

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
Form N-CSRS  
July 09, 2013

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)

Arthur Lev

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

Registrant's telephone number, including area code: 201-830-8894

Date of fiscal year end: October 31, 2013

Date of reporting period: April 30, 2013

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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

Michael Bozic

Kathleen A. Dennis

James F. Higgins

Dr. Manuel H. Johnson

Joseph J. Kearns

Michael F. Klein

Michael E. Nugent

W. Allen Reed

Fergus Reid

**Officers**

Michael E. Nugent

*Chairperson of the Board*

Arthur Lev

*President and Principal Executive Officer*

Mary Ann Picciotto

*Chief Compliance Officer*

Stefanie V. Chang Yu

*Vice President*

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.

250 Royall Street

Canton, Massachusetts 02021

**Legal Counsel**

Dechert LLP

1095 Avenue of the Americas

New York, New York 10036

**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

Emerging Markets Domestic

Debt Fund, Inc.

NYSE: EDD

**Morgan Stanley**

**Investment Management Inc.**

**Adviser**

**Semi-Annual  
Report**

**April 30, 2013**





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

**April 30, 2013**

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

**April 30, 2013**

Letter to Stockholders (unaudited)

### **Performance**

For the six-months ended April 30, 2013, the Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the "Fund") had total returns of 10.96%, based on net asset value, and 8.19% 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 7.02%. On April 30, 2013, the closing price of the Fund's shares on the New York Stock Exchange was \$17.31, representing a 9.3% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

### **Factors Affecting Performance**

- Despite drawn-out U.S. fiscal cliff negotiations and anti-austerity labor protests sweeping across Europe, global risk assets including emerging markets debt strengthened in the final two months of 2012, as manufacturing activity in China expanded, U.S. presidential election uncertainty abated, and the likelihood of a Greek euro exit fell, prompting investors to take a more optimistic tone toward global growth.
- In a tepid start to 2013, global risk assets weakened in the first quarter of 2013, as fears about Europe's ability to contain its crisis, lower global growth prospects, mainly from Europe, and U.S. debt ceiling and sequestration talks negatively impacted risk assets.
- Global risk assets strengthened in the last month of the six-month period, with the Bank of Japan's (BOJ) announcement for additional liquidity providing stimulus offset concerns about growth in China, cantankerous exchanges between North Korea and a U.S./South Korea alliance threatening the regional balance, and increased fears about homegrown terrorism following a terror attack at the Boston Marathon.
- During what has been a volatile start to the year, emerging market currencies fell against the U.S. dollar, as global factors continued to dictate the appetite for higher-yielding assets. The euro edged lower versus the U.S. dollar (USD) due to disappointing European economic data, Italy's election fragmentation, and new fears of European Union (EU) debt crisis contagion from Cyprus.
- Capital into emerging market bond funds tracked by EPFR Global rose \$24.5 billion in the six-month period ended April 30, 2013, according to weekly data. By currency, investors have displayed a clear preference for local market debt, as local currency funds grabbed \$16.5 billion, followed by hard currency funds with \$5.4 billion and blended currency funds at \$2.6 billion.
- The portfolio benefited from shorter-than-benchmark duration and overweight foreign currency in Brazil, longer-than-benchmark duration in Hungary, overweight exposure to Mexico and Turkey, exposure to the Polish zloty, and off-Index exposure to Venezuelan external debt. Brazil's economy showed signs of recovery early in the period, however, growth numbers have disappointed so far this year and concerns about a buildup of inflation pressures have risen, resulting in a reversal of its easing cycle. Hungary's economic recession deepened in the fourth quarter of 2012, prompting further speculation for rate cuts to help support growth. Mexico benefited from firming growth and improved labor markets as well as housing data in the U.S., the Latin American country's main trading partner. Turkey continued to benefit from its economy's resilience to slower growing euro-zone countries and the neighboring



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

**April 30, 2013**

Letter to Stockholders (unaudited) (cont'd)

Syrian conflict. In Venezuela, market participants speculated about the chances of a regime change with market-unfriendly President Hugo Chavez on medical leave for much of the period. He would later die after a long struggle with cancer. Exposure to shorter duration USD-denominated Argentinean local law bonds early in the period also contributed to relative performance.

- Conversely, shorter-than-benchmark duration in Malaysia detracted from relative returns. Malaysia benefited from dissipating inflation expectations. In addition, security selection in South Africa hurt relative performance.

### **Management Strategies**

- We expect the global economy to exhibit varying degrees of economic recovery in 2013. In our view, emerging markets may be poised to outperform developed markets, where growth may likely remain below potential. U.S. fiscal woes remain prominent, while uncertainty around economic conditions in Europe and, to a lesser extent, China still remain. We expect growth in the developed world to remain under pressure until there is some resolution to the fiscal issues in Europe and the U.S.
- To help promote growth, developed market central banks have increased their policy accommodation, supporting commodity prices, capital inflows into emerging countries, and demand for higher-yielding assets. Despite diminished "tail" risks (an extreme level of risk) buoying sentiment for higher yielding assets, risk emanating from both emerging and developed markets will still need to be monitored closely, as highlighted by recent events in Cyprus.
- The policy response function of developed central banks will be critical in 2013. We expect rates to remain low and in a narrow range and we believe that monetary policy will ultimately be supportive of risk assets in 2013. As a result, we believe carry strategies and an overweight to spread product remains appropriate for 2013.
- Despite challenges ahead from an uncertain global environment, we remain positive on emerging markets debt growth and debt prospects due to generally strong balance sheets and prudent fiscal and monetary management. Most emerging market countries still have scope for further policy stimulus should global growth conditions deteriorate. We believe that developing central banks will continue to adopt policies aimed at limiting local currency appreciation, but will not be able to reverse the longer-term appreciation trend in their currencies.

Sincerely,

Arthur Lev  
President and Principal Executive Officer May 2013

\* 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.



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013 (unaudited)**

Portfolio of Investments

*(Showing Percentage of Total Value of Investments)*

|                                                                                            | <b>Face<br/>Amount<br/>(000)</b> | <b>Value<br/>(000)</b> |
|--------------------------------------------------------------------------------------------|----------------------------------|------------------------|
| <b>FIXED INCOME SECURITIES (99.6%)</b>                                                     |                                  |                        |
| <b>Brazil (16.0%)</b>                                                                      |                                  |                        |
| <b>Sovereign (16.0%)</b>                                                                   |                                  |                        |
| Brazil Notas do Tesouro Nacional, Series F, 10.00%, 1/1/14 - 1/1/21                        | BRL 546,656                      | \$ 277,275             |
| <b>Chile (0.6%)</b>                                                                        |                                  |                        |
| <b>Sovereign (0.6%)</b>                                                                    |                                  |                        |
| Chile Government International Bond, 5.50%, 8/5/20                                         | CLP 4,665,000                    | 10,557                 |
| <b>Colombia (3.8%)</b>                                                                     |                                  |                        |
| <b>Sovereign (3.8%)</b>                                                                    |                                  |                        |
| Colombia Government International Bond, 7.75%, 4/14/21                                     | COP 29,000,000                   | 19,994                 |
| 9.85%, 6/28/27                                                                             | 46,000,000                       | 39,301                 |
| 12.00%, 10/22/15                                                                           | 11,000,000                       | 7,228                  |
|                                                                                            |                                  | 66,523                 |
| <b>Hungary (6.7%)</b>                                                                      |                                  |                        |
| <b>Sovereign (6.7%)</b>                                                                    |                                  |                        |
| Hungary Government Bond, 6.75%, 2/24/17                                                    | HUF 8,500,000                    | 39,893                 |
| 7.50%, 11/12/20                                                                            | 15,180,000                       | 76,314                 |
|                                                                                            |                                  | 116,207                |
| <b>Indonesia (6.5%)</b>                                                                    |                                  |                        |
| <b>Sovereign (6.5%)</b>                                                                    |                                  |                        |
| Barclays Bank PLC, Indonesia Government Bonds, Credit Linked Notes, 10.00%, 7/17/17 (a)(b) | IDR360,000,000                   | 44,367                 |
| Credit Suisse, Indonesia Government Bonds, Credit Linked Notes, 10.00%, 7/17/17            | 154,683,530                      | 19,064                 |
| Deutsche Bank AG, Republic of Indonesia Government Bond, Credit Linked Notes,              | 60,000,000                       | 8,339                  |

| 11.00%, 12/15/20 (a)(b)                                                                                  |                                  |                        |
|----------------------------------------------------------------------------------------------------------|----------------------------------|------------------------|
|                                                                                                          | <b>Face<br/>Amount<br/>(000)</b> | <b>Value<br/>(000)</b> |
| JPMorgan Chase Bank,<br>London, Indonesia<br>Government Bonds,<br>Credit Linked Notes,<br>8.25%, 7/17/21 | IDR 135,000,000                  | \$ 16,500              |
| 10.00%, 7/19/17 (b)                                                                                      | 192,525,000                      | 23,727                 |
|                                                                                                          |                                  | 111,997                |
| <b>Malaysia (2.9%)</b>                                                                                   |                                  |                        |
| <b>Sovereign (2.9%)</b>                                                                                  |                                  |                        |
| Malaysia Government Bond,<br>3.84%, 8/12/15                                                              | MYR 110,000                      | 36,878                 |
| 5.09%, 4/30/14                                                                                           | 42,152                           | 14,146                 |
|                                                                                                          |                                  | 51,024                 |
| <b>Mexico (11.2%)</b>                                                                                    |                                  |                        |
| <b>Sovereign (11.2%)</b>                                                                                 |                                  |                        |
| Mexican Bonos,<br>7.50%, 6/3/27                                                                          | MXN 72,585                       | 7,645                  |
| 8.00%, 6/11/20                                                                                           | 1,094,028                        | 110,702                |
| Petroleos Mexicanos (Units),<br>7.65%, 11/24/21 (a)(c)                                                   | 791,300                          | 75,329                 |
|                                                                                                          |                                  | 193,676                |
| <b>Peru (1.9%)</b>                                                                                       |                                  |                        |
| <b>Sovereign (1.9%)</b>                                                                                  |                                  |                        |
| Peru Government Bond,<br>7.84%, 8/12/20                                                                  | PEN 37,745                       | 17,904                 |
| Peruvian Government<br>International Bond (Units),<br>7.84%, 8/12/20 (c)                                 | 30,000                           | 14,231                 |
|                                                                                                          |                                  | 32,135                 |
| <b>Philippines (1.0%)</b>                                                                                |                                  |                        |
| <b>Sovereign (1.0%)</b>                                                                                  |                                  |                        |
| Philippine Government<br>International Bond,<br>4.95%, 1/15/21                                           | PHP 648,000                      | 17,711                 |
| <b>Poland (9.1%)</b>                                                                                     |                                  |                        |
| <b>Sovereign (9.1%)</b>                                                                                  |                                  |                        |
| Poland Government Bond,<br>5.25%, 10/25/20                                                               | PLN 314,000                      | 114,367                |
| 5.50%, 10/25/19                                                                                          | 98,947                           | 36,089                 |
| 5.75%, 4/25/29                                                                                           | 16,780                           | 6,750                  |
|                                                                                                          |                                  | 157,206                |

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

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013 (unaudited)**

Portfolio of Investments (cont'd)

*(Showing Percentage of Total Value of Investments)*

|                                                     | <b>Face<br/>Amount<br/>(000)</b> | <b>Value<br/>(000)</b> |
|-----------------------------------------------------|----------------------------------|------------------------|
| <b>Russia (11.8%)</b>                               |                                  |                        |
| <b>Corporate Bond (0.7%)</b>                        |                                  |                        |
| VimpelCom Holdings BV,<br>9.00%, 2/13/18 (a)        | RUB 378,100                      | \$ 12,767              |
| <b>Sovereign (11.1%)</b>                            |                                  |                        |
| Russian Federal Bond OFZ,<br>7.05%, 1/19/28         | 875,000                          | 28,990                 |
| 8.15%, 2/3/27                                       | 3,150,000                        | 114,732                |
| Russian Foreign Bond<br>Eurobond,<br>7.85%, 3/10/18 | 290,000                          | 10,077                 |
| 7.85%, 3/10/18 (a)                                  | 1,095,000                        | 38,051                 |
|                                                     |                                  | 191,850                |
|                                                     |                                  | 204,617                |
| <b>South Africa (8.5%)</b>                          |                                  |                        |
| <b>Sovereign (8.5%)</b>                             |                                  |                        |
| South Africa<br>Government Bond,<br>6.75%, 3/31/21  | ZAR 774,700                      | 90,205                 |
| 7.25%, 1/15/20                                      | 481,524                          | 57,553                 |
|                                                     |                                  | 147,758                |
| <b>Thailand (0.8%)</b>                              |                                  |                        |
| <b>Sovereign (0.8%)</b>                             |                                  |                        |
| Thailand Government Bond,<br>5.25%, 7/13/13         | THB 395,100                      | 13,527                 |
| <b>Turkey (14.9%)</b>                               |                                  |                        |
| <b>Corporate Bond (3.7%)</b>                        |                                  |                        |
| Turkiye Garanti Bankasi AS,<br>7.38%, 3/7/18 (a)    | TRY 111,480                      | 63,340                 |
| <b>Sovereign (11.2%)</b>                            |                                  |                        |
| Turkey Government Bond,<br>10.50%, 1/15/20          | 278,825                          | 193,789                |
|                                                     |                                  | 257,129                |
| <b>Venezuela (3.9%)</b>                             |                                  |                        |
| <b>Sovereign (3.9%)</b>                             |                                  |                        |
| Petroleos de Venezuela SA,<br>8.50%, 11/2/17        | \$ 43,240                        | 41,943                 |
| 12.75%, 2/17/22                                     | 22,000                           | 24,585                 |
|                                                     | 1,229                            | 1,214                  |

|                                                               |        |
|---------------------------------------------------------------|--------|
| Venezuela Government<br>International Bond,<br>9.25%, 9/15/27 | 67,742 |
|---------------------------------------------------------------|--------|

|                                                                |           |
|----------------------------------------------------------------|-----------|
| <b>TOTAL FIXED INCOME<br/>SECURITIES</b><br>(Cost \$1,673,850) | 1,725,084 |
|----------------------------------------------------------------|-----------|

|                                                                                                                              | Shares    | Value<br>(000) |
|------------------------------------------------------------------------------------------------------------------------------|-----------|----------------|
| <b>SHORT-TERM INVESTMENT (0.4%)</b>                                                                                          |           |                |
| <b>Investment Company (0.4%)</b>                                                                                             |           |                |
| Morgan Stanley Institutional<br>Liquidity Funds Money Market<br>Portfolio Institutional Class<br>(See Note F) (Cost \$7,437) | 7,437,359 | \$ 7,437       |

|                                                                 |           |
|-----------------------------------------------------------------|-----------|
| <b>TOTAL INVESTMENTS<br/>(100.0%)</b><br>(Cost \$1,681,287) (d) | 1,732,521 |
|-----------------------------------------------------------------|-----------|

|                                                  |           |
|--------------------------------------------------|-----------|
| <b>LIABILITIES IN EXCESS OF<br/>OTHER ASSETS</b> | (349,981) |
|--------------------------------------------------|-----------|

|                   |             |
|-------------------|-------------|
| <b>NET ASSETS</b> | \$1,382,540 |
|-------------------|-------------|

(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 April 30, 2013.

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

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

**Foreign Currency Forward Exchange Contracts:**

The Fund had the following foreign currency forward exchange contracts open at April 30, 2013:

| Counterparty              | Currency<br>to<br>Deliver<br>(000) | Value<br>(000) | Settlement<br>Date | In<br>Exchange<br>For<br>(000) | Value<br>(000) | Unrealized<br>Appreciation<br>(Depreciation)<br>(000) |           |        |
|---------------------------|------------------------------------|----------------|--------------------|--------------------------------|----------------|-------------------------------------------------------|-----------|--------|
| JPMorgan<br>Chase<br>Bank | JPY                                | 9,013,485      | \$ 92,463          | 5/9/13                         | USD            | 92,717                                                | \$ 92,717 | \$ 254 |
| UBS<br>AG                 | JPY                                | 2,937,677      | 30,136             | 5/9/13                         | USD            | 30,138                                                | 30,138    | 2      |
| UBS<br>AG                 | JPY                                | 4,808,938      | 49,332             | 5/9/13                         | USD            | 49,478                                                | 49,478    | 146    |
| JPMorgan<br>Chase<br>Bank | USD                                | 82,699         | 82,699             | 5/29/13                        | MYR            | 253,000                                               | 82,996    | 297    |



|                           |     |        |           |         |     |         |           |        |
|---------------------------|-----|--------|-----------|---------|-----|---------|-----------|--------|
| JPMorgan<br>Chase<br>Bank | USD | 30,759 | 30,759    | 5/29/13 | THB | 900,000 | 30,618    | (141)  |
|                           |     |        | \$285,389 |         |     |         | \$285,947 | \$ 558 |

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

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

**April 30, 2013 (unaudited)**

Portfolio of Investments (cont'd)

|     |                      |
|-----|----------------------|
| BRL | Brazilian Real       |
| CLP | Chilean Peso         |
| COP | Colombian Peso       |
| HUF | Hungarian Forint     |
| IDR | Indonesian Rupiah    |
| JPY | Japanese Yen         |
| MXN | Mexican New Peso     |
| MYR | Malaysian Ringgit    |
| PEN | Peruvian Nuevo Sol   |
| PHP | Philippine Peso      |
| PLN | Polish Zloty         |
| RUB | Russian Ruble        |
| THB | Thai Baht            |
| TRY | Turkish Lira         |
| USD | United States Dollar |
| ZAR | South African Rand   |

**Portfolio Composition**

| <b>Classification</b>    | <b>Percentage of<br/>Total Investments</b> |
|--------------------------|--------------------------------------------|
| Sovereign                | 95.2%                                      |
| Other*                   | 4.8                                        |
| <b>Total Investments</b> | <b>100.0%**</b>                            |

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

\*\* Does not include open foreign currency forward exchange contracts with net unrealized appreciation of approximately \$558,000.

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



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013 (unaudited)**

Financial Statements

|                                                                                                           | <b>April 30, 2013</b> |
|-----------------------------------------------------------------------------------------------------------|-----------------------|
|                                                                                                           | <b>(000)</b>          |
| Statement of Assets and Liabilities                                                                       |                       |
| <b>Assets:</b>                                                                                            |                       |
| Investments in Securities of Unaffiliated Issuers, at Value<br>(Cost \$1,673,850)                         | \$ 1,725,084          |
| Investment in Security of Affiliated Issuer, at Value (Cost<br>\$7,437)                                   | 7,437                 |
| Total Investments in Securities, at Value (Cost \$1,681,287)                                              | 1,732,521             |
| Foreign Currency, at Value (Cost \$3,628)                                                                 | 3,701                 |
| Interest Receivable                                                                                       | 38,439                |
| Receivable for Lehman Brothers Closed Reverse<br>Repurchase Transactions                                  | 8,957                 |
| Unrealized Appreciation on Foreign Currency Forward<br>Exchange Contracts                                 | 699                   |
| Receivable for Investments Sold                                                                           | 121                   |
| Receivable from Affiliate                                                                                 | 2                     |
| Other Assets                                                                                              | 128                   |
| <b>Total Assets</b>                                                                                       | <b>1,784,568</b>      |
| <b>Liabilities:</b>                                                                                       |                       |
| Payable for Line of Credit                                                                                | 400,038               |
| Payable for Advisory Fees                                                                                 | 1,438                 |
| Unrealized Depreciation on Foreign Currency Forward<br>Exchange Contracts                                 | 141                   |
| Payable for Custodian Fees                                                                                | 118                   |
| Payable for Administration Fees                                                                           | 115                   |
| Payable for Professional Fees                                                                             | 63                    |
| Payable for Stockholder Servicing Agent Fees                                                              | 1                     |
| Other Liabilities                                                                                         | 114                   |
| <b>Total Liabilities</b>                                                                                  | <b>402,028</b>        |
| <b>Net Assets</b>                                                                                         |                       |
| Applicable to 72,431,536 Issued and Outstanding \$.01 Par<br>Value Shares (100,000,000 Shares Authorized) | \$ 1,382,540          |
| <b>Net Asset Value Per Share</b>                                                                          | <b>\$ 19.09</b>       |
| <b>Net Assets Consist of:</b>                                                                             |                       |
| Common Stock                                                                                              | \$ 724                |
| Paid-in-Capital                                                                                           | 1,303,597             |
| Accumulated Undistributed Net Investment Income                                                           | 20,464                |
| Accumulated Net Realized Gain                                                                             | 6,142                 |
| Unrealized Appreciation (Depreciation) on:                                                                |                       |
| Investments                                                                                               | 51,234                |
| Foreign Currency Forward Exchange Contracts                                                               | 558                   |
| Foreign Currency Translations                                                                             | (179)                 |
| <b>Net Assets</b>                                                                                         | <b>\$ 1,382,540</b>   |

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

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013 (unaudited)**

Financial Statements (cont'd)

|                                                                               | <b>Six Months Ended<br/>April 30, 2013<br/>(000)</b> |
|-------------------------------------------------------------------------------|------------------------------------------------------|
| Statement of Operations                                                       |                                                      |
| <b>Investment Income:</b>                                                     |                                                      |
| Interest from Securities of Unaffiliated Issuers                              | \$ 58,345                                            |
| Dividends from Security of Affiliated Issuer                                  | 16                                                   |
| <b>Total Investment Income</b>                                                | <b>58,361</b>                                        |
| <b>Expenses:</b>                                                              |                                                      |
| Advisory Fees (Note B)                                                        | 8,610                                                |
| Administration Fees (Note C)                                                  | 689                                                  |
| Custodian Fees (Note D)                                                       | 476                                                  |
| Administrative Fees on Line of Credit (Note G)                                | 458                                                  |
| Stockholder Reporting Expenses                                                | 89                                                   |
| Professional Fees                                                             | 80                                                   |
| Directors' Fees and Expenses                                                  | 15                                                   |
| Stockholder Servicing Agent Fees                                              | 4                                                    |
| Other Expenses                                                                | 77                                                   |
| <b>Expenses Before Non Operating Expenses</b>                                 | <b>10,498</b>                                        |
| Interest Expense on Line of Credit (Note G)                                   | 3,445                                                |
| <b>Total Expenses</b>                                                         | <b>13,943</b>                                        |
| Rebate from Morgan Stanley Affiliate (Note F)                                 | (17)                                                 |
| Expense Offset (Note D)                                                       | ( @)                                                 |
| <b>Net Expenses</b>                                                           | <b>13,926</b>                                        |
| <b>Net Investment Income</b>                                                  | <b>44,435</b>                                        |
| <b>Realized Gain:</b>                                                         |                                                      |
| Investments Sold                                                              | 19,929                                               |
| Foreign Currency Forward Exchange Contracts                                   | 5,184                                                |
| Foreign Currency Transactions                                                 | 211                                                  |
| <b>Net Realized Gain</b>                                                      | <b>25,324</b>                                        |
| <b>Change in Unrealized Appreciation (Depreciation):</b>                      |                                                      |
| Investments                                                                   | 65,635                                               |
| Foreign Currency Forward Exchange Contracts                                   | 644                                                  |
| Foreign Currency Translations                                                 | (383)                                                |
| <b>Net Change in Unrealized Appreciation (Depreciation)</b>                   | <b>65,896</b>                                        |
| <b>Net Realized Gain and Change in Unrealized Appreciation (Depreciation)</b> | <b>91,220</b>                                        |
| <b>Net Increase in Net Assets Resulting from Operations</b>                   | <b>\$ 135,655</b>                                    |

@ Amount is less than \$500.

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





**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

Financial Statements (cont'd)

|                                                                                                                   | <b>Six Months Ended<br/>April 30, 2013<br/>(unaudited)<br/>(000)</b> | <b>Year Ended<br/>October 31,<br/>2012<br/>(000)</b> |
|-------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------|------------------------------------------------------|
| Statements of Changes in Net Assets                                                                               |                                                                      |                                                      |
| <b>Increase (Decrease) in Net Assets</b>                                                                          |                                                                      |                                                      |
| Operations:                                                                                                       |                                                                      |                                                      |
| Net Investment Income                                                                                             | \$ 44,435                                                            | \$ 95,299                                            |
| Net Realized Gain                                                                                                 | 25,324                                                               | 9,225                                                |
| Net Change in Unrealized Appreciation<br>(Depreciation)                                                           | 65,896                                                               | 6,255                                                |
| <b>Net Increase in Net Assets Resulting<br/>from Operations</b>                                                   | 135,655                                                              | 110,779                                              |
| Distributions from and/or in Excess of:                                                                           |                                                                      |                                                      |
| Net Investment Income                                                                                             | (36,216)                                                             | (83,296)                                             |
| <b>Total Increase</b>                                                                                             | 99,439                                                               | 27,483                                               |
| <b>Net Assets:</b>                                                                                                |                                                                      |                                                      |
| Beginning of Period                                                                                               | 1,283,101                                                            | 1,255,618                                            |
| <b>End of Period (Including Accumulated<br/>Undistributed Net Investment Income of<br/>\$20,464 and \$12,245)</b> | <b>\$ 1,382,540</b>                                                  | <b>\$1,283,101</b>                                   |

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

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013 (unaudited)**

Financial Statements (cont'd)

|                                                                                                                | <b>Six Months Ended<br/>April 30, 2013<br/>(000)</b> |
|----------------------------------------------------------------------------------------------------------------|------------------------------------------------------|
| Statement of Cash Flows                                                                                        |                                                      |
| <b>Cash Flows From Operating Activities:</b>                                                                   |                                                      |
| Proceeds from Sales and Maturities of Long-Term Investments                                                    | \$ 591,951                                           |
| Purchase of Long-Term Investments                                                                              | (617,976)                                            |
| Net (Increase) Decrease in Short-Term Investments                                                              | 11,197                                               |
| Net (Increase) Decrease in Foreign Currency Holdings                                                           | 5,343                                                |
| Net Realized Gain (Loss) for Foreign Currency Transactions and Foreign Currency Forward Exchange Contracts     | 5,395                                                |
| Net Investment Income                                                                                          | 44,435                                               |
| <b>Adjustments to Reconcile Net Investment Income to Net Cash Provided for (Used by) Operating Activities:</b> |                                                      |
| Net (Increase) Decrease in Receivables Related to Operations                                                   | (5,016)                                              |
| Net (Increase) Decrease in Payables Related to Operations                                                      | 82                                                   |
| Accretion/Amortization of Discounts and Premiums                                                               | 805                                                  |
| Net Cash Provided for (Used by) Operating Activities                                                           | 36,216                                               |
| <b>Cash Flows From Financing Activities:</b>                                                                   |                                                      |
| Cash Paid for Line of Credit                                                                                   |                                                      |
| Cash Distribution Paid                                                                                         | (36,216)                                             |
| Net Cash Provided for (Used by) Financing Activities                                                           | (36,216)                                             |
| Net Increase (Decrease) in Cash                                                                                |                                                      |
| <b>Cash at Beginning of Period</b>                                                                             |                                                      |
| <b>Cash at End of Period</b>                                                                                   | <b>\$</b>                                            |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                                                       |                                                      |
| Interest Paid on Line of Credit during the Period                                                              | \$ 3,426                                             |

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

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

Financial Highlights

**Selected Per Share Data and Ratios**

|                                                                 | <b>Six Months<br/>Ended April 30,<br/>2013<br/>(unaudited)</b> | <b>2012</b> | <b>2011</b> | <b>Year Ended October 31,</b> |          | <b>2009</b> | <b>2008</b>     |
|-----------------------------------------------------------------|----------------------------------------------------------------|-------------|-------------|-------------------------------|----------|-------------|-----------------|
| <b>Net<br/>Asset<br/>Value,<br/>Beginning<br/>of<br/>Period</b> | 17.71                                                          | \$ 17.34    | \$ 18.58    | \$ 16.17                      | \$ 12.61 | \$ 20.47    |                 |
| Net<br>Investment<br>Income†                                    | 0.61                                                           | 1.32        | 1.52        | 1.46                          | 1.37     | 2.12        |                 |
| Net<br>Realized<br>and<br>Unrealized<br>Gain<br>(Loss)          | 1.27                                                           | 0.20        | (1.56)      | 2.15                          | 3.40     | (7.49)      |                 |
| Total<br>from<br>Investment<br>Operations                       | 1.88                                                           | 1.52        | (0.04)      | 3.61                          | 4.77     | (5.37)      |                 |
| Distributions from and/or in excess of:                         |                                                                |             |             |                               |          |             |                 |
| Net<br>Investment<br>Income                                     | (0.50)                                                         | (1.15)      | (1.20)      | (1.20)                        | (0.50)   | (2.40)      |                 |
| Net<br>Realized<br>Gain                                         |                                                                |             |             |                               |          |             | (0.09)          |
| Return<br>of<br>Capital                                         |                                                                |             |             |                               | (0.75)   |             |                 |
| Total<br>Distributions                                          | (0.50)                                                         | (1.15)      | (1.20)      | (1.20)                        | (1.25)   | (2.49)      |                 |
| Anti-Dilutive<br>Effect<br>of<br>Share<br>Repurchase<br>Program | \$ 19.09                                                       | \$ 17.71    | \$ 17.34    | \$ 18.58                      | \$ 16.17 | \$ 12.61    | 0.04<br>(0.00)‡ |

| Net Asset Value, End of Period                                           | Per Share | Market Value, End of Period | 1           | 2           | 3           | 4         | 5 |
|--------------------------------------------------------------------------|-----------|-----------------------------|-------------|-------------|-------------|-----------|---|
| \$ 17.31                                                                 | \$ 16.47  | \$ 15.87                    | \$ 17.29    | \$ 13.75    | \$ 9.70     |           |   |
| <b>TOTAL INVESTMENT RETURN:</b>                                          |           |                             |             |             |             |           |   |
| Market Value                                                             | 8.19%#    | 11.38%                      | (1.34)%     | 35.60%      | 57.23%      | (39.43)%  |   |
| Net Asset Value(1)                                                       | 10.96%#   | 9.61%                       | 0.32%       | 23.83%      | 42.32%      | (27.22)%  |   |
| <b>RATIOS, SUPPLEMENTAL DATA:</b>                                        |           |                             |             |             |             |           |   |
| Net Assets, End of Period (Thousands)                                    | \$1,540   | \$1,283,101                 | \$1,255,618 | \$1,345,669 | \$1,171,520 | \$923,962 |   |
| Ratio of Expenses to Average Net Assets                                  | 2.10%*+   | 2.16%+                      | 2.07%+      | 2.28%+      | 2.20%+      | 2.80%+    |   |
| Ratio of Expenses to Average Net Assets Excluding Non Operating Expenses | 1.58%*+   | 1.59%+                      | 1.55%+      | 1.62%+      | 1.58%+      | 1.59%+    |   |
| Ratio of Net Investment Income to Average                                | 6.69%*+   | 7.63%+                      | 8.36%+      | 8.61%+      | 9.60%+      | 11.90%+   |   |

|                                                                                 |         |        |        |        |        |        |
|---------------------------------------------------------------------------------|---------|--------|--------|--------|--------|--------|
| Net Assets Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets | 0.00%*§ | 0.00%§ | 0.00%§ | 0.00%§ | 0.00%§ | 0.00%§ |
| Portfolio Turnover Rate                                                         | 35%#    | 64%    | 100%   | 42%    | 74%    | 130%   |

(1) 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.

† Per share amount is based on average shares outstanding.

‡ Amount is less than \$0.005 per share.

# Not annualized.

\* Annualized.

+ 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."

§ 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.**

**April 30, 2013**

### Notes to Financial Statements (unaudited)

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'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, Morgan Stanley Investment Management Inc. (the "Adviser"), believes have economic characteristics similar to such securities, such investments will be counted for purposes of the Fund's policy described in the previous sentence. 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 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. The prices provided by a pricing service take into account broker-dealer market price quotations for institutional size trading in similar groups of securities, security quality, maturity, coupon and other security characteristics as well as any developments related to the specific securities; (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 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) investments in mutual funds, including the Morgan Stanley Institutional Liquidity Funds, are valued at the net asset value as of the close of each business day; (4) short-term debt securities with remaining maturities of 60 days or less at the time of purchase may be valued at amortized cost, unless the Adviser determines such valuation does not reflect the securities' market value, in which case these securities will be valued at their fair market value as determined by the Adviser; and (5) 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.

Under procedures approved by the Directors, the Fund's Adviser has formed a Valuation Committee. The Valuation Committee provides administration and oversight of the Fund's valuation policies and procedures, which are reviewed at least annually by the Directors. Among other things, these procedures allow the Fund to utilize independent pricing services, quotations from securities





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

April 30, 2013

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

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 Measurements and Disclosures" ("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 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.



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

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

The following is a summary of the inputs used to value the Fund's investments as of April 30, 2013.

| <b>Investment Type</b>                     | <b>Level 1<br/>Unadjusted<br/>quoted<br/>prices<br/>(000)</b> | <b>Level 2<br/>Other<br/>significant<br/>observable<br/>inputs<br/>(000)</b> | <b>Level 3<br/>Significant<br/>unobservable<br/>inputs<br/>(000)</b> | <b>Total<br/>(000)</b> |
|--------------------------------------------|---------------------------------------------------------------|------------------------------------------------------------------------------|----------------------------------------------------------------------|------------------------|
| <b>Assets:</b>                             |                                                               |                                                                              |                                                                      |                        |
| <b>Fixed Income Securities</b>             |                                                               |                                                                              |                                                                      |                        |
| Corporate Bonds                            | \$                                                            | \$ 76,107                                                                    | \$                                                                   | \$ 76,107              |
| Sovereign                                  |                                                               | 1,648,977                                                                    |                                                                      | 1,648,977              |
| <b>Total Fixed Income Securities</b>       |                                                               | <b>1,725,084</b>                                                             |                                                                      | <b>1,725,084</b>       |
| <b>Short-Term Investment</b>               |                                                               |                                                                              |                                                                      |                        |
| Investment Company                         | 7,437                                                         |                                                                              |                                                                      | 7,437                  |
| <b>Foreign Currency Exchange Contracts</b> |                                                               |                                                                              |                                                                      |                        |
| Total                                      |                                                               | 699                                                                          |                                                                      | 699                    |
| <b>Assets</b>                              | <b>7,437</b>                                                  | <b>1,725,783</b>                                                             |                                                                      | <b>1,733,220</b>       |
| <b>Liabilities:</b>                        |                                                               |                                                                              |                                                                      |                        |
| <b>Foreign Currency Exchange Contracts</b> |                                                               |                                                                              |                                                                      |                        |
| Total                                      |                                                               | (141)                                                                        |                                                                      | (141)                  |
| <b>Total</b>                               | <b>\$ 7,437</b>                                               | <b>\$1,725,642</b>                                                           | <b>\$</b>                                                            | <b>\$1,733,079</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 April 30, 2013, 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 at the mean of the bid and ask prices of such currencies against U.S. dollars last quoted by a major bank 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 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)

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

April 30, 2013

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

from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of unrealized appreciation (depreciation) on 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 U.S. securities. 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, 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. 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.

**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 on the value of an underlying asset, interest rate, index or financial instrument. 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 they relate, and risks that the transactions may not be liquid. 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 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



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

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

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:

**Foreign Currency Forward Exchange Contracts:** In connection with its investments in foreign securities, the Fund also entered into contracts with banks, brokers or 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. Furthermore, such transactions 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 an 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 currency 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: Overall" ("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 April 30, 2013.

|                                                   | <b>Asset Derivatives<br/>Statement of Assets<br/>and<br/>Liabilities Location</b> | <b>Primary Risk<br/>Exposure</b> | <b>Value<br/>(000)</b> |
|---------------------------------------------------|-----------------------------------------------------------------------------------|----------------------------------|------------------------|
| Foreign Currency<br>Forward Exchange<br>Contracts | Unrealized Appreciation<br>on Foreign Currency<br>Forward Exchange<br>Contracts   | Currency Risk                    | \$ 699                 |
|                                                   | <b>Liability Derivatives<br/>Statement of Assets</b>                              | <b>Primary Risk<br/>Exposure</b> | <b>Value<br/>(000)</b> |

**and  
Liabilities Location**

|                                                   |                                                                                 |               |          |
|---------------------------------------------------|---------------------------------------------------------------------------------|---------------|----------|
| Foreign Currency<br>Forward Exchange<br>Contracts | Unrealized Depreciation<br>on Foreign Currency<br>Forward Exchange<br>Contracts | Currency Risk | \$ (141) |
|---------------------------------------------------|---------------------------------------------------------------------------------|---------------|----------|

For the six months ended April 30, 2013, the average monthly principal amount of foreign currency forward exchange contracts was approximately \$206,510,000.

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 six months ended April 30, 2013 in accordance with ASC 815.



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

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

|                                                         | <b>Realized Gain (Loss)</b> |                    |
|---------------------------------------------------------|-----------------------------|--------------------|
| <b>Primary Risk Exposure</b>                            | <b>Derivative Type</b>      | <b>Value (000)</b> |
|                                                         | Foreign Currency            |                    |
|                                                         | Forward Exchange            |                    |
| Currency Risk                                           | Contracts                   | \$ 5,184           |
| <b>Change in Unrealized Appreciation (Depreciation)</b> |                             |                    |
|                                                         | <b>Derivative Type</b>      | <b>Value (000)</b> |
|                                                         | Foreign Currency            |                    |
|                                                         | Forward Exchange            |                    |
| Currency Risk                                           | Contracts                   | \$ 644             |

**6. Indemnifications:** The Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

**7. Other:** Security transactions are accounted for on the date the securities are purchased or sold. Realized gains (losses) on the sale of investment securities are determined on the specific identified cost basis. Interest income is recognized on the accrual basis. Dividend income and distributions are recorded on the ex-dividend date (except for certain dividends which may be recorded as soon as the Fund is informed of such dividends) net of applicable withholding taxes.

**B. Advisory Fees:** The Adviser, a wholly-owned subsidiary of Morgan Stanley, provides the Fund with advisory services under the terms of an Investment Advisory Agreement, calculated weekly and payable monthly, at an annual rate of 1.00% of the Fund's average weekly managed assets.

For the six months ended April 30, 2013, the advisory fee rate (net of rebate) was equivalent to an annual effective rate of 1.00% of the Fund's weekly managed assets.

**C. Administration Fees:** The Adviser also serves as Administrator to the Fund and provides administrative services pursuant to an Administration Agreement for an annual fee, accrued daily and paid monthly, of 0.08% of the Fund's average weekly net assets. Under a Sub-Administration Agreement between the Administrator and State Street Bank and Trust Company ("State Street"), State Street provides certain administrative services to the Fund. For such services, the Administrator pays State Street a portion of the fee the Administrator receives from the Fund.

**D. Custodian Fees:** State Street (the "Custodian") and its affiliates serve as Custodian for the Fund. The Custodian holds cash, securities, and other assets of the Fund as required by the Act. Custody fees are payable monthly based on assets held in custody, investment purchases and sales activity and account maintenance fees, plus reimbursement for certain out-of-pocket expenses.

The Fund has entered into an arrangement with its Custodian whereby credits realized on uninvested cash balances may be used to offset a portion of the Fund's expenses. If applicable, these custodian credits are shown as "Expense Offset" in the Statement of Operations.

**E. Federal Income Taxes:** It is the Fund's intention to continue to qualify as a regulated investment company and distribute all of its taxable income. Accordingly, no provision for Federal income taxes is required in the financial statements. Dividend income and distributions to stockholders are recorded on the ex-dividend date.

The Fund may be subject to taxes imposed by countries in which it invests. Such taxes are generally based on income and/or capital gains earned or repatriated. Taxes are accrued and applied to net investment income, net realized gains and net unrealized appreciation as such income and/or gains are earned. Taxes may also be based on transactions in foreign currency and are accrued based on the value of investments denominated in such currency.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

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

FASB ASC 740-10 "Income Taxes - Overall" sets forth a minimum threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return. Management has concluded there are no significant uncertain tax positions that would require recognition in the financial statements. If applicable, the Fund recognizes interest accrued related to unrecognized tax benefits in "Interest Expense" and penalties in "Other Expenses" in the Statement of Operations. The Fund files tax returns with the U.S. Internal Revenue Service, New York and various states. Each of the tax years in the four-year period ended October 31, 2012, remains subject to examination by taxing authorities.

The tax character of distributions paid may differ from the character of distributions shown in the Statements of Changes in Net Assets due to short-term capital gains being treated as ordinary income for tax purposes. The tax character of distributions paid during fiscal 2012 and 2011 was as follows:

| <b>2012 Distributions<br/>Paid From:</b> |                                                 | <b>2011 Distributions<br/>Paid From:</b> |                                                 |
|------------------------------------------|-------------------------------------------------|------------------------------------------|-------------------------------------------------|
| <b>Ordinary<br/>Income<br/>(000)</b>     | <b>Long-Term<br/>Capital<br/>Gain<br/>(000)</b> | <b>Ordinary<br/>Income<br/>(000)</b>     | <b>Long-Term<br/>Capital<br/>Gain<br/>(000)</b> |
| \$ 83,296                                | \$                                              | \$ 86,918                                | \$                                              |

The amount and character of income and gains to be distributed are determined in accordance with income tax regulations which may differ from GAAP. These book/tax differences are either considered temporary or permanent in nature.

Temporary differences are attributable to differing book and tax treatments for the timing of the recognition of gains (losses) on certain investment transactions, the timing of the deductibility of certain expenses and the recognition of premium amortization.

Permanent differences, primarily due to differing treatments of gains (losses) related to foreign currency transactions and

premium amortization adjustments for certain securities sold, resulted in the following reclassifications among the components of net assets at October 31, 2012:

| <b>Accumulated<br/>Undistributed<br/>Net Investment<br/>Income<br/>(000)</b> | <b>Accumulated<br/>Net Realized<br/>Loss<br/>(000)</b> | <b>Paid-in<br/>Capital<br/>(000)</b> |
|------------------------------------------------------------------------------|--------------------------------------------------------|--------------------------------------|
| \$ (16,171)                                                                  | \$ 16,067                                              | \$ 104                               |

At October 31, 2012, distributable earnings for the Fund on a tax basis were as follows:

| <b>Undistributed Ordinary<br/>Income<br/>(000)</b> | <b>Undistributed<br/>Long-Term Capital Gain<br/>(000)</b> |
|----------------------------------------------------|-----------------------------------------------------------|
|----------------------------------------------------|-----------------------------------------------------------|

|    |        |    |
|----|--------|----|
| \$ | 11,840 | \$ |
|----|--------|----|

At April 30, 2013, the aggregate cost for federal income tax purposes approximates the aggregate cost for book purposes. The aggregate gross unrealized appreciation is approximately \$109,594,000 and the aggregate gross unrealized depreciation is approximately \$58,360,000 resulting in net unrealized appreciation of approximately \$51,234,000.

On December 22, 2010, the Regulated Investment Company Modernization Act of 2010 (the "Modernization Act") was signed into law. The Modernization Act modernizes several tax provisions related to Regulated Investment Companies ("RICs") and their shareholders. One key change made by the Modernization Act is that capital losses will generally retain their character as short-term or long-term and may be carried forward indefinitely to offset future gains. These losses are utilized before other capital loss carryforwards that expire. Generally, the Modernization Act is effective for taxable years beginning after December 22, 2010.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.****April 30, 2013**

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

At October 31, 2012, the Fund had available for Federal income tax purposes unused capital loss, which will expire on the indicated dates:

| <b>Amount<br/>(000)</b> | <b>Expiration</b> |
|-------------------------|-------------------|
| \$ 9,250                | October 31, 2017  |

To the extent that capital loss carryforwards are used to offset any future capital gains realized during the carryover period as provided by U.S. Federal income tax regulations, no capital gains tax liability will be incurred by the Fund for gains realized and not distributed. To the extent that capital gains are offset, such gains will not be distributed to the stockholders. During the year ended October 31, 2012, the Fund utilized capital loss carryforwards for U.S. Federal income tax purposes of approximately \$26,342,000.

**F. Security Transactions and Transactions with Affiliates:** For the six months ended April 30, 2013, purchases and sales of investment securities for the Fund, other than long-term U.S. Government securities and short-term investments, were approximately \$617,976,000 and \$588,165,000, respectively. There were no purchases and sales of long-term U.S. Government securities for the six months ended April 30, 2013.

The Fund invests in the Institutional Class of the Morgan Stanley Institutional Liquidity Funds Money Market Portfolio (the "Liquidity Funds"), an open-end management investment company managed by the Adviser. Advisory fees paid by the Fund are reduced by an amount equal to its pro-rata share of advisory and administration fees paid by the Fund due to its investments in the Liquidity Funds. For the six months ended April 30, 2013, advisory fees paid were reduced by approximately \$17,000 relating to the Fund's investment in the Liquidity Funds.

A summary of the Fund's transactions in shares of the Liquidity Funds during the six months ended April 30, 2013 is as follows:

| <b>Value<br/>October 31,<br/>2012<br/>(000)</b> | <b>Purchases<br/>at Cost<br/>(000)</b> | <b>Sales<br/>(000)</b> | <b>Dividend<br/>Income<br/>(000)</b> | <b>Value<br/>April 30,<br/>2013<br/>(000)</b> |
|-------------------------------------------------|----------------------------------------|------------------------|--------------------------------------|-----------------------------------------------|
| \$ 18,635                                       | \$ 145,197                             | \$ 156,395             | \$ 16                                | \$ 7,437                                      |

The Fund has an unfunded Deferred Compensation Plan (the "Compensation Plan"), which allows each independent Director to defer payment of all, or a portion, of the fees he or she receives for serving on the Board of Directors. Each eligible Director generally may elect to have the deferred amounts credited with a return equal to the total return on one or more of the Morgan Stanley funds that are offered as investment options under the Compensation Plan. Appreciation/depreciation and distributions received from these investments are recorded with an offsetting increase/decrease in the deferred compensation obligation and do not affect the net asset value of the Fund.

**G. Credit Facility:** The Fund will use the proceeds from the use of leverage to purchase additional securities consistent with the Fund's investment objectives, policies and strategies. The Fund had engaged JPMorgan Securities Inc. to arrange a syndicate of lenders to provide a revolving line of credit facility ("facility") in the amount of \$400,000,000. The term of the facility was 364 days and the loans under the facility bore interest at the rate of LIBOR for the applicable interest period plus a spread. The loans were secured by a fully perfected first priority lien on all of the assets of the Fund capable of being pledged. The facility also had a commitment fee of 0.20% of the daily unused

portion of the facility. The facility expired in May 2013. The average borrowings and interest rate for the six months ended April 30, 2013 were approximately \$400,000,000 and 1.71%, respectively. During the same period, the Fund incurred approximately \$3,445,000 in interest expense associated with the outstanding loans.

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

**April 30, 2013**

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

As of May 22, 2013, the Fund has entered into an agreement with State Street as Administrative Agent and sole lender of a \$400,000,000 facility. The loans under the facility will bear interest at the rate of LIBOR for the applicable interest period plus a spread. The facility also has a commitment fee of 0.10% of the unused portion of the facility.

**H. Other:** On January 10, 2008, the Fund commenced a share repurchase program for purposes of enhancing stockholder value and reducing the discount at which the Fund's shares trade from their net asset value per share ("NAV"). During the six months ended April 30, 2013, the Fund did not repurchase any of its shares. Since the inception of the program, the Fund has repurchased 886,200 of its shares at an average discount of 23.87% from NAV. The Directors regularly monitor the Fund's share repurchase program as part of their review and consideration of the Fund's premium/discount history. The Fund expects to continue to repurchase its outstanding shares at such time and in such amounts as it believes will further the accomplishment of the foregoing objectives, subject to review by the Directors.

**J. Accounting Pronouncement:** In January 2013, Accounting Standard Update 2013-01 ("ASU 2013-01"), "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," replaced Accounting Standards Update 2011-11 ("ASU 2011-11"), "Disclosures about Offsetting Assets and Liabilities." ASU 2013-01 is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. ASU 2011-11 was intended to enhance disclosure requirements on the offsetting of financial assets and liabilities. ASU 2013-01 limits the scope of the new balance sheet offsetting disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. Management is currently evaluating the application of ASU 2013-01 and its impact, if any, on the Fund's financial statements.

### **For More Information About Portfolio Holdings**

The Fund provides a complete schedule of portfolio holdings in its semi-annual and annual reports within 60 days of the end of the Fund's second and fourth fiscal quarters. The semi-annual reports and the annual reports are filed electronically with the Securities and Exchange Commission (SEC) on Form N-CSRS and Form N-CSR, respectively. Morgan Stanley also delivers the semi-annual and annual reports to Fund stockholders and makes these reports available on its public website, [www.morganstanley.com/im](http://www.morganstanley.com/im). Each Morgan Stanley fund also files a complete schedule of portfolio holdings with the SEC for the Fund's first and third fiscal quarters on Form N-Q. Morgan Stanley does not deliver the reports for the first and third fiscal quarters to stockholders, nor are the reports posted to the Morgan Stanley public website. You may, however, obtain the Form N-Q filings (as well as the Form N-CSR and N-CSRS filings) by accessing the SEC's website, [www.sec.gov](http://www.sec.gov). You may also review and copy them at the SEC's Public Reference Room in Washington, DC. Information on the operation of the SEC's Public Reference Room may be obtained by calling the SEC toll free at 1(800) SEC-0330. You can also request copies of these materials, upon payment of a duplicating fee, by electronic request at the SEC's e-mail address ([publicinfo@sec.gov](mailto:publicinfo@sec.gov)) or by writing the public reference section of the SEC, Washington, DC 20549-0102.

In addition to filing a complete schedule of portfolio holdings with the SEC each fiscal quarter, the Fund makes portfolio holdings information available by periodically providing the information on its public website, [www.morganstanley.com/im](http://www.morganstanley.com/im).

The Fund provides a complete schedule of portfolio holdings on the public website on a calendar-quarter basis approximately 31 calendar days after the close of the calendar quarter. The Fund also provides Top 10 holdings information on the public website approximately 15 business days following the end of each month. You may obtain copies of the Fund's monthly or calendar-quarter website postings, by calling toll free 1(800) 231-2608.



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

**April 30, 2013**

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

**Proxy Voting Policy and Procedures and Proxy Voting Record**

A copy of (1) the Fund's policies and procedures with respect to the voting of proxies relating to the Fund's portfolio securities; and (2) how the Fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30, is available without charge, upon request, by calling toll free 1(800) 548-7786 or by visiting our website at [www.morganstanley.com/im](http://www.morganstanley.com/im). This information is also available on the SEC's web site at [www.sec.gov](http://www.sec.gov).



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

**April 30, 2013**

Portfolio Management (unaudited)

The Fund is managed by members of the Emerging Markets Debt team. The team consists of portfolio managers and analysts. Current members of the team jointly and primarily responsible for the day-to-day management of the Fund's portfolio are Eric J. Baurmeister and Federico L. Kaune, each a Managing Director of the Adviser. Mr. Baurmeister has been associated with the Adviser in an investment management capacity since 1997 and began managing the Fund at its inception. Mr. Kaune has been associated with the Adviser in an investment management capacity since 2002 and began managing the Fund at its inception.

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

**April 30, 2013**

Investment Policy (unaudited)

### **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 on the value of an underlying asset, interest rate, index or financial instrument. 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 they relate, and risks that the transactions may not be liquid. 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. Certain derivative transactions may give rise to a form of leverage. Leverage magnifies the potential for gain and 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 SEC 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 may use and their associated risks:

*Foreign Currency Forward Exchange Contracts.* In connection with its investments in foreign securities, the Fund also may enter into contracts with banks, brokers or 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. In addition, the Fund may use cross currency hedging or proxy hedging with respect to currencies in which the Fund has or expects to have portfolio or currency exposure. Cross currency hedges involve the sale of one currency against the positive exposure to a different currency and may be used for hedging purposes or to establish an active exposure to the exchange rate between any two currencies. To the extent hedged by use of currency contracts, the precise matching of currency contract amounts and 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 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.

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

**April 30, 2013**

Investment Policy (unaudited) (cont'd)

*Futures.* A futures contract is a standardized, exchange-traded agreement to buy or sell a specific quantity of an underlying instrument 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. A decision as to whether, when and how to use futures 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 can lower total return, and the potential loss from futures 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.

*Options.* If the Fund buys an option, it buys a legal contract giving it the right to buy or sell a specific amount of the underlying instrument or futures contract on the underlying instrument at an agreed-upon price typically in exchange for a premium paid by the Fund. If the Fund sells an option, it sells to another person the right to buy from or sell to the Fund a specific amount of the underlying instrument or futures contract on the underlying instrument at an agreed-upon price typically in exchange for a premium received by the Fund. When options are purchased over-the-counter ("OTC"), the Fund bears the risk that the counterparty that wrote the option will be unable or unwilling to perform its obligations under the option contract. Options may also be illiquid and the Fund may have difficulty closing out its position. A decision as to whether, when and how to use options involves the exercise of skill and judgment and even a well-conceived option transaction may be unsuccessful because of market behavior or unexpected events. The prices of options can be highly volatile and the use of options can lower total returns.

*Structured Investments.* The Fund also may invest 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, 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. 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 issuer of 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 point in time, may be unable to find qualified buyers for these securities.

*Swaps.* An OTC swap contract is an agreement between two parties pursuant to which the parties exchange payments at specified dates on the basis of a specified notional amount, with the payments calculated by reference to specified securities, indexes, reference rates, currencies or other instruments. Most swap agreements provide that when the period payment dates for both parties are the same, the payments are made on a net basis (i.e., the two payment streams are netted out, with only the net amount paid by one party to the other). The Fund's obligations or rights under a swap contract entered into on a net basis will generally be equal only to the net amount to be paid or received under the agreement, based on the relative values of the positions held by each party. Most swap agreements are



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

**April 30, 2013**

### Investment Policy (unaudited) (cont'd)

not entered into or traded on exchanges and often there is no central clearing or guaranty function for swaps. These OTC swaps are often subject to credit risk or the risk of default or non-performance by the counterparty. Swaps could result in losses if interest rate or foreign currency exchange rates or credit quality changes are not correctly anticipated by the Fund or if the reference index, security or investments do not perform as expected. The Fund enters into credit default, interest rate and other forms of swap agreements to manage exposure to credit and interest rate risks. The Fund's use of swaps may include those based on the credit of an underlying security, commonly referred to as "credit default swaps." Where the Fund is the buyer of a credit default swap contract, it would be entitled to receive the par (or other agreed-upon) value of a referenced debt obligation from the counterparty to the contract only in the event of a default or similar event by a third party on the debt obligation. If no default occurs, the Fund would have paid to the counterparty a periodic stream of payments over the term of the contract and received no benefit from the contract. When the Fund is the seller of a credit default swap contract, it receives the stream of payments but is obligated to pay an amount equal to the par (or other agreed-upon) value of a referenced debt obligation upon the default or similar event of the issuer of the referenced debt obligation. The Dodd-Frank Wall Street Reform and Consumer Protection Act and related regulatory developments will require the clearing and exchange-trading of many OTC swap agreements. Mandatory exchange-trading and clearing will occur on a phased-in basis.

### **Temporary Investments**

The investment policies, limitations or practices of the Fund may not apply during periods of unusual or adverse market, economic, political or other conditions. Such market, economic, political or other conditions may include periods of abnormal or heightened market volatility, strained credit and/or liquidity conditions or increased governmental intervention in the markets or industries. During such periods, the Fund may not invest according to its principal investment strategies or in the manner in which its name may suggest, and may be subject to different and/or heightened risks. It is possible that such unusual or adverse conditions may continue for extended periods of time. During such periods, the Fund may, for temporary defensive purposes, reduce its holdings in debt obligations of issuers located in emerging markets countries that are denominated in the local currency and invest in certain liquid short-term (less than one year to maturity) and medium-term (not greater than five years to maturity) debt securities or hold cash. The short-term and medium-term debt securities in which the Fund may invest consist of (a) obligations of the U.S., emerging market or other foreign governments, their respective agencies or instrumentalities; (b) bank deposits and bank obligations (including certificates of deposit, time deposits and bankers' acceptances) of U.S. or foreign banks denominated in any currency; (c) floating rate securities and other instruments denominated in any other currency issued by various governments or international development agencies; (d) finance company and corporate commercial paper and other short-term corporate debt obligations of United States, emerging market or other foreign corporations; and (e) repurchase agreements with banks and broker-dealers with respect to such securities. The Fund intends to invest for temporary defensive purposes only in short-term and medium-term debt securities that the Adviser believes to be of high quality, i.e., subject to relatively low risk of loss of interest or principal (there is currently no rating system for debt securities in certain emerging market countries in which the Fund may invest).

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

**April 30, 2013**

Dividend Reinvestment Plan (unaudited)

Pursuant to the Dividend Reinvestment Plan (the Plan), each stockholder will be deemed to have elected, unless Computershare Trust Company, N.A. (the Plan Agent) is otherwise instructed by the stockholder in writing, to have all distributions automatically reinvested in Fund shares.

Dividend and capital gain distributions (Distribution) will be reinvested on the reinvestment date in full and fractional shares. If the market price per share equals or exceeds net asset value per share on the reinvestment date, the Fund will issue shares to participants at net asset value or, if net asset value is less than 95% of the market price on the reinvestment date, shares will be issued at 95% of the market price. If net asset value exceeds the market price on the reinvestment date, participants will receive shares valued at market price. The Fund may purchase shares of its Common Stock in the open market in connection with dividend reinvestment requirements at the discretion of the Board of Directors. Should the Fund declare a Distribution payable only in cash, the Plan Agent will purchase Fund shares for participants in the open market as agent for the participants.

The Plan Agent's fees for the reinvestment of a Distribution will be paid by the Fund. However, each participant's account will be charged a pro rata share of brokerage commissions incurred on any open market purchases effected on such participant's behalf. Although stockholders in the Plan may receive no cash distributions, participation in the Plan will not relieve participants of any income tax which may be payable on such dividends or distributions.

In the case of stockholders, such as banks, brokers or nominees, that hold shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of shares certified from time to time by the stockholder as representing the total amount registered in the stockholder's name and held for the account of beneficial owners who are participating in the Plan.

Stockholders who do not wish to have Distributions automatically reinvested should notify the Plan Agent in writing. There is no penalty for non-participation or withdrawal from the Plan, and stockholders who have previously withdrawn from the Plan may rejoin at any time. Requests for additional information or any correspondence concerning the Plan should be directed to the Plan Agent at:

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
Computershare Trust Company, N.A.  
P.O. Box 43078  
Providence, Rhode Island 02940-3078  
1 (800) 231-2608



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

**April 30, 2013**

U.S. Privacy Policy (unaudited)

### **An Important Notice Concerning Our U.S. Privacy Policy**

*This privacy notice describes the U.S. privacy policy of Morgan Stanley Distribution, Inc., and the Morgan Stanley family of mutual funds ("us", "our", "we").*

We are required by federal law to provide you with notice of our U.S. privacy policy ("Policy"). This Policy applies to both our current and former clients unless we state otherwise and is intended for individual clients who purchase products or receive services from us for personal, family or household purposes. This Policy is not applicable to partnerships, corporations, trusts or other non-individual clients or account holders, nor is this Policy applicable to individuals who are either beneficiaries of a trust for which we serve as trustee or participants in an employee benefit plan administered or advised by us. This Policy is, however, applicable to individuals who select us to be a custodian of securities or assets in individual retirement accounts, 401(k) accounts, or accounts subject to the Uniform Gifts to Minors Act.

This notice sets out our business practices to protect your privacy; how we collect and share personal information about you; and how you can limit our sharing or certain uses by others of this information. We may amend this Policy at any time, and will inform you of any changes to our Policy as required by law.

### **We Respect Your Privacy**

We appreciate that you have provided us with your personal financial information and understand your concerns about your information. We strive to safeguard the information our clients entrust to us. Protecting the confidentiality and security of client information is an important part of how we conduct our business.

This notice describes what personal information we collect about you, how we collect it, when we may share it with others, and how certain others may use it. It discusses the steps you may take to limit our sharing of certain information about you with our affiliated companies, including, but not limited to our affiliated banking businesses, brokerage firms and credit service affiliates. It also discloses how you may limit our affiliates' use of shared information for marketing purposes.

Throughout this Policy, we refer to the nonpublic information that personally identifies you as "personal information." We also use the term "affiliated company" in this notice. An affiliated company is a company in our family of companies and includes companies with the Morgan Stanley name. These affiliated companies are financial institutions such as broker-dealers, banks, investment advisers and credit card issuers. We refer to any company that is not an affiliated company as a nonaffiliated third party. For purposes of Section 5 of this notice, and your ability to limit certain uses of personal information by our affiliates, this notice applies to the use of personal information by our affiliated companies.

### **1. What Personal Information Do We Collect From You?**

We may collect the following types of information about you: (i) information provided by you, including information from applications and other forms we receive from you, (ii) information about your transactions with us or our affiliates, (iii) information



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

**April 30, 2013**

U.S. Privacy Policy (unaudited) (cont'd)

about your transactions with nonaffiliated third parties, (iv) information from consumer reporting agencies, (v) information obtained from our websites, and (vi) information obtained from other sources. For example:

- We collect information such as your name, address, e-mail address, telephone/fax numbers, assets, income and investment objectives through applications and other forms you submit to us.
- We may obtain information about account balances, your use of account(s) and the types of products and services you prefer to receive from us through your dealings and transactions with us and other sources.
- We may obtain information about your creditworthiness and credit history from consumer reporting agencies.
- We may collect background information from and through third-party vendors to verify representations you have made and to comply with various regulatory requirements.

### **2. When Do We Disclose Personal Information We Collect About You?**

*We may disclose personal information we collect about you in each of the categories listed above to affiliated and nonaffiliated third parties.*

**a. Information We Disclose to Affiliated Companies.** We may disclose personal information that we collect about you to our affiliated companies to manage your account(s) effectively, to service and process your transactions, and to let you know about products and services offered by us and affiliated companies, to manage our business, and as otherwise required or permitted by law. Offers for products and services from affiliated companies are developed under conditions designed to safeguard your personal information.

**b. Information We Disclose to Third Parties.** We may disclose personal information that we collect about you to nonaffiliated third parties to provide marketing services on our behalf or to other financial institutions with whom we have joint marketing agreements. We may also disclose all of the information we collect to other nonaffiliated third parties for our everyday business purposes, such as to process transactions, maintain account(s), respond to court orders and legal investigations, report to credit bureaus, offer our own products and services, protect against fraud, for institutional risk control, to perform services on our behalf, and as otherwise required or permitted by law.

When we share personal information about you with a nonaffiliated third party, they are required to limit their use of personal information about you to the particular purpose for which it was shared and they are not allowed to share personal information about you with others except to fulfill that limited purpose or as may be permitted or required by law.

### **3. How Do We Protect the Security and Confidentiality of Personal Information We Collect About You?**

We maintain physical, electronic and procedural security measures that comply with applicable law and regulations to help safeguard the personal information we collect about you. We have internal policies governing the proper handling of client information by



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

**April 30, 2013**

U.S. Privacy Policy (unaudited) (cont'd)

employees. Third parties that provide support or marketing services on our behalf may also receive personal information about you, and we require them to adhere to appropriate security standards with respect to such information.

### **4. How Can You Limit Our Sharing Certain Personal Information About You With Our Affiliated Companies for Eligibility Determination?**

By following the opt-out procedures in Section 6 below, you may limit the extent to which we share with our affiliated companies, personal information that was collected to determine your eligibility for products and services such as your credit reports and other information that you have provided to us or that we may obtain from third parties ("eligibility information"). Eligibility information does not include your identification information or personal information pertaining to our transactions or experiences with you. Please note that, even if you direct us not to share eligibility information with our affiliated companies, we may still share your personal information, including eligibility information, with our affiliated companies under circumstances that are permitted under applicable law, such as to process transactions or to service your account.

### **5. How Can You Limit the Use of Certain Personal Information About You by Our Affiliated Companies for Marketing?**

By following the opt-out instructions in Section 6 below, you may limit our affiliated companies from marketing their products or services to you based on personal information we disclose to them. This information may include, for example, your income and account history with us. Please note that, even if you choose to limit our affiliated companies from using personal information about you that we may share with them for marketing their products and services to you, our affiliated companies may use your personal information that they obtain from us to market to you in circumstances permitted by law, such as if the affiliated party has its own relationship with you.

### **6. How Can You Send Us an Opt-Out Instruction?**

If you wish to limit our sharing of eligibility information about you with our affiliated companies, or our affiliated companies' use of personal information for marketing purposes, as described in this notice, you may do so by:

- Calling us at (800) 548-7786  
Monday - Friday between 8a.m. and 5p.m. (EST)
- Writing to us at the following address:

Morgan Stanley Services Company Inc.  
c/o Privacy Coordinator  
201 Plaza Two, 3rd Floor  
Jersey City, New Jersey 07311

If you choose to write to us, your request should include: your name, address, telephone number and account number(s) to which the opt-out applies and whether you are opting out with respect to sharing of eligibility information (Section 4 above), or information



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

**April 30, 2013**

U.S. Privacy Policy (unaudited) (cont'd)

used for marketing (Section 5 above), or both. Written opt-out requests should not be sent with any other correspondence. In order to process your request, we require that the request be provided by you directly and not through a third party. Once you have informed us about your privacy preferences, your opt-out preference will remain in effect with respect to this Policy (as it may be amended) until you notify us otherwise. If you are a joint account owner, we will accept instructions from any one of you and apply those instructions to the entire account.

Please understand that if you limit our sharing or our affiliated companies' use of personal information, you and any joint account holder(s) may not receive information about our affiliated companies' products and services, including products or services that could help you manage your financial resources and achieve your investment objectives.

If you have more than one account or relationship with us, please specify the accounts to which you would like us to apply your privacy choices. If you have accounts or relationships with our affiliates, you may receive multiple privacy policies from them, and will need to separately notify those companies of your privacy choices for those accounts or relationships.

**7. What if an affiliated company becomes a nonaffiliated third party?**

If, at any time in the future, an affiliated company becomes a nonaffiliated third party, further disclosures of personal information made to the former affiliated company will be limited to those described in Section 2(b) above relating to nonaffiliated third parties. If you elected under Section 6 to limit disclosures we make to affiliated companies, or use of personal information by affiliated companies, your election will not apply to use by any former affiliated company of your personal information in their possession once it becomes a nonaffiliated third party.

**SPECIAL NOTICE TO RESIDENTS OF VERMONT**

**The following section supplements our Policy with respect to our individual clients who have a Vermont address and supersedes anything to the contrary in the above Policy with respect to those clients only.**

The State of Vermont requires financial institutions to obtain your consent prior to sharing personal information that they collect about you with nonaffiliated third parties, or eligibility information with affiliated companies, other than in certain limited circumstances. Except as permitted by law, we will not share personal information we collect about you with nonaffiliated third parties or eligibility information with affiliated companies, unless you provide us with your written consent to share such information.

**SPECIAL NOTICE TO RESIDENTS OF CALIFORNIA**

**The following section supplements our Policy with respect to our individual clients who have a California address and supersedes anything to the contrary in the above Policy with respect to those clients only.**

In response to a California law, if your account has a California home address, your personal information will not be disclosed to nonaffiliated third parties except as permitted by applicable California law, and we will limit sharing such personal information with our affiliates to comply with California privacy laws that apply to us.







Item 2. Code of Ethics.

Not applicable for semiannual reports.

Item 3. Audit Committee Financial Expert.

Not applicable for semiannual reports.

Item 4. Principal Accountant Fees and Services

Not applicable for semiannual reports.

Item 5. Audit Committee of Listed Registrants.

Not applicable for semiannual reports.

Item 6.

(a) Refer to Item 1.

(b) Not applicable.

Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

Not applicable for semiannual reports.

Item 8. Portfolio Managers of Closed-End Management Investment Companies

Applicable only to annual reports filed by closed-end funds.

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Item 9. Closed-End Fund Repurchases

**REGISTRANT PURCHASE OF EQUITY SECURITIES**

| <b>Period</b>         | <b>(a) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased</b> | <b>(b) Average<br/>Price Paid per<br/>Share (or Unit)</b> | <b>(c) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased as<br/>Part of Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>(d) Maximum<br/>Number (or<br/>Approximate<br/>Dollar Value)<br/>of Shares (or<br/>Units) that May<br/>Yet Be<br/>Purchased<br/>Under the Plans<br/>or Programs</b> |
|-----------------------|------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| mo-da-year mo-da-year |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |
| <b>Total</b>          |                                                                        |                                                           | N/A                                                                                                                                    | N/A                                                                                                                                                                    |

Item 10. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 11. Controls and Procedures

(a) The Trust s/Fund s principal executive officer and principal financial officer have concluded that the Trust s/Fund s disclosure controls and procedures are sufficient to ensure that information required to be disclosed by the Trust/Fund in this Form N-CSR was recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, based upon such officers evaluation of these controls and procedures as of a date within 90 days of the filing date of the report.

(b) There were no changes in the registrant's internal control over financial reporting that occurred during the second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 12. Exhibits

(a) Code of Ethics Not applicable for semiannual reports.

(b) A separate certification for each principal executive officer and principal financial officer of the registrant are attached hereto as part of EX-99.CERT.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

/s/ Arthur Lev  
Arthur Lev  
Principal Executive Officer  
June 19, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Arthur Lev  
Arthur Lev  
Principal Executive Officer  
June 19, 2013

/s/ Francis Smith  
Francis Smith  
Principal Financial Officer  
June 19, 2013

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