

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
Form N-CSR  
January 09, 2017

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED  
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number 811-22011

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
(Exact name of registrant as specified in charter)

522 Fifth Avenue, New York, New York  
(Address of principal executive offices)

10036  
(Zip code)

John H. Gernon

522 Fifth Avenue, New York, New York 10036  
(Name and address of agent for service)

Registrant's telephone number, including area code: 212-296-0289

Date of fiscal year October 31,  
end:

Date of reporting period: October 31, 2016

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Item 1 - Report to Shareholders

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**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**Directors**

Frank L. Bowman

Kathleen A. Dennis

Nancy C. Everett

Jakki L. Haussler

Dr. Manuel H. Johnson

Joseph J. Kearns

Michael F. Klein

Michael E. Nugent,

*Chair of the Board*

W. Allen Reed

Fergus Reid

**Officers**

John H. Gernon

*President and Principal  
Executive Officer*

Timothy J. Knierim

*Chief Compliance Officer*

Francis J. Smith

*Treasurer and Principal  
Financial Officer*

Mary E. Mullin

*Secretary*

**Adviser and Administrator**

Morgan Stanley Investment Management Inc.

522 Fifth Avenue

New York, New York 10036

**Custodian**

State Street Bank and Trust Company

One Lincoln Street

Boston, Massachusetts 02111

**Stockholder Servicing Agent**

Computershare Trust Company, N.A.

211 Quality Circle, Suite 210

College Station, Texas 77845

**Legal Counsel**

Dechert LLP

1095 Avenue of the Americas

New York, New York 10036

**Counsel to the Independent Directors**

Perkins Coie LLP

30 Rockefeller Plaza

New York, New York 10112

**Independent Registered Public Accounting Firm**

Ernst & Young LLP

200 Clarendon Street

Boston, Massachusetts 02116

For additional Fund information, including the Fund's net asset value per share and information regarding the investments comprising the Fund's portfolio, please call toll free 1 (800) 231-2608 or visit our website at [www.morganstanley.com/im](http://www.morganstanley.com/im). All investments involve risks, including the possible loss of principal.

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INVESTMENT MANAGEMENT

Morgan Stanley  
Investment Management Inc.  
Adviser

Morgan Stanley  
Emerging Markets Domestic Debt Fund, Inc.  
NYSE: EDD

Annual Report

October 31, 2016

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**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

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## **Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

Letter to Stockholders (unaudited)

### **Performance**

For the year ended October 31, 2016, the Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the "Fund") had total returns of 10.37%, based on net asset value, and 15.59% based on market value per share (including reinvestment of distributions), compared to its benchmark, the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index (the "Index"),\* which returned 11.04%. On October 31, 2016, the closing price of the Fund's shares on the New York Stock Exchange was \$7.87, representing a 11.9% discount to the Fund's net asset value per share. Past performance is no guarantee of future results. Please keep in mind that high double-digit returns are highly unusual and cannot be sustained.

### **Factors Affecting Performance**

- Emerging markets (EM) asset prices touched their lows for the reporting period in January 2016 as commodity prices and economic growth bottomed. As the negative headwinds from global macro trends and idiosyncratic events faded, EM domestic debt prices led the way higher among risky assets, returning 11.04% as measured by the Index in U.S. dollar terms. Within the Index, local EM bond performance returned 9.99%, while EM currencies strengthened 1.06% versus the U.S. dollar.<sup>1</sup> Domestic debt from Brazil, Indonesia, Russia, Peru, and Chile outperformed the broader market, driven primarily by local bond performance, with currency strength in Chile and Brazil also aiding performance measured in U.S. dollars. Conversely, currency weakness versus the U.S. dollar weighed on the performance of domestic debt from Mexico, Poland, Romania, the Philippines, and Turkey, which lagged the broader market.
- During the latter part of 2015 and the early part of 2016, downgrades to the outlook for global economic growth, particularly in China, pressured commodity prices, especially oil, which touched multi-year lows in January. Sentiment subsequently improved and asset prices turned the corner in February as energy and commodity prices rebounded and China fears eased in tandem with a weaker U.S. dollar and accommodative central bank policies. Geopolitics and idiosyncratic events such as the U.K. Brexit, Brazil's impeachment of former-President Rousseff, Italian bank capitalization concerns, and an attempted coup in Turkey drove periodic volatility in the market.
- Economic weakness in Europe was met by further quantitative easing (QE) support by the European Central Bank (ECB), lowering yields across Europe and driving a search for yield and duration, which further accelerated in the second quarter of 2016 and post the Brexit vote. The search for yield drove inflows into EM assets, which, combined with attractive valuations and stabilizing fundamentals, provided support to fixed income assets. The easing of monetary policy and economic weakness in Europe was in contrast to overall steady growth in the U.S., which supported the U.S. Federal Reserve's (Fed) December 2015 decision to hike interest rates for the first time in over nine years. However, the Fed was forced to slow its hiking cycle as global factors and a second-quarter slowdown in U.S. economic growth weighed on its outlook.
- Brazil completed its seven-year ratings roundtrip after Moody's stripped the country of its final investment grade rating while policymakers were distracted by the far-reaching corruption probe, Lava Jato, which continued to claim political and business leaders as President Dilma Rousseff was impeached. Vice President Michel Temer was elevated to acting president, but despite a





## **Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

Letter to Stockholders (unaudited) (cont'd)

strong start toward making the necessary changes in reforming the economy, his acting administration was marred by allegations that his appointed planning minister, Romero Juca, was attempting to obstruct the Lava Jato corruption probe. Despite the turmoil, investors were hopeful that the new administration would signal a turning point for the country, driving a rally in Brazilian assets.

- The unsuccessful coup in Turkey provided President Recep Tayyip Erdogan an opportunity to consolidate power and purge over 100,000 civil servants. The weakening of the country's institutional framework, coupled with weaker economic growth and growing external funding requirements, contributed to Moody's decision to downgrade the country's foreign currency debt rating to below investment grade (Ba1 from Baa3). Concerns over Mexico's fiscal spending and the rapid deterioration of the country's debt-to-gross domestic product (GDP) level triggered S&P to lower its ratings outlook for the country's BBB+ rating to negative from stable. Mexico also faced deteriorating sentiment. With negative rhetoric toward Mexico prominently featured in the U.S. presidential election adding to the negative headwinds for the country, the government of Mexico must take more concrete steps in the fiscal consolidation effort to convince ratings agencies and investors. The weakening fundamental outlook in Mexico and Turkey contributed to the weakness of their currencies versus the U.S. dollar.
- Overall, performance was a tale of two periods, where the market retreated from November to February, before moving higher through the rest of the period. During the period, the Fund benefited from the use of leverage and broad duration positioning. Investments in Argentina were beneficial to performance over the year as the country returned to international debt markets. Also contributing to performance was duration and yield curve positioning in Brazil, Peru, Turkey, Russia, Hungary, Romania, and India. Security selection in Peru, Turkey, and Indonesia was also beneficial to relative performance.
- The use of derivatives both contributed and detracted from performance during the period. The primary instruments used were bond futures (U.S. Treasury and German bund) and currency forwards. Bond futures were used to hedge interest rate exposure and currency forwards were used to hedge or add to currency exposure.
- Broadly, currency positioning was detrimental to relative performance, particularly in Mexico, South Africa, Colombia, and Poland.

### **Management Strategies**

- Subject to potential near-term event risks being resolved in the next few weeks, we remain optimistic about the prospects for EM fixed income as fundamentals, technicals, and the macro environment remain supportive. The various factors both pushing and pulling investors into EM fixed income remain in place: developed market yields remain very low, economic data in emerging markets appears to have stabilized, fears of multiple Fed rate hikes have subsided, and concerns of a sharp slowdown in China have diminished. We believe that EM assets could well absorb a Fed rate hike if driven by the prospects for higher growth; however, assets remain vulnerable to rate hikes driven by a surge in inflation. The emerging markets/developed markets growth differential has stabilized and appears to be recovering in favor of emerging markets as the negative growth impacts from Brazil

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

Letter to Stockholders (unaudited) (cont'd)

and Russia lessen. China's growth slowdown is likely to continue in the medium term, with short-term growth prospects reliant on continued fiscal and monetary policy support. U.S. elections reflect a potential event risk for some key emerging markets and the outlook for global trade.

Sincerely,

John H. Gernon  
President and Principal Executive Officer November 2016

\*J.P. Morgan Government Bond Index Emerging Markets Global Diversified Index tracks local currency government bonds issued by emerging markets. It is not possible to invest directly in an Index.

<sup>i</sup> Source: J.P. Morgan



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Portfolio of Investments

*(Showing Percentage of Total Value of Investments)*

	<b>Face Amount (000)</b>	<b>Value (000)</b>
<b>FIXED INCOME SECURITIES (97.1%)</b>		
<b>Argentina (3.7%)</b>		
<b>Corporate Bond (1.0%)</b>		
YPF SA, 26.33%, 7/7/20 (a)(b)	\$ 7,500	\$ 8,302
<b>Sovereign (2.7%)</b>		
Argentina Bonar Bonds, 25.00%, 10/9/17 (b)	ARS 148,220	9,353
Argentina Treasury Bond, 2.25%, 4/28/20	92,300	6,064
Republic of Argentina, 18.20%, 10/3/21	114,900	8,014
		23,431
		31,733
<b>Brazil (13.5%)</b>		
<b>Sovereign (13.5%)</b>		
Brazil Letras do Tesouro Nacional, 0.00%, 1/1/19	BRL 31,220	7,758
Brazil Notas do Tesouro Nacional, Series F, 10.00%, 1/1/21 - 1/1/23	366,381	110,332
		118,090
<b>Chile (0.2%)</b>		
<b>Sovereign (0.2%)</b>		
Chile Government International Bond, 5.50%, 8/5/20	CLP 1,165,000	1,899
<b>Colombia (6.3%)</b>		
<b>Corporate Bond (0.5%)</b>		
Fideicomiso PA Costera, 6.25%, 1/15/34 (a)	COP 13,958,175	4,375
<b>Sovereign (5.8%)</b>		
Colombia Government International Bond, 9.85%, 6/28/27	22,100,000	8,903
Colombian TES, 7.75%, 9/18/30	16,848,100	5,758

10.00%, 7/24/24		74,128,500	29,033
Financiera de Desarrollo Territorial SA Findeter,			
7.88%, 8/12/24 (a)		21,492,000	6,762
			50,456
			54,831
		<b>Face Amount (000)</b>	<b>Value (000)</b>
<b>Hungary (4.4%)</b>			
<b>Sovereign (4.4%)</b>			
Hungary Government Bond,			
3.00%, 6/26/24	HUF	1,200,000	\$ 4,381
5.50%, 6/24/25		4,700,000	20,150
7.50%, 11/12/20		3,154,000	13,829
			38,360
<b>India (1.0%)</b>			
<b>Sovereign (1.0%)</b>			
India Government Bond,			
8.40%, 7/28/24	INR	550,000	8,916
<b>Indonesia (11.0%)</b>			
<b>Sovereign (11.0%)</b>			
Barclays Bank PLC, Indonesia Government Bonds, Credit Linked Notes,			
10.00%, 7/17/17 (a)	IDR	90,000,000	22,884
Credit Suisse, Indonesia Government Bonds, Credit Linked Notes,			
10.00%, 7/17/17		54,683,530	12,206
Indonesia Treasury Bond,			
8.38%, 3/15/34		2,600,000	16,311
8.75%, 5/15/31		12,855,000	35,399
9.00%, 3/15/29		5,894,000	9,020
			95,820
<b>Malaysia (4.6%)</b>			
<b>Sovereign (4.6%)</b>			
Malaysia Government Bond,			
3.96%, 9/15/25	MYR	23,754	5,750
4.18%, 7/15/24		141,175	34,721
			40,471
<b>Mexico (11.6%)</b>			
<b>Sovereign (11.6%)</b>			
Mexican Bonos,			
6.50%, 6/10/21	MXN	677,185	36,654
7.75%, 5/29/31 - 11/23/34		207,500	12,167
8.50%, 5/31/29		188,400	11,672
Petroleos Mexicanos, (Units)			
7.65%, 11/24/21 (a)(c)		791,300	40,693
			101,186

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Portfolio of Investments (cont'd)

*(Showing Percentage of Total Value of Investments)*

		Face Amount (000)	Value (000)
<b>Peru (3.1%)</b>			
<b>Sovereign (3.1%)</b>			
Peru Government Bond, (Units)			
5.70%, 8/12/24 (c)	PEN	44,037	\$ 13,434
Peruvian Government International Bond, (Units)			
5.70%, 8/12/24 (a)(c)		14,001	4,271
6.35%, 8/12/28 (a)(c)		16,390	5,026
8.20%, 8/12/26 (c)		13,154	4,647
			27,378
<b>Poland (10.6%)</b>			
<b>Sovereign (10.6%)</b>			
Poland Government Bond,			
3.25%, 7/25/25	PLN	50,950	13,213
5.25%, 10/25/20		130,500	36,999
5.75%, 9/23/22		141,500	41,960
			92,172
<b>Romania (1.3%)</b>			
<b>Sovereign (1.3%)</b>			
Romania Government Bond,			
4.75%, 2/24/25	RON	42,515	11,648
<b>Russia (6.7%)</b>			
<b>Sovereign (6.7%)</b>			
Russian Federal Bond OFZ,			
6.70%, 5/15/19	RUB	760,300	11,537
7.05%, 1/19/28		1,775,000	25,372
8.15%, 2/3/27		1,398,800	21,769
			58,678
<b>South Africa (9.0%)</b>			
<b>Sovereign (9.0%)</b>			
South Africa Government Bond,			
6.75%, 3/31/21	ZAR	604,200	42,584
7.25%, 1/15/20		24	2
8.00%, 1/31/30		524,450	35,628
			78,214
<b>Thailand (1.4%)</b>			
<b>Sovereign (1.4%)</b>			



Thailand Government Bond, 3.63%, 6/16/23	THB	380,000	11,976
		<b>Face Amount (000)</b>	<b>Value (000)</b>
<b>Turkey (8.7%)</b>			
<b>Corporate Bond (3.6%)</b>			
Turkiye Garanti Bankasi AS, 7.38%, 3/7/18 (a)	TRY	102,980	\$ 31,608
<b>Sovereign (5.1%)</b>			
Turkey Government Bond, 7.10%, 3/8/23		38,300	10,862
8.00%, 3/12/25		55,950	16,274
10.50%, 1/15/20		52,225	17,443
			44,579
			76,187
<b>TOTAL FIXED INCOME SECURITIES</b>			
(Cost \$982,499)			847,559
<b>SHORT-TERM INVESTMENTS (2.9%)</b>			
<b>U.S. Treasury Security (0.9%)</b>			
U.S. Treasury Bill, 0.41%, 3/23/17 (d)			
(Cost \$8,217)	\$	8,230	8,218
<b>Argentina (2.0%)</b>			
<b>Sovereign (2.0%)</b>			
Letras del Banco Central de la Republica Argentina, 28.25%, 1/11/17	ARS	52,710	3,313
29.50%, 1/11/17		52,920	3,327
30.25%, 12/28/16		72,500	4,597
30.50%, 12/28/16		95,280	6,040
<b>Total Sovereign</b> (Cost \$18,361)			17,277
<b>TOTAL SHORT-TERM INVESTMENTS</b>			
(Cost \$26,578)			25,495
<b>TOTAL INVESTMENTS (100.0%)</b>			
(Cost \$1,009,077) (e)(f)			873,054
<b>LIABILITIES IN EXCESS OF OTHER ASSETS</b>			
			(273,935)
<b>NET ASSETS</b>			
			\$ 599,119

(a) 144A security Certain conditions for public sale may exist. Unless otherwise noted, these securities are deemed to be liquid.

(b) Variable/Floating Rate Security Interest rate changes on these instruments are based on changes in a designated base rate. The rates shown are those in effect on October 31, 2016.

(c) Consists of one or more classes of securities traded together as a unit.

The accompanying notes are an integral part of the financial statements.



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Portfolio of Investments (cont'd)

(d) Rate shown is the yield to maturity at October 31, 2016.

(e) Securities are available for collateral in connection with open foreign currency forward exchange contracts and futures contracts.

(f) At October 31, 2016, the aggregate cost for federal income tax purposes is approximately \$1,098,229,000. The aggregate gross unrealized appreciation is

approximately \$17,470,000 and the aggregate gross unrealized depreciation is approximately \$242,645,000 resulting in net unrealized depreciation of approximately \$225,175,000.

OFZ Obilgatsyi Federal'novno Zaima (Russian Federal Loan Obligation)

**Foreign Currency Forward Exchange Contracts:**

The Fund had the following foreign currency forward exchange contracts open at October 31, 2016:

<b>Counterparty</b>		<b>Contracts to Deliver (000)</b>		<b>In Exchange For (000)</b>	<b>Delivery Date</b>	<b>Unrealized Appreciation (Depreciation) (000)</b>
JPMorgan Chase Bank NA	BRL	2,200	\$	673	11/3/16	\$ (16)
JPMorgan Chase Bank NA	BRL	34,000	\$	10,735	11/3/16	83
JPMorgan Chase Bank NA	BRL	8,800	\$	2,766	11/3/16	9
JPMorgan Chase Bank NA	BRL	113,358	\$	35,635	11/3/16	122
JPMorgan Chase Bank NA	BRL	2,800	\$	880	11/3/16	3
JPMorgan Chase Bank NA	\$	2,705	BRL	8,800	11/3/16	52
JPMorgan Chase Bank NA	\$	878	BRL	2,800	11/3/16	(1)
JPMorgan Chase Bank NA	\$	36,044	BRL	113,358	11/3/16	(531)
JPMorgan Chase Bank NA	\$	692	BRL	2,200	11/3/16	(2)
JPMorgan Chase Bank NA	\$	10,688	BRL	34,000	11/3/16	(36)
State Street Bank and Trust Co.	BRL	88,758	\$	27,206	11/3/16	(600)
	IDR	394,438,000	\$	30,225	11/3/16	(1)

State Street Bank  
and Trust Co.

JPMorgan Chase Bank NA	TRY	71,382	\$ 23,505	11/4/16	451
JPMorgan Chase Bank NA	TRY	15,000	\$ 4,905	11/4/16	61
JPMorgan Chase Bank NA	TRY	31,570	\$ 10,259	11/4/16	62
JPMorgan Chase Bank NA	\$	8,756	TRY 27,000	11/4/16	(36)
JPMorgan Chase Bank NA	HUF	1,715,400	\$ 6,207	11/14/16	108
JPMorgan Chase Bank NA	HUF	1,800,000	\$ 6,350	11/14/16	(50)
JPMorgan Chase Bank NA	PHP	292,000	\$ 6,039	11/14/16	9
JPMorgan Chase Bank NA	PLN	22,000	\$ 5,598	11/14/16	(8)
JPMorgan Chase Bank NA	RON	18,500	\$ 4,508	11/14/16	( @)
JPMorgan Chase Bank NA	RON	12,000	\$ 2,912	11/14/16	(12)
JPMorgan Chase Bank NA	RUB	1,588,054	\$ 25,130	11/14/16	157
JPMorgan Chase Bank NA	SGD	8,220	\$ 5,961	11/14/16	52
JPMorgan Chase Bank NA	SGD	8,300	\$ 5,998	11/14/16	32
JPMorgan Chase Bank NA	SGD	8,350	\$ 5,989	11/14/16	(13)
JPMorgan Chase Bank NA	\$	6,013	HUF 1,700,000	11/14/16	31
JPMorgan Chase Bank NA	\$	2,577	PHP 126,500	11/14/16	35
JPMorgan Chase Bank NA	\$	5,977	PHP 287,000	11/14/16	(50)
JPMorgan Chase Bank NA	\$	2,613	PLN 10,150	11/14/16	(26)
JPMorgan Chase Bank NA	\$	2,790	RON 11,360	11/14/16	(21)
JPMorgan Chase Bank NA	\$	5,610	RON 23,000	11/14/16	(6)
JPMorgan Chase Bank NA	\$	4,997	RON 20,600	11/14/16	23

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Portfolio of Investments (cont'd)

**Foreign Currency Forward Exchange Contracts: (cont'd)**

<b>Counterparty</b>		<b>Contracts to Deliver (000)</b>		<b>In Exchange For (000)</b>	<b>Delivery Date</b>	<b>Unrealized Appreciation (Depreciation) (000)</b>
JPMorgan Chase Bank NA	\$	9,441	RUB	590,000	11/14/16	\$ (163)
JPMorgan Chase Bank NA	\$	5,959	SGD	8,250	11/14/16	(29)
JPMorgan Chase Bank NA	\$	31,600	THB	1,119,700	11/14/16	384
JPMorgan Chase Bank NA	\$	1,443	THB	50,900	11/14/16	11
JPMorgan Chase Bank NA	\$	5,913	ZAR	84,500	11/14/16	338
JPMorgan Chase Bank NA	\$	6,187	ZAR	84,000	11/14/16	28
JPMorgan Chase Bank NA	ZAR	226,626	\$	15,903	11/14/16	(865)
JPMorgan Chase Bank NA	ZAR	119,300	\$	8,568	11/14/16	(259)
JPMorgan Chase Bank NA	ZAR	42,000	\$	3,017	11/14/16	(91)
Citibank NA	COP	12,600,000	\$	4,278	11/15/16	97
JPMorgan Chase Bank NA	COP	37,522,000	\$	12,804	11/15/16	352
State Street Bank and Trust Co.	INR	200,000	\$	2,981	11/15/16	(8)
State Street Bank and Trust Co.	INR	410,000	\$	6,107	11/15/16	(20)
JPMorgan Chase Bank NA	EUR	2,000	\$	2,175	11/16/16	(22)
JPMorgan Chase Bank NA	\$	2,922	EUR	2,679	11/16/16	21
JPMorgan Chase Bank NA	\$	21,569	MYR	90,490	11/21/16	(22)
JPMorgan Chase Bank NA	\$	4,869	CLP	3,255,000	11/25/16	106
JPMorgan Chase Bank NA	\$	17,752	PEN	60,400	11/25/16	160
JPMorgan Chase Bank NA	MXN	586,663	\$	31,296	11/28/16	344
	MXN	218,000	\$	11,472	11/28/16	(30)

JPMorgan Chase Bank NA					
JPMorgan Chase Bank NA	\$	4,602	MXN	87,200	11/28/16 (1)
State Street Bank and Trust Co.	IDR	394,438,000	\$	30,117	12/1/16 @
JPMorgan Chase Bank NA	BRL	113,358	\$	35,728	12/2/16 515
JPMorgan Chase Bank NA	BRL	77,300	\$	23,950	12/2/16 (61)
JPMorgan Chase Bank NA	\$	11,959	BRL	38,300	12/2/16 (62)
Citibank NA	ARS	76,760	\$	4,583	12/30/16 (313)
Citibank NA	ARS	77,080	\$	4,583	12/30/16 (333)
Citibank NA	ARS	194,500	\$	12,256	12/30/16 (149)
Citibank NA	ARS	25,000	\$	1,518	12/30/16 (76)
Citibank NA	\$	10,631	ARS	168,500	12/30/16 115
Citibank NA	ARS	19,640	\$	1,205	1/18/17 (33)
Citibank NA	ARS	5,860	\$	360	1/18/17 (10)
Citibank NA	ARS	101,000	\$	6,364	1/18/17 (3)
Citibank NA	CNY	250,000	\$	36,380	4/25/17 (355)
Citibank NA	ARS	87,400	\$	5,141	6/13/17 13
Citibank NA	ARS	34,900	\$	2,053	6/13/17 5
Citibank NA	ARS	52,000	\$	2,921	6/13/17 (130)
Citibank NA	ARS	137,800	\$	7,520	6/13/17 (566)
Citibank NA	\$	6,254	ARS	108,000	6/13/17 83
Citibank NA	\$	12,441	ARS	212,000	6/13/17 (2)
Citibank NA	\$	8,771	ARS	152,000	6/13/17 148
					\$ (1,002)

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Portfolio of Investments (cont'd)

**Futures Contracts:**

The Fund had the following futures contracts open at October 31, 2016:

	<b>Number of Contracts</b>	<b>Value (000)</b>	<b>Expiration Date</b>	<b>Unrealized Appreciation (000)</b>
<b>Short:</b>				
German Euro BOBL	387	\$(55,699)	Dec-16	\$ 291
U.S. Treasury 10 yr. Note	222	(28,777)	Dec-16	86
				\$ 377

@ Value is less than \$500.

ARS Argentine Peso

BRL Brazilian Real

CLP Chilean Peso

CNY Chinese Yuan Renminbi

COP Colombian Peso

EUR Euro

HUF Hungarian Forint

IDR Indonesian Rupiah

INR Indian Rupee

MXN Mexican Peso

MYR Malaysian Ringgit

PEN Peruvian Nuevo Sol

PHP Philippine Peso

PLN Polish Zloty

RON	Romanian New Leu
RUB	Russian Ruble
SGD	Singapore Dollar
THB	Thai Baht
TRY	Turkish Lira
ZAR	South African Rand

### Portfolio Composition

<b>Classification</b>	<b>Percentage of Total Investments</b>
Sovereign	92.0%
Corporate Bonds	5.1
Other*	2.9
Total Investments	100.0%**

\* Industries and/or investment types representing less than 5% of total investments.

\*\* Does not include open short futures contracts with an underlying face amount of approximately \$84,476,000 with total unrealized appreciation of approximately \$378,000. Does not include open foreign currency forward exchange contracts with net unrealized depreciation of approximately \$1,002,000.

The accompanying notes are an integral part of the financial statements.





**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Financial Statements

	<b>October 31, 2016</b>
	<b>(000)</b>
Statement of Assets and Liabilities	
<b>Assets:</b>	
Investments in Securities of Unaffiliated Issuers, at Value (Cost \$1,009,077)	\$ 873,054
Foreign Currency, at Value (Cost \$2,412)	2,436
Interest Receivable	17,481
Unrealized Appreciation on Foreign Currency Forward Exchange Contracts	4,010
Receivable for Investments Sold	2,590
Due from Broker	417
Receivable for Variation Margin on Futures Contracts	377
Dividends Receivable	2
Receivable from Affiliate	1
Other Assets	36
<b>Total Assets</b>	<b>900,404</b>
<b>Liabilities:</b>	
Payable for Line of Credit	294,843
Unrealized Depreciation on Foreign Currency Forward Exchange Contracts	5,012
Payable for Advisory Fees	761
Bank Overdraft	402
Payable for Custodian Fees	132
Payable for Administration Fees	61
Deferred Capital Gain Country Tax	24
Payable for Professional Fees	22
Payable for Stockholder Servicing Agent Fees	2
Other Liabilities	26
<b>Total Liabilities</b>	<b>301,285</b>
<b>Net Assets</b>	
Applicable to 67,125,800 Issued and Outstanding \$0.01 Par Value Shares (100,000,000 Shares Authorized)	\$ 599,119
<b>Net Asset Value Per Share</b>	<b>\$ 8.93</b>
<b>Net Assets Consist of:</b>	
Common Stock	\$ 671
Paid-in-Capital	872,868
Accumulated Net Investment Loss	(61,043)
Accumulated Net Realized Loss	(76,538)
Unrealized Appreciation (Depreciation) on:	
Investments (Net of \$24 of Deferred Capital Gain Country Tax)	(136,047)
Futures Contracts	377
Foreign Currency Forward Exchange Contracts	(1,002)

Foreign Currency Translations	(167)
<b>Net Assets</b>	<b>\$ 599,119</b>

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Financial Statements (cont'd)

	<b>Year Ended October 31, 2016 (000)</b>
Statement of Operations	
<b>Investment Income:</b>	
Interest from Securities of Unaffiliated Issuers (Net of \$416 of Foreign Taxes Withheld)	\$ 67,656
Dividends from Security of Affiliated Issuer (Note F)	23
<b>Total Investment Income</b>	<b>67,679</b>
<b>Expenses:</b>	
Advisory Fees (Note B)	8,697
Interest Expense on Line of Credit (Note G)	4,948
Administration Fees (Note C)	696
Custodian Fees (Note D)	505
Professional Fees	129
Stockholder Reporting Expenses	100
Directors' Fees and Expenses	15
Stockholder Servicing Agent Fees	9
Other Expenses	211
<b>Expenses Before Non Operating Expenses</b>	<b>15,310</b>
Bank Overdraft Expense	10
<b>Total Expenses</b>	<b>15,320</b>
Rebate from Morgan Stanley Affiliate (Note F)	(13)
Reimbursement of Custodian Fees (Note D)	(61)
<b>Net Expenses</b>	<b>15,246</b>
<b>Net Investment Income</b>	<b>52,433</b>
<b>Realized Gain (Loss):</b>	
Investments Sold (Net of \$372 of Capital Gain Country Tax)	(157,191)
Foreign Currency Forward Exchange Contracts	146,616
Foreign Currency Transactions	(178,567)
Futures Contracts	(1,532)
<b>Net Realized Loss</b>	<b>(190,674)</b>
<b>Change in Unrealized Appreciation (Depreciation):</b>	
Investments (Net of Increase in Deferred Capital Gain Country Tax of \$24)	181,840
Foreign Currency Forward Exchange Contracts	3,091
Foreign Currency Translations	196
Futures Contracts	377
<b>Net Change in Unrealized Appreciation (Depreciation)</b>	<b>185,504</b>
<b>Net Realized Loss and Change in Unrealized Appreciation (Depreciation)</b>	<b>(5,170)</b>
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$ 47,263</b>

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Financial Statements (cont'd)

	<b>Year Ended October 31, 2016 (000)</b>	<b>Year Ended October 31, 2015 (000)</b>
Statements of Changes in Net Assets		
<b>Increase (Decrease) in Net Assets:</b>		
Operations:		
Net Investment Income	\$ 52,433	\$ 54,970
Net Realized Loss	(190,674)	(107,581)
Net Change in Unrealized Appreciation (Depreciation)	185,504	(211,894)
<b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>	<b>47,263</b>	<b>(264,505)</b>
Distributions from and/or in Excess of:		
Paid-in-Capital	(51,099)	(62,394)
<b>Total Distributions</b>	<b>(51,099)</b>	<b>(62,394)</b>
Capital Share Transactions:		
Repurchase of Shares (830,897 and 1,858,510 shares)	(6,032)	(18,582)
<b>Net Decrease in Net Assets Resulting from Capital Share Transactions</b>	<b>(6,032)</b>	<b>(18,582)</b>
<b>Total Decrease</b>	<b>(9,868)</b>	<b>(345,481)</b>
<b>Net Assets:</b>		
Beginning of Period	608,987	954,468
<b>End of Period (Including Accumulated Net Investment Loss of \$(61,043) and \$(47,193))</b>	<b>\$ 599,119</b>	<b>\$ 608,987</b>

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Financial Statements (cont'd)

	<b>Year Ended October 31, 2016 (000)</b>
Statement of Cash Flows	
<b>Cash Flows From Operating Activities:</b>	
Proceeds from Sales and Maturities of Long-Term Investments	\$ 751,462
Purchase of Long-Term Investments	(713,711)
Net (Increase) Decrease in Short-Term Investments	(10,313)
Net (Increase) Decrease in Foreign Currency Holdings	(627)
Net Realized Gain (Loss) for Foreign Currency Transactions, Foreign Currency Forward Exchange Contracts and Futures Contracts	(33,926)
Net Investment Income	52,433
<b>Adjustments to Reconcile Net Investment Income to Net Cash Provided for (Used by) Operating Activities:</b>	
Net (Increase) Decrease in Interest Receivable	(222)
Net (Increase) Decrease in Receivables Related to Operations	1,975
Net (Increase) Decrease in Advisory Fees Payable	7
Net (Increase) Decrease in Interest Payable	8
Net (Increase) Decrease in Payables Related to Operations	(64)
Accretion/Amortization of Discounts and Premiums	(7,001)
Net Cash Provided for (Used by) Operating Activities	40,021
<b>Cash Flows From Financing Activities:</b>	
Net Cash Proceeds for Line of Credit	17,500
Cash Paid for Repurchase of Shares	(6,478)
Cash Distribution Paid	(51,099)
Net Cash Provided for (Used by) Financing Activities	(40,077)
Net Increase (Decrease) in Cash	(56)
<b>Cash at Beginning of Period</b>	<b>(346)</b>
<b>Cash at End of Period</b>	<b>\$ (402)</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>	
Interest Paid on Line of Credit during the Period	\$ 4,940

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Financial Highlights

**Selected Per Share Data and Ratios**

	Year Ended October 31,				
	2016 <sup>(1)</sup>	2015	2014	2013	2012
<b>Net Asset Value, Beginning of Period</b>	\$ 8.96	\$ 13.67	\$ 16.45	\$ 17.71	\$ 17.34
Net Investment Income <sup>(2)</sup>	0.78	0.80	0.94	1.19	1.32
Net Realized and Unrealized Gain (Loss)	(0.07)	(4.64)	(2.11)	(1.48)	0.20
Total from Investment Operations	0.71	(3.84)	(1.17)	(0.29)	1.52
Distributions from and/or in excess of:					
Net Investment Income			(0.49)	(1.00)	(1.15)
Net Realized Gain			(0.51)		
Paid-in-Capital	(0.76)	(0.91)	(0.65)		
Total Distributions	(0.76)	(0.91)	(1.65)	(1.00)	(1.15)
Anti-Dilutive Effect of Share Repurchase Program	0.02	0.04	0.04	0.03	
<b>Net Asset Value, End of Period</b>	\$ 8.93	\$ 8.96	\$ 13.67	\$ 16.45	\$ 17.71
<b>Per Share Market Value, End of Period</b>	\$ 7.87	\$ 7.54	\$ 11.96	\$ 14.35	\$ 16.47



**TOTAL INVESTMENT RETURN:(3)**

Market Value	15.59%	(30.35)%	(5.52)%	(7.21)%	11.38%
Net Asset Value	10.37%	(27.58)%	(5.80)%	(1.08)%	9.61%

**RATIOS, SUPPLEMENTAL DATA:**

<b>Net Assets, End of Period (Thousands)</b>	\$599,119	\$608,987	\$954,468	\$1,172,019	\$1,283,101
Ratio of Expenses to Average Net Assets	2.60%(4)	2.44%(4)	2.20%(4)	2.10%(4)	2.16%(4)
Ratio of Expenses to Average Net Assets Excluding Interest Expense	1.76%(4)	1.74%(4)	1.63%(4)	1.59%(4)	1.59%(4)
Ratio of Net Investment Income to Average Net Assets	8.89%(4)	7.37%(4)	6.30%(4)	6.72%(4)	7.63%(4)
Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets	0.00%(5)	0.00%(5)	0.00%(5)	0.00%(5)	0.00%(5)
Portfolio Turnover Rate	80%	36%	107%	75%	64%

(1) Refer to Note D in the Notes to Financial Statements for discussion of prior period custodian out-of-pocket expenses that were reimbursed in the current period. The amount of the reimbursement was immaterial on a per share basis and did not impact the total return of the Fund. The Ratio of Expenses to Average Net Assets would have been 0.01% higher and the Ratio of Net Investment Income to Average Net Assets would have been 0.01% lower had the custodian not reimbursed the Fund.

(2) Per share amount is based on average shares outstanding.

(3) Total investment return based on net asset value per share reflects the effects of changes in net asset value on the performance of the Fund during each period, and assumes dividends and distributions, if any, were reinvested. This percentage is not an indication of the performance of a stockholder's investment in the Fund based on market value due to differences between the market price of the stock and the net asset

value per share of the Fund. Total returns are based upon the market value and net asset value on the last business day of each period.

(4) The Ratios of Expenses and Net Investment Income reflect the rebate of certain Fund expenses in connection with the investments in Morgan Stanley affiliates during the period. The effect of the rebate on the ratios is disclosed in the above table as "Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets."

(5) Amount is less than 0.005%.

The accompanying notes are an integral part of the financial statements.



## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2016

### Notes to Financial Statements

The Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the "Fund") was incorporated in Maryland on January 25, 2007 and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the "Act"). The Fund applies investment company accounting and reporting guidance. The Fund's primary investment objective is to seek a high level of current income, with a secondary investment objective of long-term capital appreciation. The Fund seeks to achieve its investment objectives by investing, under normal circumstances, at least 80% of its managed assets in emerging markets domestic debt. To the extent the Fund invests in derivative instruments that Morgan Stanley Investment Management Inc. (the "Adviser"), believes have economic characteristics similar to such securities, such investments will be counted for purposes of meeting the Fund's investment objective. To the extent the Fund makes such investments, the Fund will be subject to the risk of such derivative instruments as described herein.

**A. Significant Accounting Policies:** The following significant accounting policies are in conformity with United States ("U.S.") generally accepted accounting principles ("GAAP"). Such policies are consistently followed by the Fund in the preparation of its financial statements. GAAP may require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results may differ from those estimates.

**1. Security Valuation:** (1) Bonds and other fixed income securities may be valued according to the broadest and most representative market. In addition, bonds and other fixed income securities may be valued on the basis of prices provided by a pricing service/vendor. The pricing service/vendor may employ a pricing model that takes into account, among other things, bids, yield spreads, and/or other market data and specific security characteristics. Alternatively, if a valuation is not available from an outside pricing service/vendor, and the security trades on an

exchange, the security may be valued at its latest reported sale price (or at the exchange official closing price if such exchange reports an official closing price), prior to the time when assets are valued. If there are no sales on a given day and if there is no official exchange closing price for that day, the security is valued at the mean between the last reported bid and asked prices if such bid and asked prices are available in the relevant exchanges; (2) when market quotations are not readily available, including circumstances under which the Adviser determines that the closing price, last sale price or the mean between the last reported bid and asked prices are not reflective of a security's market value, portfolio securities are valued at their fair value as determined in good faith under procedures established by and under the general supervision of the Fund's Board of Directors (the "Directors"). Occasionally, developments affecting the closing prices of securities and other assets may occur between the times at which valuations of such securities are determined (that is, close of the foreign market on which the securities trade) and the close of business of the New York Stock Exchange ("NYSE"). If developments occur during such periods that are expected to materially affect the value of such securities, such valuations may be adjusted to reflect the estimated fair value of such securities as of the close of the NYSE, as determined in good faith by the Directors or by the Adviser using a pricing service and/or procedures approved by the Directors; (3) futures are valued at the settlement price on the exchange on which they trade or, if a settlement price is unavailable, at the last sale price on the exchange; (4) quotations of foreign portfolio securities, other assets and liabilities and forward contracts stated in foreign currency are translated into U.S. dollar equivalents at the prevailing market rates prior to the close of the NYSE; and (5) investments in mutual funds, including the Morgan Stanley Institutional



## **Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

### Notes to Financial Statements (cont'd)

Liquidity Funds, are valued at the net asset value ("NAV") as of the close of each business day.

The Directors have responsibility for determining in good faith the fair value of the investments, and the Directors may appoint others, such as the Fund's Adviser or a valuation committee, to assist the Directors in determining fair value and to make the actual calculations pursuant to the fair valuation methodologies previously approved by the Directors. Under procedures approved by the Directors, the Fund's Adviser has formed a Valuation Committee whose members are approved by the Directors. The Valuation Committee provides administration and oversight of the Fund's valuation policies and procedures, which are reviewed at least annually by the Directors. These procedures allow the Fund to utilize independent pricing services, quotations from securities and financial instrument dealers, and other market sources to determine fair value.

The Fund has procedures to determine the fair value of securities and other financial instruments for which market prices are not readily available. Under these procedures, the Valuation Committee convenes on a regular and ad hoc basis to review such securities and considers a number of factors, including valuation methodologies and significant unobservable valuation inputs, when arriving at fair value. The Valuation Committee may employ a market-based approach which may use related or comparable assets or liabilities, recent transactions, market multiples, book values, and other relevant information for the investment to determine the fair value of the investment. An income-based valuation approach may also be used in which the anticipated future cash flows of the investment are discounted to calculate fair value. Discounts may also be applied due to the nature or duration of any restrictions on the disposition of the investments. Due to the inherent uncertainty of valuations of such investments, the fair

values may differ significantly from the values that would have been used had an active market existed. The Valuation Committee employs various methods for calibrating these valuation approaches including a regular review of valuation methodologies, key inputs and assumptions, transactional back-testing or disposition analysis, and reviews of any related market activity.

**2. Fair Value Measurement:** Financial Accounting Standards Board ("FASB") Accounting Standards Codification™ ("ASC") 820, "Fair Value Measurement" ("ASC 820"), defines fair value as the value that the Fund would receive to sell an investment or pay to transfer a liability in a timely transaction with an independent buyer in the principal market, or in the absence of a principal market the most advantageous market for the investment or liability. ASC 820 establishes a three-tier hierarchy to distinguish between (1) inputs that reflect the assumptions market participants would use in valuing an asset or liability developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in valuing an asset or liability developed based on the best information available in the circumstances (unobservable inputs) and to establish classification of fair value measurements for disclosure purposes. Various inputs are used in determining the value of the Fund's investments. The inputs are summarized in the three broad levels listed below.

- Level 1 unadjusted quoted prices in active markets for identical investments
- Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 significant unobservable inputs including the Fund's own assumptions in determining the fair value of



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Notes to Financial Statements (cont'd)

investments. Factors considered in making this determination may include, but are not limited to, information obtained by contacting the issuer, analysts, or the appropriate stock exchange (for exchange-traded securities), analysis of the issuer's financial statements or other available documents and, if necessary, available information concerning other securities in similar circumstances

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities and the determination of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each security.

The following is a summary of the inputs used to value the Fund's investments as of October 31, 2016.

<b>Investment Type</b>	<b>Level 1 Unadjusted quoted prices (000)</b>	<b>Level 2 Other significant observable inputs (000)</b>	<b>Level 3 Significant unobservable inputs (000)</b>	<b>Total (000)</b>
<b>Assets:</b>				
<b>Fixed Income Securities</b>				
Corporate Bonds	\$	\$ 44,285	\$	\$ 44,285
Sovereign		803,274		803,274
<b>Total Fixed Income Securities</b>		<b>847,559</b>		<b>847,559</b>
<b>Short-Term Investments</b>				
Sovereign		17,277		17,277
U.S. Treasury Securities		8,218		8,218
<b>Total Short-Term Investments</b>		<b>25,495</b>		<b>25,495</b>
<b>Investment Type</b>	<b>Level 1 Unadjusted quoted prices (000)</b>	<b>Level 2 Other significant observable inputs (000)</b>	<b>Level 3 Significant unobservable inputs (000)</b>	<b>Total (000)</b>
<b>Assets: (cont'd)</b>				



<b>Foreign Currency Forward Exchange Contracts</b>	\$	\$ 4,010	\$	\$ 4,010
<b>Futures Contracts</b>	377			377
<b>Total Assets</b>	<b>377</b>	<b>877,064</b>		<b>877,441</b>
<b>Liabilities:</b>				
<b>Foreign Currency Forward Exchange Contracts</b>		(5,012)		(5,012)
<b>Total</b>	<b>\$ 377</b>	<b>\$ 872,052</b>	<b>\$</b>	<b>\$872,429</b>

Transfers between investment levels may occur as the markets fluctuate and/or the availability of data used in an investment's valuation changes. The Fund recognizes transfers between the levels as of the end of the period. As of October 31, 2016, the Fund did not have any investments transfer between investment levels.

**3. Foreign Currency Translation and Foreign Investments:** The books and records of the Fund are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars as follows:

investments, other assets and liabilities at the prevailing rate of exchange on the valuation date;

investment transactions and investment income at the prevailing rates of exchange on the dates of such transactions.

Although the net assets of the Fund are presented at the foreign exchange rates and market values at the close of the period, the Fund does not isolate that portion of the results

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

Notes to Financial Statements (cont'd)

of operations arising as a result of changes in the foreign exchange rates from the fluctuations arising from changes in the market prices of securities held at period end. Similarly, the Fund does not isolate the effect of changes in foreign exchange rates from the fluctuations arising from changes in the market prices of securities sold during the period. Accordingly, realized and unrealized foreign currency gains (losses) on investments in securities are included in the reported net realized and unrealized gains (losses) on investment transactions and balances. However, pursuant to U.S. federal income tax regulations, gains and losses from certain foreign currency transactions and the foreign currency portion of gains and losses realized on sales and maturities of foreign denominated debt securities are treated as ordinary income for U.S. federal income tax purposes.

Net realized gains (losses) on foreign currency transactions represent net foreign exchange gains (losses) from foreign currency forward exchange contracts, disposition of foreign currencies, currency gains (losses) realized between the trade and settlement dates on securities transactions, and the difference between the amount of investment income and foreign withholding taxes recorded on the Fund's books and the U.S. dollar equivalent amounts actually received or paid. Net unrealized currency gains (losses) from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of unrealized appreciation (depreciation) in investments and foreign currency translations in the Statement of Assets and Liabilities. The change in unrealized currency gains (losses) on foreign currency translations for the period is reflected in the Statement of Operations.

A significant portion of the Fund's net assets consist of securities of issuers located in emerging markets, which are denominated in foreign currencies. Such securities may be

concentrated in a limited number of countries and regions and may vary throughout the year. Changes in currency exchange rates will affect the value of and investment income from foreign currency denominated securities. Emerging market securities are often subject to greater price volatility, limited capitalization and liquidity, and higher rates of inflation than securities of companies based in the U.S. In addition, emerging market issuers may be subject to substantial governmental involvement in the economy and greater social, economic and political uncertainty.

**4. Structured Investments:** The Fund invested a portion of its assets in structured investments. A structured investment is a derivative security designed to offer a return linked to a particular underlying security, currency, commodity or market. Structured investments may come in various forms including notes (such as exchange-traded notes), warrants and options to purchase securities. The Fund will typically use structured investments to gain exposure to a permitted underlying security, currency, commodity or market when direct access to a market is limited or inefficient from a tax or cost standpoint. There can be no assurance that structured investments will trade at the same price or have the same value as the underlying security, currency, commodity or market. Investments in structured investments involve risks including issuer risk, counterparty risk and market risk. Holders of structured investments bear risks of the underlying investment and are subject to issuer or counterparty risk because the Fund is relying on the creditworthiness of such issuer or counterparty and has no rights with respect to the underlying investment. Certain structured investments may be thinly traded or have a limited trading market and may have the effect of increasing the Fund's illiquidity to the extent that the Fund, at a particular time, may be unable to find qualified buyers for these securities.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**October 31, 2016**

Notes to Financial Statements (cont'd)

**5. Derivatives:** The Fund may, but is not required to, use derivative instruments for a variety of purposes, including hedging, risk management, portfolio management or to earn income. Derivatives are financial instruments whose value is based, in part, on the value of an underlying asset, interest rate, index or financial instrument. Prevailing interest rates and volatility levels, among other things, also affect the value of derivative instruments. A derivative instrument often has risks similar to its underlying asset and may have additional risks, including imperfect correlation between the value of the derivative and the underlying asset, risks of default by the counterparty to certain transactions, magnification of losses incurred due to changes in the market value of the securities, instruments, indices or interest rates to which the derivative instrument relates, risks that the transactions may not be liquid and risks arising from margin requirements. The use of derivatives involves risks that are different from, and possibly greater than, the risks associated with other portfolio investments. Derivatives may involve the use of highly specialized instruments that require investment techniques and risk analyses different from those associated with other portfolio investments. All of the Fund's holdings, including derivative instruments, are marked-to-market each day with the change in value reflected in unrealized appreciation (depreciation). Upon disposition, a realized gain or loss is recognized.

Certain derivative transactions may give rise to a form of leverage. Leverage magnifies the potential for gain and the risk of loss. Leverage associated with derivative transactions may cause the Fund to liquidate portfolio positions when it may not be advantageous to do so to satisfy its obligations or to meet earmarking or segregation requirements, pursuant to applicable Securities and Exchange Commission rules and regulations, or may cause the Fund to be more volatile than if the Fund had not been

leveraged. Although the Adviser seeks to use derivatives to further the Fund's investment objectives, there is no assurance that the use of derivatives will achieve this result.

Following is a description of the derivative instruments and techniques that the Fund used during the period and their associated risks:

**Futures:** A futures contract is a standardized, exchange-traded agreement to buy or sell a specific quantity of an underlying asset, reference rate or index at a specific price at a specific future time. The value of a futures contract tends to increase and decrease in tandem with the value of the underlying instrument. Depending on the terms of the particular contract, futures contracts are settled through either physical delivery of the underlying instrument on the settlement date or by payment of a cash settlement amount on the settlement date. During the period the futures contract is open, payments are received from or made to the broker based upon changes in the value of the contract (the variation margin). A decision as to whether, when and how to use futures contracts involves the exercise of skill and judgment and even a well-conceived futures transaction may be unsuccessful because of market behavior or unexpected events. In addition to the derivatives risks discussed above, the prices of futures contracts can be highly volatile, using futures contracts can lower total return, and the potential loss from futures contracts can exceed the Fund's initial investment in such contracts. No assurance can be given that a liquid market will exist for any particular futures contract at any particular time. There is also the risk of loss by the Fund of margin deposits in the event of bankruptcy of a broker with which the Fund has open positions in the futures contract.

**Foreign Currency Forward Exchange Contracts:** In connection with its investments in foreign securities, the Fund also entered into contracts with banks, brokers or



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

## Notes to Financial Statements (cont'd)

dealers to purchase or sell securities or foreign currencies at a future date. A foreign currency forward exchange contract ("currency contract") is a negotiated agreement between the contracting parties to exchange a specified amount of currency at a specified future time at a specified rate. The rate can be higher or lower than the spot rate between the currencies that are the subject of the contract. Currency contracts may be used to protect against uncertainty in the level of future foreign currency exchange rates or to gain or modify exposure to a particular currency. To the extent hedged by the use of currency contracts, the precise matching of the currency contract amounts and the value of the securities involved will not generally be possible because the future value of such securities in foreign currencies will change as a consequence of market movements in the value of those securities between the date on which the contract is entered into and the date it matures. Furthermore, such transactions may reduce or preclude the opportunity for gain if the value of the currency should move in the direction opposite to the position taken. There is additional risk to the extent that currency contracts create exposure to currencies in which the Fund's securities are not denominated. Unanticipated changes in currency prices may result in poorer overall performance for the Fund than if it had not entered into such contracts. The use of currency contracts involves the risk of loss from the insolvency or bankruptcy of the counterparty to the contract or the failure of the counterparty to make payments or otherwise comply with the terms of the contract. A currency contract is marked-to-market daily and the change in market value is recorded by the Fund as unrealized gain or loss. The Fund records realized gains (losses) when the currency contract is closed

equal to the difference between the value of the currency contract at the time it was opened and the value at the time it was closed.

FASB ASC 815, "Derivatives and Hedging" ("ASC 815"), is intended to improve financial reporting about derivative instruments by requiring enhanced disclosures to enable investors to better understand how and why the Fund uses derivative instruments, how these derivative instruments are accounted for and their effects on the Fund's financial position and results of operations.

The following table sets forth the fair value of the Fund's derivative contracts by primary risk exposure as of October 31, 2016.

	<b>Asset Derivatives Statement of Assets and Liabilities Location</b>	<b>Primary Risk Exposure</b>	<b>Value (000)</b>
Foreign Currency Forward Exchange Contracts	Unrealized Appreciation on Foreign Currency Forward Exchange Contracts	Currency Risk	\$ 4,010
Futures Contracts	Variation Margin on Futures Contracts	Interest Rate Risk	377(a)
<b>Total</b>			<b>\$ 4,387</b>
	<b>Liability Derivatives Statement of Assets and</b>	<b>Primary Risk Exposure</b>	<b>Value (000)</b>

**Liabilities Location**

Foreign Currency	Unrealized		
Forward Exchange	Depreciation		
Contracts	on Foreign Currency		
	Forward Exchange		
	Contracts	Currency Risk	\$(5,012)

(a) This amount represents the cumulative appreciation (depreciation) as reported in the Portfolio of Investments. The Statement of Assets and Liabilities only reflects the current day's net variation margin.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Notes to Financial Statements (cont'd)

The following tables set forth by primary risk exposure the Fund's realized gains (losses) and change in unrealized appreciation (depreciation) by type of derivative contract for the year ended October 31, 2016 in accordance with ASC 815.

<b>Primary Risk Exposure</b>	<b>Realized Gain (Loss) Derivative Type</b>	<b>Value (000)</b>
	Foreign Currency Forward	
Currency Risk	Exchange Contracts	\$146,616
Interest Rate Risk	Futures Contracts	(1,532)
<b>Total</b>		<b>\$145,084</b>

<b>Change in Unrealized Appreciation (Depreciation)</b>		
<b>Primary Risk Exposure</b>	<b>Derivative Type</b>	<b>Value (000)</b>
	Foreign Currency Forward	
Currency Risk	Exchange Contracts	\$ 3,091
Interest Rate Risk	Futures Contracts	377
<b>Total</b>		<b>\$ 3,468</b>

At October 31, 2016, the Fund's derivative assets and liabilities are as follows:

**Gross Amounts of Assets and Liabilities Presented in the Statement of Assets and Liabilities**

<b>Derivatives(b)</b>	<b>Assets(c) (000)</b>	<b>Liabilities(c) (000)</b>
Foreign Currency Forward Exchange Contracts	\$ 4,010	\$ (5,012)

(b)Excludes exchange-traded derivatives.

(c)Absent an event of default or early termination, OTC derivative assets and liabilities are presented gross and not offset in the Statement of Assets and Liabilities.

The Fund typically enters into International Swaps and Derivatives Association, Inc. Master Agreements ("ISDA Master Agreements") or similar master agreements (collectively, "Master Agreements") with its contract counterparties for certain OTC derivatives in order to, among other things, reduce its credit risk to counterparties. ISDA Master Agreements include provisions for general obligations, representations, collateral and events of default or termination. Under an ISDA Master Agreement, the Fund typically may offset with the counterparty certain OTC derivative financial instruments' payables and/or receivables with collateral held and/or posted and create one single net payment (close-out netting) in the event of default, termination and/or potential deterioration in the credit quality of the counterparty. Various Master Agreements govern the terms of certain transactions with counterparties, including transactions such as swap, forward, repurchase and reverse repurchase agreements. These Master Agreements typically attempt to reduce the counterparty risk associated with such transactions by specifying credit protection mechanisms and providing standardization that improves legal certainty. Cross-termination provisions

under Master Agreements typically provide that a default in connection with one transaction between the Fund and a counterparty gives the non-defaulting party the right to terminate any other transactions in place with the defaulting party to create one single net payment due to/due from the defaulting party and may be a feature in certain Master Agreements. In the event the Fund exercises its right to terminate a Master Agreement after a counterparty experiences a termination event as defined in the Master Agreement, the return of collateral with market value in excess of the Fund's net liability may be delayed or denied.



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****October 31, 2016**

Notes to Financial Statements (cont'd)

The following tables present derivative financial instruments that are subject to enforceable netting arrangements as of October 31, 2016.

**Gross Amounts Not Offset in the Statement of Assets and Liabilities**

<b>Counterparty</b>	<b>Gross Asset Derivatives Presented in Statement of Assets and Liabilities (000)</b>	<b>Financial Instrument (000)</b>	<b>Collateral Received (000)</b>	<b>Net Amount (not less than \$0) (000)</b>
Citibank NA	\$ 461	\$ (461)	\$	\$ 0
JPMorgan Chase Bank NA	3,549	(2,413)		1,136
State Street Bank and Trust Co.	@	( @)		0
<b>Total</b>	<b>\$ 4,010</b>	<b>\$ (2,874)</b>	<b>\$</b>	<b>\$ 1,136</b>

**Gross Amounts Not Offset in the Statement of Assets and Liabilities**

<b>Counterparty</b>	<b>Gross Liability Derivatives Presented in Statement of Assets and Liabilities (000)</b>	<b>Financial Instrument (000)</b>	<b>Collateral Pledged (000)(d)</b>	<b>Net Amount (not less than \$0) (000)</b>
Citibank NA	\$ 1,970	\$ (461)	\$ (1,133)	\$ 376
JPMorgan Chase Bank NA	2,413	(2,413)		0
State Street Bank and Trust Co.	629	( @)		629
<b>Total</b>	<b>\$</b>			