	6%	Ps. 59.9	5%	Ps. 71.0	6%	Ps. 66.1	5%
Energy.....	3.5	1	5.9	1	7.0	1	7.4	1	7.2	1
Industry.....	84.3	14	122.1	14	146.3	13	162.9	13	163.5	13
Services and other activities	182.9	31	274.4	32	292.0	26	246.3	20	227.8	18
Commerce	86.7	15	128.9	15	140.2	12	145.2	12	141.1	11
Government	72.5	12	127.8	15	212.0	19	239.7	19	235.6	19
Total, including others	Ps.583.5	100%	Ps.872.3	100%	Ps.1,129.2	100%	Ps.1,231.2	100%	Ps. 1,239.4	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 declined significantly from 1990 to 1993, freeing up capital for private investment, but increased from 12.0% of total credit to 19.0% of total credit from 1993 to 1996.

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, domiciled 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 January 29, 1997, 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* (legal persons, such as corporations, partnerships and trusts, that are not individuals) 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 per-shareholder limits will not apply to any foreign financial institution that, in accordance with a program to acquire a Mexican-owned securities firm that has been approved by the Ministry of Finance and Public Credit, acquires shares of that securities firm.

The market capitalization of the Mexican Stock Exchange was U.S. \$106.8 billion at the end of 1996, representing an increase of 17.4% from its year-end 1995 level. The value of transactions on the Mexican Stock Exchange reached U.S. \$46.6 billion in 1996, representing a 7.1% increase over the 1995 level. Fixed income securities (*i.e.*, commercial paper, notes, bonds and ordinary participation certificates) accounted for 6.0% and variable-income securities (*i.e.*, shares and certificates of patrimonial contribution or CAPs) accounted for the remaining 94.0% 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 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 12.6% in nominal peso terms and 14.5% in real terms from the end of 1997 to the end of January 1998.

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 1996, approximately 98.6% of tariff items and 93.1% 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)

	1992	1993	1994	1995	1996(2)	1997(2)
	(in millions of dollars, except average price of Mexican oil mix)					
Merchandise exports (f.o.b.)						
Oil and oil products.....	\$ 8,307	\$ 7,418	\$ 7,445	\$ 8,423	\$ 11,654	\$ 11,323
Crude oil.....	7,420	6,485	6,624	7,420	10,705	10,334
Other.....	887	933	821	1,003	949	989
Non-oil products.....	37,889	44,468	53,438	71,119	84,346	99,108
Agricultural.....	2,112	2,505	2,678	4,016	3,592	3,828
Mining.....	356	278	357	545	449	478
Manufactured goods.....	35,421	41,685	50,402	66,558	80,305	94,802
In-bond industry.....	18,680	21,853	26,269	31,103	36,920	45,166
Other.....	16,741	19,832	24,132	35,455	43,385	49,637
Total merchandise exports.....	46,196	51,886	60,882	79,542	96,000	110,432
Merchandise imports (f.o.b.)						
Consumer goods.....	7,744	7,842	9,510	5,335	6,657	9,326
Intermediate goods.....	42,830	46,468	56,514	58,421	71,890	85,366
In-bond industry.....	13,937	16,443	20,466	26,179	30,505	36,332
Other.....	28,893	30,025	36,048	32,242	41,385	49,034
Capital goods.....	11,556	11,056	13,322	8,697	10,922	15,116
Total merchandise imports.....	62,129	65,367	79,345	72,453	89,469	109,808
Trade balance.....	\$ (15,934)	\$ (13,481)	\$ (18,464)	\$ 7,089	\$ 6,531	\$ 624
Average price of Mexican oil mix(3).....	\$ 14.88	\$ 13.20	\$ 13.88	\$ 15.70	\$ 18.94	\$ 16.54

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. \$84.3 billion (or 87.9% of total merchandise exports including in-bond industries) in 1996. During the period from 1992 through 1996, non-oil exports, including in-bond industries, grew at a compound annual rate of 20.1%.

In recent years, the composition of Mexico's non-oil exports has also changed. In 1996, U.S. \$80.3 billion (or 95.2%) 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 60.9% in 1996.

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. \$0.88 billion in 1990, U.S. \$7.28 billion in 1991, U.S. \$15.93 billion in 1992, 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 economic crisis led to a rapid turnaround in its trade balance in 1995 as the dollar value of exports grew 30.6% and imports decreased 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 20.7%, while 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.

Mexico registered a surplus in its trade balance of U.S. \$624 million during 1997, as compared with a trade surplus of approximately U.S. \$6,531 million during 1996. Merchandise imports during 1997 increased at an annual rate of 22.7%, as compared with an increase of 23.5% during 1996. Of the three categories of merchandise imports, imports of intermediate goods increased by 18.7% while imports of capital goods increased by 38.4%, and consumer goods increased by 40.1%. Merchandise exports totaled U.S. \$110.4 billion in 1997 as compared with U.S. \$96.0 billion in 1996. Petroleum exports decreased by 2.8% in 1997, while non-petroleum exports increased by 17.5%. Exports of manufactured goods, which represented 85.8% of total merchandise exports, increased by 18.1% during 1997, as compared with an increase of 20.7% during 1996.

Geographic Distribution of Trade

The United States is Mexico's most important trading partner. In 1996, trade with the United States accounted for approximately 84.0% of total exports and 76.0% of total imports.

During 1996, the most important markets for Mexican exports were as follows: the United States, representing 84.0% of exports, Canada, representing 2.3% of exports, Japan, representing 1.4% of exports, Spain, representing 1.0% of exports, Germany, representing 0.7% of exports and France, representing 0.4% of exports. The majority of Mexican imports originated in the United States (76.0% of imports), followed by Japan (4.4% of imports), Germany (3.6% of imports), Canada (2.0% of imports), France (1.1% of imports) and Spain (0.7% of imports).

Thus, taking both exports and imports into account, the United States continues to be Mexico's largest trading partner, followed by Japan, Canada, Germany, France and Spain.

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 was signed in June 1994 and a similar agreement with Bolivia was signed in September 1994; both agreements 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 February 18, 1992, Mexico and France signed a Framework Agreement for Cooperation that aims to encourage bilateral cooperation through increased trade and investment, and on November 18, 1993, Mexico was admitted as a member of the Asian Pacific Economic Cooperation Association.

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 1996 that number had increased to 728. More than half the value added by in-bond industry is in the production of auto parts, transportation equipment and electronic products.

At September of 1997, the number of in-bond plants totaled 2,793, which together employed approximately 939,532 workers. Net revenues from maquiladora operation in the first nine months of 1997 totaled U.S. \$6,361 million, an increase of 39.8% as compared with the same period of 1996.

Balance of International Payments

From 1983 to 1987, the current account of the balance of payments was in a surplus position, with the exception of 1986, due to a sharp fall in oil prices, which more than halved oil exports from U.S. \$14.8 billion in 1985 to U.S. \$6.3 billion. In 1988, 1989 and 1990, the current account showed deficits of U.S. \$2.4 billion, U.S. \$5.8 billion and U.S. \$7.5 billion, respectively, due primarily to the increase in private-sector imports and the Government's trade liberalization policies. Mexico recorded current account deficits of 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. \$29.6 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 "—Events During 1994 and 1995". The current account deficit was U.S. \$1,579 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) and to positive tourism balance on non-factors services recorded under the item of international travels.

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. The capital account included U.S. \$11.0 billion of direct foreign investment in 1994. 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. Direct foreign investment during 1995 totaled U.S. \$9.5 billion.

During 1996, Mexico's current account registered a negative balance of U.S. \$1,922 million, as compared with a deficit of U.S. \$1,577 million in the same period of 1995. The capital account surplus for 1996 was U.S. \$3,323 million. Direct foreign investment during 1996 totaled U.S. \$7,619 million.

According to preliminary figures during 1997, Mexico's current account registered a deficit of U.S. \$7,315 million, as compared with a deficit of U.S. \$1,922 million in 1996. The capital account surplus for 1997 was U.S. \$14,373 million. Direct foreign investment during 1997 totaled U.S. \$12,101 million.

The following table sets forth Mexico's balance of payments for the periods indicated:

Balance of Payments

	1992	1993	1994	1995	1996(1)	First nine months of 1997(1)
(in millions of dollars, except average price of Mexican oil mix)						
I. Current Account(2)	\$ (24,438)	\$ (23,399)	\$ (29,662)	\$ (1,577)	\$ (1,922)	\$ (4,005)
Credits	61,669	67,752	78,372	97,029	115,494	96,384
Merchandise exports (f.o.b.)	46,196	51,886	60,882	79,542	96,000	80,659
Non-factor services	9,192	9,419	10,301	9,665	10,779	8,600
Tourism	6,085	6,167	6,364	6,179	6,934	5,673
Others	3,107	3,252	3,938	3,486	3,845	2,927
Factor Services	2,876	2,790	3,367	3,828	4,154	3,254
Interest	2,160	2,048	2,700	3,018	3,307	2,661
Others	716	742	667	810	847	593
Transfers	3,406	3,657	3,822	3,995	4,561	3,871
Debits	86,107	91,152	108,034	98,606	117,416	100,389
Merchandise imports (f.o.b.)	62,129	65,367	79,346	72,453	89,469	78,814
Non-factor services	11,488	11,550	12,270	9,001	10,231	8,549
Insurance and freight	2,084	2,181	2,640	1,975	2,510	2,372
Tourism	6,107	5,562	5,338	3,171	3,387	2,725
Others	3,297	3,807	4,292	3,856	4,334	3,453
Factor services	12,471	14,219	16,378	17,117	17,686	13,011
Interest	9,611	10,934	11,807	13,575	13,493	9,387
Others	2,860	3,285	4,571	3,542	4,193	3,624
Transfers	19	16	40	35	30	15
II. Capital Account	26,419	32,482	14,584	15,406	3,323	10,572
Liabilities	20,867	36,085	20,254	22,763	9,779	7,649
Loans and deposits	(1,567)	2,777	1,100	22,952	(11,994)	(8,887)
Development banks	1,175	194	1,329	959	(1,246)	(915)
Commercial banks	295	3,328	1,471	(4,982)	(1,520)	(2,769)
Banco de México	(460)	(1,175)	(1,203)	13,333	(3,524)	(3,293)
Non-financial public sector	(4,705)	(2,402)	(1,690)	10,493	(7,672)	(4,875)
Non-financial private sector	2,129	2,832	1,193	3,149	1,968	2,965
Foreign investment	22,434	33,308	19,155	(188)	21,772	16,536
Direct	4,393	4,389	10,973	9,526	7,619	9,955
Portfolio	18,041	28,919	8,182	(9,715)	14,154	6,581
Equity Securities	4,783	10,717	4,084	519	2,995	3,533
Debt securities in pesos	8,147	7,406	(2,225)	(13,860)	908	996
Public sector	8,147	7,013	(1,942)	(13,791)	949	967
Private sector	0	393	(283)	(69)	(41)	29
Debt securities in foreign currency	5,111	10,797	6,324	3,626	10,251	2,052
Public sector	1,552	4,872	3,980	2,994	8,909	(1,620)
Private sector	3,559	5,925	2,344	632	1,342	3,671
Assets	5,552	(3,603)	(5,670)	(7,358)	(6,456)	2,924
III. Errors and Omissions	(961)	(3,142)	(3,314)	(4,238)	373	375
IV. Change in net international reserves(3)	1,008	5,983	(18,389)	9,593	1,768	6,933

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.

The current account deficit in 1994 exceeded the capital account surplus, leading to a decline in international reserves. By December 31, 1994, the level of Mexico's international reserves was U.S. \$6.148 billion, as compared with U.S. \$24.538 billion at the end of 1993. However, such reserves increased again in 1995 by U.S. \$9.6 billion and totaled U.S. \$15.741 billion.

On December 31, 1996, Mexico's international reserves totaled U.S. \$17,509 million. On December 29, 1995 and December 31, 1996, net international assets of Banco de México totaled U.S.

\$(35) million and U.S. \$5,829 million, respectively. On February 20, 1998, Mexico's international reserves totaled U.S. \$28,442 million, and net international assets of Banco de México totaled U.S. \$20,162 million, respectively.

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 boost its international reserves each month by auctioning rights to sell U.S. dollars to Banco de México. This initiative was announced by Banco de México at the same time that it outlined its 1996 Monetary Program. Under the program, Banco de México currently auctions at the end of each month a total of U.S. \$250 million in selling rights (the plan originally envisioned a total of U.S. \$130 million per month but this amount was increased twice in 1996 and once in August 1997, however, the plan's amount was recently 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 the immediately preceding day. That exchange rate, however, may not be higher than its previous 20-day average calculated to the moment an auction winner exercises its option. The first auction took place on August 7, 1996.

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 aims 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 and January 12, 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)	Net International Assets(2)(3)
	(in millions of dollars)	
1992	\$18,554	—
1993	24,538	—
1994	6,148	—
1995	15,741(4)	\$ (35)
1996	17,509(4)	6,313
1997	28,003(4)	20,269
February 20, 1998	28,442(4)	20,162

(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) Beginning in 1991, total international reserves are calculated net of foreign exchange liabilities of Banco de México with a tenor of six months or less.

(4) Banco de México has begun 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 1996, direct foreign investment in Mexico notified to the NFIC and National Foreign Investment Register ("NFIR") totaled U.S. \$5.6 billion (including temporary net imports of machinery and equipment of the in-bond industry). Total accumulated direct foreign investment in Mexico for the period 1994-1996, including new foreign investment projects authorized by the NFIC and NFIR, amounted to approximately U.S. \$23.4 billion. Of the total direct foreign investment accumulated for the 1994-1996 period, excluding that in securities, 58.5% has been channeled to industry, 28.8% to services, 11.5% to commerce, 1.1% to mining and 0.2% to agriculture and fishing.

During 1996, net foreign investment in Mexico, as recorded in the balance of payments, totaled U.S. \$21.8 billion, which was comprised of direct foreign investment of U.S. \$7.6 billion and U.S. \$14.2 billion in portfolio investment.

The following table shows, by country of origin, direct foreign investment in Mexico notified in 1996 and the cumulative totals from 1994 through December 31, 1996.

Direct Foreign Investment(1)(2)

	Direct Foreign Investment Notified in 1996		Cumulative Total	
	(in millions of dollars)			
United States	\$3,723.9	66.0 %	\$13,066.6	55.8 %
United Kingdom	59.2	1.0	855.3	3.7
Germany	162.7	2.9	1,010.6	4.3
Japan	94.7	1.7	982.4	3.8
Switzerland	66.8	1.2	320.5	1.4
France	69.8	1.2	275.5	1.2
Netherlands	325.0	5.8	1,743.6	7.4
Spain	40.4	0.7	221.1	0.9
Canada	493.2	8.7	1,389.0	5.9
Sweden	60.2	1.1	130.6	0.6
Italy	17.6	0.3	30.4	0.1
Others	532.6	9.4	3,492.6	14.9
Total	<u>\$5,646.1</u>	<u>100.0%</u>	<u>\$23,418.2</u>	<u>100.0%</u>

Note: Totals may differ due to rounding.

(1) Excluding portfolio investment. The direct foreign investment corresponds to the notified investment by the NFIR and to 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: NFI

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. The average differential between the rates was 1.7% in 1988, 1.2% in 1989, 1.1% in 1990 and 0.3% at November 10, 1991. 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 peso/dollar exchange rate 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 attributed 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 "—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, 1994, 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 "—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. The peso/dollar exchange rate fell to a low for the year of Ps. 8.14 = U.S. \$1.00 on November 13, 1995. 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 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 February 18, 1998 (to take effect on the second business day thereafter) for the payment of obligations denominated in dollars and payable in pesos was Ps. 8.5427 = 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 average daily and end-of-period exchange rates announced by Banco de México for the payment of obligations denominated in currencies other than pesos and payable within Mexico.

Exchange Rates

Year	Representative Market Rate	
	End-of-Period	Average
1992	3.115	3.095
1993	3.106	3.115
1994	5.325	3.375
1995	7.643	6.419
1996	7.851	7.598
1997	8.083	7.918
January 1998	8.360	8.179

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.

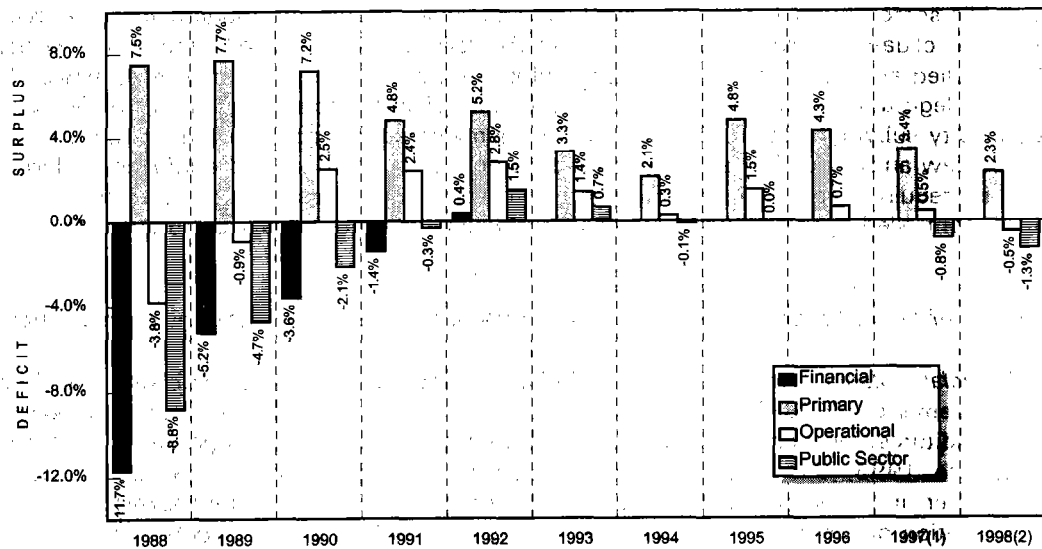
Under the Constitution, no payment may be made by any ministry or budget-controlled agency unless it is included in the Federal Expenditure Budget or approved under a law subsequently passed by Congress. However, under the Federal Expenditure Budget for 1998 and the Federal Annual Revenue Law for 1998, 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 General 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 in a moderate public-sector deficit;
- continuing the promotion of the fiscal federalism; and
- increasing the efficiency and competitiveness of the economy and the effectiveness of the tax collection system.

See "The Economy—Government's Response".

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.
- consolidate the basis of 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 Government's 1998 budget (the "1998 Budget"), as approved by the Congress in December 1997, are to strengthen the conditions for a 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, as well as through public investment. The 1998 Budget stresses careful management of public finance, macroeconomic stability, structural adjustment and modernization of the economy. During 1998, expenditures related to recent pension reforms will total approximately 1.47% of GDP. Nonetheless, the 1998 Budget projects a public-sector deficit of 1.25% 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 is in response to the expected decrease in revenues due to the decrease in oil prices in international markets. This precautionary measure is intended to prevent any increase in the public deficit, which is expected to equal 1.25% of 1998 GDP. The reduction will be reflected in the Government's ordinary and investment expenditures. The decrease in ordinary expenditures will likely limit the creation of new jobs and will 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. No changes in the 1998 Budget with respect to the Government's welfare programs and the federal contributions to states and municipalities are expected.

The assumptions and targets underlying the 1998 Budget embodied in the *Crterios Generales de Poltica Econmica* ("General Economic Policy Guidelines for 1998"), results for 1996 and preliminary results for 1997 are set forth below:

1996 and Preliminary 1997 Results; and 1998 Budget Assumptions and Targets

	1996 Results	Preliminary 1997 Results	1998 budget
Real GDP growth	5.1%	7.0%	5.0%
Increase in NCPI.....	27.7%	15.7%	12.0%
Average export price of Mexican oil mix.....	\$18.94/barrel	\$16.54/barrel	\$13.5/barrel
Current account deficit as % of GDP	(0.6%)	(1.8%)	(2.49%)
Average exchange rate	Ps. 7.598/\$1.00	Ps. 7.918/\$1.00	Ps. 8.74/\$1.00
Average rate on 28-day <i>Cetes</i>	31.4%	19.8%	18.71%
Public sector balance as % of GDP	(0.02%)	(0.76%)	(1.25%)
Primary balance as % of GDP	4.3%	3.42%	2.32%

Source: Ministry of Finance and Public Credit.

During 1996, budgetary public-sector expenditures exceeded budgetary public-sector revenues (excluding off-budget revenues and expenditures of the public sector) by approximately Ps. 3.3 billion in nominal terms, or approximately Ps. 1.7 billion in constant pesos with purchasing power as of December 31, 1993, a decrease of 0.3% in real terms over the deficit registered in 1995. The public-sector primary surplus was approximately Ps. 109.6 billion in nominal terms, or approximately Ps. 55.7 billion in constant 1993 pesos, a decrease of 5.9% in real terms over the surplus registered in 1995. The public-sector surplus during 1996 was approximately Ps. 0.3 billion in nominal terms, or approximately Ps. 0.1 billion in constant 1993 pesos.

During 1997, budgetary public-sector expenditures exceeded budgetary public-sector revenues (excluding off-budget revenues and expenditures of the public sector) by approximately Ps. 21.6 billion in nominal terms, or approximately Ps. 9.2 billion in constant pesos with purchasing power as of December 31, 1993. The public-sector primary surplus was approximately Ps. 110.1 billion in nominal terms, or approximately Ps. 47.0 billion in constant 1993 pesos, a decrease of 16.7% in real terms over the surplus registered in 1996. The public sector deficit during 1997 was approximately Ps. 24.5 billion in nominal terms, or approximately Ps. 10.5 billion in constant 1993 pesos.

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, 1996 and preliminary information for 1997.

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
	(In millions of pesos)(2)									
1 Budgetary revenues.....	Ps.290.7	23.1%	Ps.302.6	23.1%	Ps.290.1	23.6%	Ps. 295.2	22.8%	Ps.312.1	22.7%
Federal Government	160.0	12.7	201.3	15.3	194.0	15.8	199.6	15.4	215.0	15.6
Public enterprises and agencies.....	130.7	10.4	101.3	7.7	96.1	7.8	95.7	7.4	97.0	7.1
Budgetary public sector outlays	282.2	22.5	306.8	23.4	292.3	23.7	296.9	23.0	321.3	23.3
(a) Budgetary primary expenditures (excluding interest payments).....	248.8	19.8	276.0	21.0	233.6	19.0	240.7	18.6	265.9	19.3
Programmable	207.4	16.5	232.5	17.7	195.7	15.9	201.4	15.6	220.0	16.0
Non-programmable	41.4	3.3	43.6	3.3	37.9	3.1	39.3	3.0	45.9	3.3
(b) Interest payments (budgetary sector)	33.3	2.7	30.8	2.3	58.7	4.8	56.2	4.4	55.4	4.0
Budgetary primary surplus (1-2(a))	41.9	3.3	26.6	2.0	56.5	4.6	54.5	4.2	46.2	3.4
Off-budgetary primary surplus	0.1	0.0	0.9	0.1	2.9	0.2	1.2	0.1	0.9	0.0
Total primary surplus (3 + 4)	42.0	3.3	27.5	2.1	59.4	4.8	55.7	4.3	47.0	3.4
	33.6	2.7	31.0	2.4	58.9	4.8	56.3	4.4	55.5	4.0
	0.2	0.0	1.9	0.1	(0.6)	(0.1)	—	0.0	—	0.0
9. Financial intermediation	8.2	0.7	(1.6)	(0.1)	(0.1)	(0.1)	0.1	0.0	(10.5)	(0.8)
10. Financial balance (total public-sector borrowing requirement) (on a cash basis) (8 + 9)	—	—	—	—	—	—	—	—	—	—

Note: Totals may differ due to rounding.

(1) Preliminary.

(2) Constant pesos with purchasing power at December 31, 1993.

Source: Ministry of Finance and Public Credit.

Revenues, Taxation and Expenditures

Revenues. Fiscal measures have been taken to increase the Government's primary balance and promote private-sector savings. As part of the PARAUSEE and the ARE, the Government has increased the prices of goods provided by the public sector to reflect international price levels. The price of gasoline and diesel fuel increased by 58.5% in 1995. Residential natural gas and electricity prices increased by 20% in March 1995, and increased each month thereafter by 0.8%, resulting in an aggregate increase of 40.98% by the end of 1995. Prices of other services, such as railroads, airports and highways, were also gradually increased by an average of 2.5% per month, with aggregate annual increases limited to 30%. The prices of all other goods provided by the public sector for which international market prices were available as a comparison were adjusted to eliminate subsidies. See "—The Government's Response—Fiscal Reform".

During 1996, budgetary public revenues increased 3.3% in real terms in comparison with 1995. This increase resulted primarily from an increase in economic activity and an increase in international oil prices, despite the loss of revenues due to tax incentives initiated to promote investment and employment. Of the total budgetary revenues, non-oil revenues represented 61.8% of all revenues, representing a decrease of 0.9% in the real terms, while oil revenues represented 38.2% of all revenues, representing an increase of 10.9% in real terms. Within non-oil revenues, non-tax revenues showed an increase of 7.3% in real terms while the tax revenues decreased by 0.6% in real terms even though the collection of tax revenues showed an increase during the second half of 1996.

During 1997, budgetary public revenues increased 4.3% in real terms in comparison with 1996. Of the total budgetary revenues, non-oil revenues represented 63.4% of all revenues, representing a decrease of 6.7% in the real terms, while oil revenues represented 36.6% of all revenues, representing an increase of 0.3% in real terms. Within non-oil revenues, non-tax revenues showed an increase of 12.2% in real terms while the tax revenues decreased by 3.1% in real terms.

Public-sector budgetary revenues decreased as a percentage of real GDP, from 23.7% in 1992 to 22.7% 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. In 1993, Congress approved amendments to Mexico's income tax law decreasing the income tax rate for corporations and certain self-employed individuals from 35% to 34% and, for the next two years, reducing withholding taxes related to interest payments made by Mexican companies to non-residents of Mexico in certain circumstances to 4.9%. In connection with the ARE, the income tax law was amended to extend indefinitely the application of the 4.9% rate on such payments. See "The Economy—Prices and Wages".

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, pursuant to the PARAUSEE, 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%). See "—The Government's Response—Fiscal Reform".

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.

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) business firms that in 1996 accumulated income up to Ps. 8.9 million were exempted from the Asset Tax in 1997, (b) business firms whose investments in 1997 exceeded their investments of 1995 were allowed to deduct a total of 62.5% of such additional investment, (c) business firms that in 1997 employed an average number of workers that was higher than such number for 1996 were granted a fiscal credit that could be applied against their taxes on income and assets for 1997; such 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, firms were allowed to deduct, without any requirement, 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 are able to impose (in addition to the federal taxes on these items), taxes on lodging services and new vehicles. Moreover, local governments will be 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 as of December 31, 1997, 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 December 31, 1997, was equivalent to U.S. \$32.2 billion, an increase of U.S. \$9.1 billion from the U.S. \$23.1 billion outstanding net internal public debt as of December 31, 1996.

The outstanding principal amount of Tesobonos was reduced sharply during 1995, from U.S. \$29.2 billion as of December 31, 1994 to U.S. \$246 million as of 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. 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.

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,					
	1992	1993	1994	1995(1)	1996(1)	1997(1)
	(in billions of dollars)					
Total net internal debt (2).....	\$40.5	\$40.1	\$31.4	\$17.2	\$23.1	\$32.2
Government	39.4	39.4	30.9	17.1	22.8	32.1
Peso-denominated	39.1	38.2	13.7	16.8	22.8	32.1
Foreign currency-denominated (Tesobonos) (2)	0.3	1.2	17.2	0.2	0.0	0.0
Budget-controlled agencies	1.1	0.7	0.5	0.2	0.3	0.1
Peso-denominated	0.3	0.4	0.2	0.1	0.1	N.S.
Foreign currency-denominated	0.8	0.3	0.3	0.1	0.2	0.1

Note: Totals may differ due to rounding.

N.S. Not significant.

(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. \$12 billion as of 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,						
1992	41,281	7,485	23,523	72,289	3,466	75,755
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	4,061	88,321

By Currencies (3)

	December 31,											
	1992		1993		1994		1995		1996		1997	
	(in millions of \$)	(%)	(in millions of \$)	(%)	(in millions of \$)	(%)	(in millions of \$)	(%)	(in millions of \$)	(%)	(in millions of \$)	(%)
U.S. Dollars	61,117	80.7	64,818	82.3	70,569	82.6	86,902	86.1	81,757	83.2	71,750	81.2
Japanese Yen	5,904	7.8	6,589	8.4	7,153	8.4	6,288	6.2	7,802	7.9	6,881	7.8
Deutsche Marks	2,971	3.9	2,460	3.1	2,699	3.2	2,593	2.6	3,239	3.3	3,940	4.5
Pounds Sterling	838	1.1	594	0.8	524	0.6	478	0.5	480	0.5	903	1.0
French Francs	2,537	3.4	2,338	3.0	2,511	2.9	2,620	2.6	2,317	2.4	1,909	2.2
Swiss Francs	312	0.4	313	0.4	337	0.4	370	0.4	302	0.3	268	0.3
Others	2,077	2.7	1,635	2.1	1,643	1.9	1,683	1.6	2,389	2.4	2,670	3.0
Total	75,755	100.0	78,747	100.0	85,436	100.0	100,934	100.0	98,285	100.0	88,321	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 December 31, 1997 (using an exchange rate of one SDR = U.S. \$1.3492) and (b) 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. At December 31, 1996, commercial banks held approximately 8.7% of Mexico's total public-sector external debt (excluding bonds issued in debt exchange transactions), multilateral and bilateral creditors (excluding the IMF) held 33.1%, bondholders (including commercial banks holding bonds issued in debt exchange transactions) held 58.1% and suppliers held the remainder (0.1%).

Outstanding gross external debt decreased by approximately U.S. \$10 billion in 1997, from U.S. \$98.3 billion at December 31, 1996, to U.S. \$88.3 billion at December 31, 1997. Of this amount, U.S. \$84.3 billion represented long-term debt and U.S. \$4.0 billion represented short-term debt, as compared

with U.S. \$93.3 billion of long-term debt and U.S. \$5.0 billion of short-term debt as of December 31, 1996. Overall, total public debt (gross external debt plus net internal debt) represented 27.5% of nominal GDP in 1997.

During October 1997, The Government issued euro 400 million of 7.625% Notes due 2004 and issued Canadian U.S. \$500 million of 7% Notes due 2003.

In each of 1987, 1988 and 1989, interest payments on total external public-sector debt absorbed, on average, approximately 74.1% of the Government's total current account receipts. In 1990, interest payments on external public-sector debt accounted for only 50.3% of such receipts as a result of interest savings following implementation of the 1989-92 Financing Package for Mexico and rising foreign exchange receipts. In 1991, interest payments on external public-sector debt accounted for 65.1% of the Government's total current account receipts, mainly as a result of lower foreign exchange receipts. In 1993 and 1994 interest payments on external public-sector debt accounted for 73.1% and 73.7%, respectively, of such receipts. See "—External Debt and Debt Service Reduction Transactions" below and "The External Sector of the Economy—Balance of International Payments".

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) which decreased from 20.7% in 1987 to 5.9% in 1997.

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 FRBNY, 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, 1996 approximately U.S. \$1,326.5 million 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 being privatized.

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.

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.

GENERAL INFORMATION

1. The Notes have been accepted for clearance and settlement in DTC's book-entry settlement system. The Notes have been accepted for clearance through Cedel Bank and Euroclear. The appropriate CUSIP, Common Code(s) and International Securities Identification Number(s), as applicable, with respect to each issue of Notes will be set forth in the Pricing Supplement relating thereto. All payments of principal and interest with respect to DTC Global Notes denominated in a currency other than U.S. dollars and registered in the name of DTC's nominee, will be converted to U.S. dollars unless the relevant participants in DTC elect to receive such payment of principal or interest in that other currency.

2. In connection with the application to list the Notes issued under the program described herein on the Luxembourg Stock Exchange, a legal notice relating to the program 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 obtained the authorization of its Board of Directors on February 18, 1998 to issue up to U.S. \$1,476,400,000 of Notes and of the Ministry of Finance and Public Credit on February 26, 1998 to issue up to U.S. \$1,000,000,000 of Notes and all necessary consents, approvals and authorizations in Mexico in connection with the issue of, and performance of its rights and obligations under, the Notes, including the registration of the Fiscal Agency Agreement, the Guaranty Agreement and the forms of Notes attached to the Fiscal Agency Agreement; *provided, however*, that in connection with each issue of Notes under the program, the Issuer will obtain the authorization of the Ministry of Finance and Public Credit of the terms of such issue and in connection with the issuance of Notes in excess of U.S. \$1,476,400,000 or U.S. \$1,000,000,000, the Issuer will obtain the necessary Board of Directors and Ministry of Finance and Public authorization necessary therefor. The Issuer is obliged and has undertaken to register the Notes 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 herein, 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 Petróleos Mexicanos 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 Notes nor so far as the Issuer or any of the Guarantors is aware is any such litigation or arbitration proceedings 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 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 Fiscal Agency Agreement, incorporating the form of Notes, 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 each of the Paying Agents, so long as any of the Notes are outstanding. The Issuer is not required to, and does not, publish interim financial statements. The Guarantors do not publish their own accounts and will not publish interim financial statements.

8. The principal offices of Coopers & Lybrand, Despacho Roberto Casas Alatríste, auditors of PEMEX, are located at Durango 81, Mexico D.F. 06700, Mexico.

9. The Government is not legally liable for obligations incurred by PEMEX.

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 production, transportation, storage, 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 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.

13. All Bearer Notes and coupons will bear the following legend:

"Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code."

14. The Treaty on European Union provides that a single European currency will be introduced and will replace certain of the currencies of the member states of the European Community. The process of European economic and monetary union is currently scheduled to begin on January 1, 1999 by irrevocably fixing the value of participating member state currencies against the European single currency, to be known as the euro, and is to be completed in 2002 by the withdrawal from

legal tender of the national currencies of participating member states. As of the date hereof, it is not possible to predict whether the single European currency will be introduced in the form and according to the timetable currently proposed, which European Community member states will participate or how European economic and monetary union may affect the value of the Notes or the rights of holders of the Notes. Each prospective investor in the Notes that may be affected by European economic and monetary union is responsible for informing himself or herself about European economic and monetary union and the effects European economic and monetary union may have on his or her contemplated investment and assumes for himself or herself the associated investment risks. See "Description of Notes—Possible Introduction of a Single European Currency", "—Redenomination" and "—Consolidation" above.

The first step in the process of identifying a problem is to define the problem. This involves identifying the symptoms of the problem and determining the scope of the problem. Once the problem has been defined, the next step is to identify the causes of the problem. This involves identifying the factors that are contributing to the problem and determining the underlying causes of the problem. Once the causes of the problem have been identified, the next step is to develop a plan of action. This involves identifying the steps that need to be taken to solve the problem and determining the resources that will be needed to implement the plan. Once a plan of action has been developed, the next step is to implement the plan. This involves carrying out the steps that have been identified in the plan and monitoring the progress of the implementation. Finally, the last step in the process is to evaluate the results of the implementation. This involves determining whether the problem has been solved and whether the resources have been used effectively.

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FORM OF PRICING SUPPLEMENT

(to be completed by the Issuer and the Relevant Agent)

Pricing Supplement No. _____

To Offering Circular dated [DATE]

[LOGO]

Petróleos Mexicanos

**U.S. \$1,500,000,000
Medium-Term Notes, Series B**

[Currency and Amount] [Description of Notes] [due]]
Issue price: []

jointly and severally guaranteed by
Pemex-Exploración y Producción
Pemex-Refinación
and
Pemex-Gas y Petroquímica Básica

[AGENT NAME(S)]

The date of this Pricing Supplement is [].

This Pricing Supplement is issued to give details of a tranche of notes (the "Notes") to be issued by Petróleos Mexicanos (the "Issuer"), pursuant to a program for the issuance of up to U.S. \$1,500,000,000 of Medium-Term Notes, Series B (the "Program"). It is supplementary to, and should be read in conjunction with, the Offering Circular issued in relation to the Program dated [DATE], as supplemented by the Offering Circular Supplement dated [DATE].

This Pricing Supplement does not constitute, and may not be used for the purposes of, an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it is unlawful to make such offer or solicitation, and no action is being taken to permit an offering of the Notes or the distribution of this Pricing Supplement in any jurisdiction where such action is required.

THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR ANY STATE SECURITIES LAWS [AND THE NOTES COMPRISE BEARER NOTES THAT ARE SUBJECT TO U.S. TAX LAW REQUIREMENTS]. THE NOTES MAY NOT BE [OFFERED OR SOLD/OFFERED, SOLD OR DELIVERED] WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT ("REGULATION S")) EXCEPT EXEMPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS. ACCORDINGLY, THE NOTES MAY BE [OFFERED AND SOLD] [OFFERED, SOLD AND DELIVERED] ONLY [(A) TO QUALIFIED INSTITUTIONAL BUYERS (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) AND (B) PURSUANT TO OFFERS AND SALES THAT OCCUR OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT. [PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT SELLERS OF THE NOTES MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A]. FOR A DESCRIPTION OF THESE AND CERTAIN FURTHER RESTRICTIONS ON OFFERS AND SALES OF THE NOTES AND DISTRIBUTION OF THIS PRICING SUPPLEMENT, SEE "OFFERING AND SALE" AND "NOTICE TO INVESTORS" IN THE OFFERING CIRCULAR.

[Set out any additions or variations to the selling restrictions].

Description of Notes

The following items under this heading "Description of Notes" are the particular terms which relate to the tranche of the Notes that is the subject of this Pricing Supplement.

[Include whichever of the following apply to the relevant Tranche of Notes]

- | | | |
|-----|---|--|
| 1. | Series No. | [Number] |
| 2. | Principal Amount: | [Amount] |
| 3. | Issue Price: | [Price] |
| 4. | Issue Date: | [Date] |
| 5. | Form of Notes: | [Registered Notes/Bearer Notes] |
| 6. | Authorized Denomination(s): | [Currency and amount(s)] |
| 7. | Specified Currency: | [Currency of denomination] |
| 8. | Specified Principal Payment
Currency: | [Currency] |
| 9. | Specified Interest Payment
Currency: | [Currency] |
| 10. | Stated Maturity Date (Fixed Interest
Rate and Zero Coupon): | [Dates] |
| 11. | Stated Maturity Month
(Variable Interest Rate): | [Month and year] |
| 12. | Interest Basis: | [Fixed Rate Note/Floating Rate Note/Zero
Coupon Note] |
| 13. | Interest Commencement Date (if different
from the Issue Date): | [Date] |
| 14. | Fixed Rate Notes: | |
| | (a) Interest Rate: | []% per annum |
| | (b) Interest Payment Date(s): | [Date(s)] |
| | (c) Fixed Rate Day Count Fraction(s) if
not 30/360 basis: | [Fraction] |
| 15. | Floating Rate Notes: | |
| | (a) Interest Rate Basis: | [LIBOR] [Treasury Rate] [Other] |

- (b) Primary Source for LIBOR Quotations: [Reuters Screen LIBO Page/Telerate Page 3750]
- (c) Indexed Maturity: [Number of months, weeks or days]
- (d) Interest Reset Dates: [Dates]
- (e) Interest Determination Dates: [Specify if other than as provided in Offering Circular]
- (f) Interest Payment Dates: [Dates]
- (g) Calculation Agent: [Fiscal Agent] [Specify any Other]
16. Basis of Calculation of Floating Interest Rate where Offering Circular provisions do not apply: [Give details]
17. Other Floating Interest Rate Terms:
- (a) Minimum Interest Rate: []% per annum
- (b) Maximum Interest Rate: []% per annum
- (c) Spread: [+/- []% per annum]
- (d) Spread Multiplier(s): [Specify]
- (e) Variable Rate Day Count Fraction(s) if not actual/360: [Fraction]
- (f) Initial Interest Rate: []% per annum
18. Discount Notes:
- (a) Accrual Yield: [Yield]
- (b) Basis: [Specify if other than as provided in Offering Circular]
- (c) Fixed Rate Day Count Fraction(s) if not 30/360 basis: [Fraction]
19. Redemption at the option of the Issuer: Yes/No
- (a) Amount: [All or less than all and, if less than all, minimum amounts]
- (b) Redemption Commencement Date: [Date(s)]

- (c) **Redemption Price(s) for each Redemption Period:** [Specify]
20. **Repayment at the option of the holders:** Yes/No
- (a) **Deposit Period:** [Specify other maximum and minimum number of days for deposit period]
- (b) **Amount:** [All or less than all and, if less than all, minimum amounts]
- (c) **Date(s):** [Date(s)]
- (d) **Repayment Price:** [Price and other details]
- (e) **Withdrawal of Notes:** [No] [Give details]
21. **Indexed Notes:** [Specify relevant details]
22. **Principal Payment Dates and Amount of each Installment for Amortizing Notes:** [Specify]
23. **Additional provisions relating to the Notes:** [Give details]
26. **Option to Elect Payments in Other than Specified Currency:** Yes/No
- Other Relevant Terms**
1. **Listing (if yes, specify Stock Exchange):** Yes/No [Specify Stock Exchange]
2. **Syndicated:** Yes/No
3. **If Syndicated:**
- (a) **Lead Agents:** [Name]
- (b) **Stabilizing Agent(s):** [Name]
4. **Commissions and Concessions:** [Specify]
5. **Codes:**
- (a) **Common Code:** [Number]
- (b) **ISIN:** [Number]
- (c) **CUSIP:** [Number] [Restricted Global Note]
[Number] [Regulation S Global Note]

- (d) CINS: [Number] [Restricted Global Note]
[Number] [Regulation S Global Note]
- (e) Other: [Specify]
6. Identity of Agent(s): [Names]
7. Provisions for Bearer Notes:
- (a) Exchange Date: [None/Date]
- (b) Permanent Global Note: Yes/No
- (c) Definitive Bearer Notes: Yes/No
8. Provisions for Registered Notes:
- (a) Rule 144A eligible: Yes/No
- (b) Regulation S Global Note deposited with or on behalf of DTC: Yes/No
- (c) Restricted Global Note deposited with or on behalf of DTC: Yes/No
- (d) Regulation S Global Note deposited with Common Depository: Yes/No
9. Use of Proceeds (if different from Offering Circular): [Specify]
10. Details of any additions or variations to the Distribution Agreement: []
11. Details of any additional Investment Considerations: []
12. Details of any additional Selling Restrictions: [Insert the restrictions relating to the Specified Currency of the Notes or the jurisdiction(s) in which Notes are to be offered if not contained in, or if varied from, the Offering Circular.]
13. [Additional Information]: [Set out]

[Supplemental Offering Circular Information]

The Offering Circular is hereby supplemented with the following information, which shall be deemed to be incorporated in, and to form part of, the Offering Circular.]

[Set out any additional disclosure and, if applicable, an indication as to where it should be inserted into the Offering Circular.]

[Application has been made to list this issue of Notes pursuant to the listing of the program of U.S. \$1,000,000,000 Medium-Term Notes, Series B of Petróleos Mexicanos.]

**HEAD OFFICE OF THE ISSUER AND
EACH OF THE GUARANTORS**

Avenida Marina Nacional 329
11311 México, D.F.

AUDITORS OF THE ISSUER

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Despacho Roberto Casas Alatríste,
Durango 81
06700 México, D.F.

FISCAL AGENT, PRINCIPAL PAYING AGENT AND TRANSFER AGENT

Bankers Trust Company
Corporate Trust & Agency Group
4 Albany Street, 7th Floor
New York, NY 10006

PAYING AGENTS AND TRANSFER AGENTS

Bankers Trust Company, London Office
Corporate Trust & Agency Group
1 Appold Street
Broadgate
London EC2A 2HE

Bankers Trust Luxembourg S.A.
P.O. Box 807
14 Boulevard F.D. Roosevelt
L-2450 Luxembourg

LEGAL ADVISORS

To the Agents as to U.S. law

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125 Broad Street
New York, NY 10004

To the Issuer as to U.S. law

Cleary, Gottlieb, Steen & Hamilton
One Liberty Plaza
New York, NY 10006

*To the Agents and the Fiscal Agent
as to Mexican law*

Ritch, Heather y Mueller, S.C.
Amberes 5
06600 México, D.F.

To the Issuer as to Mexican law

**General Counsel and
Head of the Legal Department**
Petróleos Mexicanos
Avenida Marina Nacional 329
11311 México, D.F.

LISTING AGENT

Kredietbank S.A. Luxembourgeoise
43 Boulevard Royal
L-2955 Luxembourg



Petróleos Mexicanos

(A Decentralized Public Entity of the Federal Government of the United Mexican States)

jointly and severally guaranteed by

Pemex-Exploración y Producción,

Pemex-Refinación and

Pemex-Gas y Petroquímica Básica



US\$350,000,000 8³/₈% Global Guaranteed Notes due 2005

Issue price: 99.782%

US\$350,000,000 9¹/₄% Global Guaranteed Bonds due 2018

Issue price: 99.892%

Issued under Medium-Term Note Program, Series B

The 8³/₈% Global Guaranteed Notes due 2005 (the "Notes") and the 9¹/₄% Global Guaranteed Bonds due 2018 (the "Bonds", and, together with the Notes, the "Securities"), will be issued by Petróleos Mexicanos ("Petróleos Mexicanos" or the "Issuer"), a decentralized public entity of the Federal Government of the United Mexican States ("Mexico"), and are part of a program for the issuance from time to time of Medium-Term Notes, Series B, Due from 1 Year to 30 Years from Date of Issue (the "Program") described in the accompanying Offering Circular dated February 26, 1998 (the "Offering Circular"). The payment of principal of and interest on the Securities will be unconditionally guaranteed jointly and severally by Pemex-Exploración y Producción, Pemex-Refinación and Pemex-Gas y Petroquímica Básica (collectively, the "Guarantors"), each of which is a decentralized public entity of the Federal Government of Mexico. The Notes will mature on March 30, 2005. The Bonds will mature on March 30, 2018. Interest on the Notes will be payable semiannually on March 30 and September 30 of each year, commencing September 30, 1998. Interest on the Bonds will be payable semiannually on March 30 and September 30 of each year, commencing on September 30, 1998.

Application will be made to list the Securities on the Luxembourg Stock Exchange. The Securities have been designated for trading in the PORTAL system of The NASDAQ Stock Market, Inc.

THE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE OFFERED, SOLD OR DELIVERED IN THE UNITED STATES OR TO OR FOR THE ACCOUNT OR BENEFIT OF ANY U.S. PERSON, EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR IN ACCORDANCE WITH AN AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. ACCORDINGLY, THE SECURITIES ARE BEING OFFERED AND SOLD ONLY (A) TO QUALIFIED INSTITUTIONAL BUYERS (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN RELIANCE ON RULE 144A AND (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT. FOR CERTAIN RESTRICTIONS ON TRANSFER, SEE "NOTICE TO INVESTORS" IN THE OFFERING CIRCULAR.

	Price to investors ⁽¹⁾	Discounts and commissions ⁽²⁾	Proceeds to the Issuer ⁽¹⁾⁽³⁾
Per Note	99.782%	.550%	99.232%
Per Bond	99.892%	.875%	99.017%
Total	US\$698,859,000	US\$4,987,500	US\$693,871,500

(1) Plus accrued interest, if any, from April 1, 1998 for the Notes and the Bonds.

(2) The Issuer and the Guarantors have agreed jointly and severally to indemnify the Agents against certain liabilities, including liabilities under the Securities Act.

(3) Before deduction of expenses payable by the Issuer.

The Securities are offered, subject to prior sale, when, as and if accepted by the Agents and subject to the approval of certain legal matters. It is expected that delivery of the Securities will be made on or about April 1, 1998 through the facilities of DTC, Euroclear and Cedel Bank against payment therefor in immediately available funds.

For the Notes:
As Sole Bookrunner,
J.P. Morgan & Co.

SBC Warburg Dillon Read

Goldman, Sachs & Co.

ABN AMRO Incorporated

Barclays Capital

Deutsche Morgan Grenfell Inc.

Société Générale
Securities Corporation

UBS Securities

For the Bonds:
As Sole Bookrunner,
J.P. Morgan & Co.

Goldman, Sachs & Co.

SBC Warburg Dillon Read

Chase Securities Inc.

Lehman Brothers

Merrill Lynch & Co.

Morgan Stanley Dean Witter

Salomon Smith Barney

March 25, 1998