Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.
Form N-CSR
January 03, 2019

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	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: 212-296-0289

Date of fiscal year end: October 31,

Date of reporting period: October 31, 2018

Item 1 - Report to Shareholders

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

Directors

Frank L. Bowman

Kathleen A. Dennis

Nancy C. Everett

Jakki L. Haussler

Dr. Manuel H. Johnson

Joseph J. Kearns

Michael F. Klein

Patricia Maleski

Michael E. Nugent,

Chair of the Board

W. Allen Reed

Fergus Reid

Officers

John H. Gernon

President and Principal
Executive Officer

Timothy J. Knierim

Chief Compliance Officer

Francis J. Smith

Treasurer and Principal
Financial Officer

Mary E. Mullin

Secretary

Michael J. Key

Vice President

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.

P.O. Box 505000

Louisville, Kentucky 40233

Legal Counsel

Dechert LLP

1095 Avenue of the Americas

New York, New York 10036

Counsel to the Independent Directors

Perkins Coie LLP

30 Rockefeller Plaza

New York, New York 10112

Independent Registered Public Accounting Firm

Ernst & Young LLP

200 Clarendon Street

Boston, Massachusetts 02116

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

INVESTMENT MANAGEMENT

Morgan Stanley
Investment Management Inc.
Adviser

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

Annual Report

October 31, 2018

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Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

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Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

Letter to Stockholders (unaudited)

Performance

For the year ended October 31, 2018, the Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the "Fund") had total returns of -9.81%, based on net asset value, and -15.32% 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 -6.58%. On October 31, 2018, the closing price of the Fund's shares on the New York Stock Exchange was $6.12, representing a 15.6% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

Factors Affecting Performance

• Emerging market (EM) domestic debt assets struggled during the year as EM currencies weakened versus the U.S. dollar, trade disputes threatened global activity and the removal of accommodative monetary policy by the U.S. Federal Reserve (Fed) dimmed the outlook for carry-trade strategies (which underweight or short lower yielding investments to invest in higher yielding investments). The reduction of global liquidity (the raising of policy rates and reduction of Fed balance sheet assets) has caused the market to focus on countries with external vulnerabilities, specifically those with twin deficits (current account and fiscal). This has led to pressure on assets, especially EM currencies. While the changing monetary policy landscape prompted a change in investor sentiment, most of these countries were facing their own idiosyncratic issues which left them vulnerable to shifts in risk appetite. While performance has been poor, there has been limited contagion and no substantial uptick in the outlook for defaults as this sell-off was more idiosyncratically driven than systemic in our opinion.

• EM domestic debt lagged other areas of the EM fixed income markets over the period. Performance was driven by local bond performance, which returned 1.62%, while EM currencies weakened by -8.07% versus the U.S. dollar, leading to a total return of -6.58% for the market as measured by the Index for the 12-month period.[i] Countries with large twin deficits, such as Argentina and Turkey, were especially pressured as the market grew concerned about their ability to finance those deficits with the headwinds of rising yields and a stronger U.S. dollar. Bonds from Indonesia, the Philippines, Hungary and Russia also lagged the broader market. Bonds from Malaysia and South Africa posted positive performance as yields fell following positive changes in the government in those countries. Bonds from Thailand, Colombia, Poland and Peru also outperformed on a relative basis in the period.

• Broadly, for the Fund, yield curve/duration positioning contributed to relative performance, while currency positioning was detrimental to relative performance. The use of derivatives both contributed and detracted from performance during the period. The primary instruments used were bond futures (U.S. Treasury and German bund) and currency forwards. Bond futures were used to hedge interest rate exposure, and currency forwards were used to hedge or add to currency exposure. The use of leverage, while incurring borrowing costs, did allow the portfolio to invest in higher-performing positions.

• Duration positioning in Turkey, Brazil, Egypt, Nigeria, Malaysia, Czech Republic and Poland contributed to relative performance in the period. Conversely, currency positioning in Argentina, Indonesia, South Africa, Uruguay, Russia and Mexico detracted from relative performance, as did duration positioning in India and Hungary.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

Letter to Stockholders (unaudited) (cont'd)

Management Strategies

• While we believe second- and third-quarter weakness in EM valuations has created market opportunities to add risk, we have become more selective as the outlook for EM fundamentals has become less certain. At a structural level, the world seems to be leaving global growth synchronicity behind and entering a new phase of diverging growth, as evidenced by still healthy growth in the U.S., a stabilization in Europe and Japan, but a more recent deceleration of activity in EM. Trade issues top the list of concerns, with the U.S. and China locked in what seems likely to be a protracted battle that could undermine growth expectations more broadly. Threats that the U.S. may consider expanding tariffs to the remaining $267 billion worth of U.S. imports from China could unleash another retaliatory round from the latter, thus weighing on global growth/market sentiment.[ii] On the positive side, however, the announcement of a revamped North American Free Trade Agreement (NAFTA), named the U.S.-Mexico-Canada Agreement (USMCA), highlights the propensity for the U.S. to strike a deal and is an important step toward removing one large source of trade-related uncertainty, once national congresses approve the tentative deal.

• While we believe the risks to be relatively benign, they bear monitoring, including the health of the U.S. stock market, which sold off aggressively in October 2018, weighing on overall risk sentiment. Continued dollar strength driven by widening U.S.-rest of developed market growth differentials is another risk worth watching, given the negative impact on local currency and external fixed income strategies. We are also keeping an eye on China, as the government relies on multiple policy tools to deal with conflicting goals involving deleveraging, an activity slowdown and currency stability, amid a dwindling current account surplus and a trade spat with the U.S. The U.S. midterm elections are another key event that we will monitor, given its implication on the continuity of President Trump's agenda during the second half of his term. Finally, geopolitical risks may flare up by year end, as the U.S. State Department implements the second phase of sanctions against Russia under the Chemical and Biological Weapons Control and Warfare Elimination Act, and Congress may resume activity over a sanctions bill.

• Many EM-specific drivers are also worth monitoring: most notably, policy signals from incoming administrations in systematically important EM countries such as Mexico and Brazil. Regarding the former, President-elect Andres Manuel Lopez Obrador's decision to scrap the Mexico City airport project, following a controversial public consultation, has raised concerns about the predictability of policymaking under the new administration. On the other hand, soundbites from the incoming Brazilian President Bolsonaro have been more constructive, as he unveils a market-friendly economic agenda prioritizing fiscal consolidation and particularly a swift pension reform. In addition, we will assess progress of the second International Monetary Fund-Argentina program which, by expanding the size of the original program and significantly frontloading disbursements, have reduced concerns over 2018-2019 external debt redemptions. Key to the success of the program is the authorities' commitment to a stringent monetary/fiscal policy mix, in an already shocked economy and ahead of key presidential elections next year. In Turkey, following the market-positive release of U.S. pastor Brunson, focus will be on the government's willingness to follow up on needed macroeconomic rebalancing. In response to the global and idiosyncratic events highlighted above, many EM economies have taken a more proactive policy response as of late, as seen by a shift toward tighter monetary policy in countries viewed as vulnerable, despite negative consequences on growth/politics. Finally, the negative performance of EM debt in the

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

Letter to Stockholders (unaudited) (cont'd)

year-to-date through October 31, 2018 is considerable and among the worst in the asset class' history. EM debt returns have historically been strong after similar retracements, indicating that investors may be rewarded for staying invested over the long term. Relatedly, it appears to us that the sell-off is overdone in countries with improving fundamentals, thus offering attractive entry points should we see a stabilization in the global backdrop, in particular, a dialing down of trade-war-related volatility.

Sincerely,

John H. Gernon
President and Principal Executive Officer November 2018

*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.

[i] Source: Bloomberg L.P.

[ii] Source: *Financial Times,* "Trump threatens new tariffs on $267 billion on Chinese goods," September 7, 2018.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

Portfolio of Investments

(Showing Percentage of Total Value of Investments)

		Face Amount (000)	Value (000)
FIXED INCOME SECURITIES (95.2%)			
Argentina (2.7%)			
Corporate Bonds (2.7%)			
Autonomous City of Buenos Aires Argentina, BADLAR + 3.25%, 53.94%, 3/29/24 (a)	ARS	92,677	$ 2,330
Banco Hipotecario SA, 3 Month USD LIBOR + 4.00%, 57.25%, 11/7/22 (a)(b)		25,000	610
Provincia de Buenos Aires, BADLAR + 3.83%, 50.31%, 5/31/22 (a)		218,010	5,583
Provincia de Mendoza Argentina, BADLAR + 4.38%, 52.24%, 6/9/21 (a)		172,370	4,390
Tarjeta Naranja SA, BADLAR + 3.50%, 52.29%, 4/11/22 (a)(b)	$	5,150	1,532
YPF SA, BADLAR + 4.00%, 47.83%, 7/7/20 (a)(b)		9,137	3,885
			18,330
Brazil (16.0%)			
Sovereign (16.0%)			
Brazil Notas do Tesouro Nacional, Series F, 10.00%, 1/1/21 - 1/1/25	BRL	397,695	110,223
Chile (1.0%)			
Sovereign (1.0%)			
Bonos de la Tesoreria de la Republica en pesos, 5.00%, 3/1/35	CLP	3,570,000	5,158
Chile Government International Bond, 5.50%, 8/5/20		1,165,000	1,726
			6,884
Colombia (5.7%)			
Corporate Bond (0.2%)			

		Face Amount (000)	Value (000)
Fideicomiso PA Costera, 6.25%, 1/15/34 (b)	COP	4,979,415	1,564
Sovereign (5.5%)			
Colombia Government International Bond, 9.85%, 6/28/27	COP	1,466,000	$ 563
Colombian TES, 6.00%, 4/28/28		15,000,000	4,299
7.75%, 9/18/30		16,848,100	5,416
10.00%, 7/24/24		44,128,500	15,991
11.00%, 7/24/20		14,087,000	4,797
Financiera de Desarrollo Territorial SA Findeter, 7.88%, 8/12/24 (b)		21,492,000	6,900
			37,966
			39,530
Dominican Republic (0.1%)			
Sovereign (0.1%)			
Dominican Republic International Bond, 8.90%, 2/15/23 (b)	DOP	22,000	439
Georgia (0.8%)			
Corporate Bond (0.8%)			
Bank of Georgia JSC, 11.00%, 6/1/20 (b)	GEL	14,300	5,320
Hungary (3.4%)			
Sovereign (3.4%)			
Hungary Government Bond, 3.00%, 10/27/27	HUF	3,407,390	11,414
5.50%, 6/24/25		2,992,920	11,930
			23,344
India (2.9%)			
Sovereign (2.9%)			
India Government Bond, 8.40%, 7/28/24	INR	1,445,000	20,008
Indonesia (8.6%)			
Sovereign (8.6%)			
Indonesia Treasury Bond, 8.38%, 3/15/34	IDR	291,441,000	18,385
8.75%, 5/15/31		412,855,000	27,140
9.00%, 3/15/29		204,725,000	13,807
			59,332

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

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2018

Portfolio of Investments (cont'd)

(Showing Percentage of Total Value of Investments)

		Face Amount (000)	Value (000)
Malaysia (4.5%)			
Sovereign (4.5%)			
Malaysia Government Bond,			
3.96%, 9/15/25	MYR	23,754	$ 5,634
4.18%, 7/15/24		86,575	20,890
4.23%, 6/30/31		19,500	4,541
			31,065
Mexico (10.4%)			
Sovereign (10.4%)			
Mexican Bonos,			
Series M			
6.50%, 6/10/21	MXN	237,760	11,137
7.50%, 6/3/27		212,300	9,624
7.75%, 5/29/31		62,900	2,826
8.00%, 12/7/23		129,000	6,178
10.00%, 12/5/24		97,500	5,090
Petroleos Mexicanos,			
(Units)			
7.65%, 11/24/21 (b)(c)		791,300	36,532
			71,387
Peru (4.1%)			
Sovereign (4.1%)			
Peru Government Bond,			
(Units)			
5.70%, 8/12/24 (c)	PEN	44,037	13,585
6.15%, 8/12/32 (b)		20,660	6,120
Peruvian Government			
International Bond,			
(Units)			
5.70%, 8/12/24 (b)(c)		14,001	4,319
8.20%, 8/12/26 (c)		13,154	4,548
			28,572
Poland (10.3%)			
Sovereign (10.3%)			
Poland Government Bond,			
5.25%, 10/25/20	PLN	75,898	21,210
Republic of Poland			
Government Bond,			
3.25%, 7/25/25		29,850	7,954

5.75%, 9/23/22		141,500		41,703
				70,867
		Face Amount (000)		**Value (000)**
Romania (1.4%)				
Sovereign (1.4%)				
Romania Government Bond,				
4.75%, 2/24/25	RON	36,275	$	8,785
5.80%, 7/26/27		4,190		1,081
				9,866
Russia (5.3%)				
Sovereign (5.3%)				
Russian Federal Bond OFZ,				