MORGAN STANLEY EMERGING MARKETS DEBT FUND INC
Form N-CSR
March 10, 2014

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 811-07694

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

522 Fifth Avenue, New York, New York	10036
(Address of principal executive offices)	(Zip code)

John H. Gernon

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

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

Date of fiscal year end: December 31, 2013

Date of reporting period: December 31, 2013

Item 1 - Report to Shareholders

Morgan Stanley Emerging Markets 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

John H. Gernon

President and Principal
Executive Officer

Stefanie V. Chang Yu

Chief Compliance Officer

Joseph C. Benedetti

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.

211 Quality Circle, Suite 210

College Station, Texas 77845

Legal Counsel

Dechert LLP

1095 Avenue of the Americas

New York, New York 10036

Counsel to the Independent Directors

Kramer Levin Naftalis & Frankel LLP

1177 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. All investments involve risks, including the possible loss of principal.

INVESTMENT MANAGEMENT

Morgan Stanley
Investment Management Inc.
Adviser

Morgan Stanley

Emerging Markets Debt Fund, Inc. NYSE: MSD

Annual Report

December 31, 2013

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Morgan Stanley Emerging Markets Debt Fund, Inc.

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December 31, 2013

Letter to Stockholders (unaudited)

Performance

For the year ended December 31, 2013, the Morgan Stanley Emerging Markets Debt Fund, Inc. (the "Fund") had total returns of -7.84%, based on net asset value, and -12.27% based on market value per share (including reinvestment of distributions), compared to its benchmark, the J.P. Morgan Emerging Markets Bond Global Index (the "Index")*, which returned -6.58%. On December 31, 2013, the closing price of the Fund's shares on the New York Stock Exchange was $9.54, representing a 13.0% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

Factors Affecting Performance

• Emerging markets (EM) came under significant pressure during the year as external debt spreads widened, domestic debt yields rose and EM currencies weakened versus the U.S. dollar. During the period, the U.S. Treasury 10-year yield rose by 127 basis points to 3.03% (as per Bloomberg data), due to positive U.S. economic data releases, the Federal Reserve's (Fed) optimistic growth outlook and signs of an improving labor market. This led to a widespread perception among investors that the Fed would begin "tapering" quantitative easing (QE) sooner than previously expected. This expectation was validated by the Federal Open Market Committee (FOMC) in December, as they announced their intention to reduce the size of asset purchases starting in January.

• The generalized weakness in EM debt accrued mainly from positioning rather than a shift in fundamentals. Starting in late May, sustained outflows from the asset class weighed on prices and investor sentiment. For the last few years, investors had been increasing their exposure to EM debt due to the relatively higher economic growth rates of emerging markets versus developed markets, the strong balance sheets in emerging markets and the additional yield offered versus traditional "safe haven" assets. These attributes may have also attracted investors who are tactical in nature and wanted to participate in the "carry trade," a strategy that borrows in a lower yielding currency to invest in potentially higher yielding assets. For investors of this nature, a change in the pace of Fed accommodation was sufficient reason to reduce their exposure to emerging markets.

• In addition to events in the developed world, concerns over China's declining growth rates weighed on countries that export to China, such as Chile, Indonesia and Brazil. Furthermore, idiosyncratic developments in countries such as Turkey, South Africa, Egypt, Ukraine and Brazil exacerbated the more complex global environment for emerging markets. In the case of Turkey, protests that began in late May stabilized during June, but damaged investor perception of the country, its institutions and the outlook for European Union (EU) membership. Also, in December an anti-corruption investigation targeting high-profile figures connected to Prime Minister Recep Tayyip Erdogan's government and a CEO of a state-run bank caused weakness in Turkish debt and currency. In addition, geopolitical tensions across the Middle East remained elevated throughout the year. In Brazil, demonstrations against bus fare hikes spread throughout the country, with protestors complaining about poor-quality services, rising inflation, and the excessive cost of the 2014 World Cup and the 2016 Olympics. In response, the Brazilian government cancelled the fare hikes and proposed a political reform. However, continued fiscal deterioration, persistent inflation and an increasing current account deficit led investors to believe that Brazil may soon be downgraded by the rating agencies. In South Africa, Fitch cut the country's foreign currency long-term rating to BBB from BBB+, citing weaker economic growth prospects

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Letter to Stockholders (unaudited) (cont'd)

with weaker mining production weighing on economic activity. In Ukraine, the government's refusal to sign an association agreement with the EU prompted street protests by opposition parties, which demanded the resignation of President Viktor Yanukovych and his cabinet, and called for early presidential and parliamentary elections. Lastly, demonstrators in Thailand demanded Prime Minister Yingluck Shinawatra's resignation.

• However, there were positive developments in 2013 as well. Moody's upgraded the Philippines from Ba1 to Baa3 with a positive outlook on the back of robust economic performance, ongoing fiscal and debt consolidation, political stability and improved governance. In addition, an incipient growth recovery in the euro area boosted the growth outlook and improved the current account balances of Eastern European countries such as Poland, Hungary and the Czech Republic. Finally, in December, Mexico passed a landmark energy reform, allowing private investment in the energy sector, which could lead to higher growth and increased foreign direct investment. The passage of this legislation combined with improvements in the fiscal framework prompted S&P to raise Mexico's sovereign rating to BBB+.

• Overweights to Ukraine, Brazil and Russia for much of the year detracted from Fund returns for the reporting period. Exposure to local markets in Turkey, Colombia, Peru and Russia in the first half of the year also hurt relative returns for the overall period. In addition, an underweight allocation to Argentina and Lebanon detracted from relative returns. Both countries' bonds performed well despite deteriorating macro-economic and political conditions. In Argentina, an opposition victory in a midterm election last October raised investors' hopes of a more market-friendly approach to economic policy in the future, whereas Lebanon spreads rallied on the back of financial aid from Saudi Arabia.

• Conversely, the Fund benefited from maintaining an interest rate duration lower than the Index, which was managed with short positions in U.S. Treasury futures, and overweight exposure to Mexico. In addition, an off-Index position in Slovenia and an underweight allocation to Uruguay aided returns. Lastly, an overweight to quasi-sovereign bonds in Indonesia and selected corporate bonds in Peru and Mexico also contributed to relative returns.

Management Strategies

• We continue to see a divergence in monetary policy between the U.S. and the rest of the developed world for the time being. We expect the Fed to gradually continue reducing the pace of monetary stimulus, amid an environment of improved growth and contained inflation pressures. Nonetheless, the Fed's dovish bias (or preference for low interest rates) will probably remain under the new forward guidance policy (that is, using communications to manage the market's expectations) and the expected leadership of Janet Yellen. On the other hand, in the eurozone and Japan, where the economic recovery remains fragile and inflation pressures are very subdued, we expect highly accommodative monetary conditions to remain for the near term.

• In contrast with past episodes, we do not believe that an expected recovery in developed market economies will necessarily translate into a broad-based positive impact on EM asset prices. On the contrary, we expect differentiation between EM countries to deepen those countries with current account deficits and low exposure to developed markets, overheating domestic demand and poor institutional frameworks are likely to diverge from those with contained macro imbalances and/or undergoing

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Letter to Stockholders (unaudited) (cont'd)

structural reforms. While EM demand-side stimulus may have been warranted in the wake of the 2008 global financial crisis, several countries have been unwilling or unable to reverse fiscal stimulus. Unfortunately, this situation is likely to persist in 2014. This is because within the group of countries exhibiting the largest imbalances (Brazil, South Africa, Turkey, India and Indonesia) most will hold general or local elections in 2014. Moreover, a further sell-off in developed market interest rates could exert added pressure on EM rates and currencies in 2014. In the presence of such external shocks, EM central banks are likely to allow their currencies to weaken as the main channel of adjustment. Such an environment calls for a selective investment approach coupled with active duration management.

Sincerely,

John H. Gernon
President and Principal Executive Officer January 2014

*The J.P. Morgan Emerging Markets Bond Global ("EMBG") Index tracks total returns for U.S. dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady Bonds, loans, Eurobonds and local market instruments for over 30 emerging market countries. It is not possible to invest directly in an index.

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Portfolio of Investments

(Showing Percentage of Total Value of Investments)

	Face Amount (000)	Value (000)
FIXED INCOME SECURITIES (83.6%)		
Brazil (6.2%)		
Corporate Bonds (2.8%)		
Banco Safra SA, 6.75%, 1/27/21	$ 690	$ 728
6.75%, 1/27/21 (a)	1,360	1,435
ESAL GmbH, 6.25%, 2/5/23	1,500	1,354
Odebrecht Finance Ltd., 5.13%, 6/26/22	3,750	3,679
Odebrecht Offshore Drilling Finance Ltd., 6.75%, 10/1/22 (a)	699	717
		7,913
Sovereign (3.4%)		
Banco Nacional de Desenvolvimento, Economico e Social, 5.50%, 7/12/20 (a)	1,960	2,009
5.50%, 7/12/20	800	820
Brazil Minas SPE via State of Minas Gerais, 5.33%, 2/15/28 (a)	5,790	5,399
Caixa Economica Federal, 3.50%, 11/7/22 (a)(b)	1,760	1,435
		9,663
		17,576
China (2.3%)		
Sovereign (2.3%)		
Sinopec Group Overseas Development 2013 Ltd., 4.38%, 10/17/23	6,520	6,435
Colombia (2.6%)		
Corporate Bonds (1.0%)		
Ecopetrol SA, 5.88%, 9/18/23	830	878
Pacific Rubiales Energy Corp., 5.38%, 1/26/19 (a)(b)	1,870	1,888

	Face Amount (000)	Value (000)
		2,766
Sovereign (1.6%)		
Colombia Government International Bond, 4.38%, 7/12/21	$ 1,460	$ 1,507
7.38%, 3/18/19	390	471
11.75%, 2/25/20	1,815	2,614
		4,592
		7,358
Costa Rica (0.3%)		
Sovereign (0.3%)		
Costa Rica Government International Bond, 4.25%, 1/26/23 (a)	1,020	938
Croatia (1.3%)		
Sovereign (1.3%)		
Croatia Government International Bond, 5.50%, 4/4/23	730	714
6.00%, 1/26/24 (a)(b)	3,000	2,992
		3,706
Ecuador (0.1%)		
Sovereign (0.1%)		
Ecuador Government International Bond, 9.38%, 12/15/15	355	376
Hungary (2.1%)		
Sovereign (2.1%)		
Hungary Government International Bond, 5.75%, 11/22/23	4,710	4,757
6.38%, 3/29/21	1,050	1,131
		5,888
India (0.2%)		
Corporate Bond (0.2%)		
Vedanta Resources PLC, 7.13%, 5/31/23 (a)(b)	560	515
Indonesia (6.6%)		
Sovereign (6.6%)		
Indonesia Government International Bond, 6.88%, 1/17/18	320	360
7.75%, 1/17/38	630	714
11.63%, 3/4/19	430	577
11.63%, 3/4/19 (a)	2,169	2,912

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

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Portfolio of Investments (cont'd)

(Showing Percentage of Total Value of Investments)

	Face Amount (000)	Value (000)
Indonesia (cont'd)		
Sovereign (cont'd)		
Majapahit Holding BV, 7.75%, 1/20/20	$ 7,190	$ 7,927
Pertamina Persero PT, 4.88%, 5/3/22	2,350	2,162
5.25%, 5/23/21	870	842
Perusahaan Listrik Negara PT, 5.50%, 11/22/21	3,470	3,357
		18,851
Ivory Coast (0.5%)		
Sovereign (0.5%)		
Ivory Coast Government International Bond, 5.75%, 12/31/32	1,620	1,458
Kazakhstan (4.8%)		
Sovereign (4.8%)		
Development Bank of Kazakhstan JSC, 4.13%, 12/10/22 (a)	1,850	1,663
5.50%, 12/20/15	230	244
Intergas Finance BV, 6.38%, 5/14/17	700	756
KazAgro National Management Holding JSC, 4.63%, 5/24/23 (a)	1,950	1,798
KazMunayGas National Co., JSC, 5.75%, 4/30/43 (a)	2,760	2,391
6.38%, 4/9/21	1,510	1,646
6.38%, 4/9/21 (a)	2,430	2,649
9.13%, 7/2/18	2,180	2,651
		13,798
Lithuania (1.0%)		
Sovereign (1.0%)		
Lithuania Government International Bond, 6.63%, 2/1/22	2,470	2,893
Mexico (14.2%)		
Corporate Bonds (3.2%)		

Cemex SAB de CV,		
6.50%, 12/10/19 (a)	1,310	1,356
7.25%, 1/15/21 (a)(b)	1,590	1,650
9.50%, 6/15/18	480	547
9.50%, 6/15/18 (a)(b)	1,300	1,482

	Face Amount (000)	Value (000)
Mexichem SAB de CV,		
4.88%, 9/19/22	$ 1,500	$ 1,474
Tenedora Nemak SA de CV,		
5.50%, 2/28/23 (a)(b)	1,090	1,071
5.50%, 2/28/23	1,500	1,474
		9,054