

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.
Form N-CSR
January 09, 2012

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: 212-296-6990

Date of fiscal year end: October 31, 2011

Date of reporting period: October 31, 2011

Item 1 - Report to Shareholders

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

Directors

Michael E. Nugent

Frank L. Bowman

Michael Bozic

Kathleen A. Dennis

James F. Higgins

Dr. Manuel H. Johnson

Joseph J. Kearns

Michael F. Klein

W. Allen Reed

Fergus Reid

Stefanie V. Chang Yu

Vice President

Francis J. Smith

*Treasurer and Principal
Financial Officer*

Mary Ann Picciotto

Chief Compliance Officer

Mary E. Mullin

Secretary

Officers

Michael E. Nugent

Chairman of the Board and Director

Arthur Lev

President and Principal Executive Officer

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

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INVESTMENT MANAGEMENT

Morgan Stanley

Emerging Markets Domestic

Debt Fund, Inc. (EDD)

Morgan Stanley

Investment Management Inc.

Investment Adviser

**Annual
Report**

October 31, 2011

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

Overview

Letter to Stockholders (unaudited)

Performance

For the year ended October 31, 2011, the Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the "Fund") had total returns of 0.32%, based on net asset value, and -1.34% 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 1.53%. On October 31, 2011, the closing price of the Fund's shares on the New York Stock Exchange was \$15.87, representing an 8.5% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

Factors Affecting Performance

- Emerging markets (EM) fixed income, like most risk assets, generally declined during the last couple of months of 2010, as global risk appetite subsided in November due to the fiscal crisis in Ireland. Nevertheless, in relation to other episodes where global investors had become averse to risk, the negative returns were modest, coinciding with positive EM data releases, confirming that well established and favorable fundamentals remained intact.
- The first three months of 2011 were volatile with a number of unexpected global events from political turmoil in the Middle East and Africa, to the Japan earthquake, to the precarious fiscal situation in Europe. During the period, emerging market central banks adopted divergent tightening strategies. Some central banks, such as Chile and Israel, surprised the market by stepping up the pace of rate hikes; others such as Brazil and Turkey tightened regulations in lieu of rate hikes.
- In the second quarter of 2011, developed market worries began to take center stage as European officials lacked a clear resolution to Greece's sovereign-debt crisis and U.S. economic data disappointed. In addition to Greece, other peripheral Europe countries showed significant signs of stress, including Portugal, Italy and Spain. Despite these headwinds, EM asset classes performed well with EM external debt slightly outpacing EM local currency debt. Inflation continued to be an important concern in the emerging markets as rising food and energy prices prompted emerging market central banks to remain vigilant. Against this backdrop, many emerging market central banks resumed monetary tightening policies to combat inflationary pressures.
- Global risk sentiment further weakened in the third quarter of 2011 due to increased concerns about significant economic slowing in the developed world and the European sovereign debt crisis despite signs of economic progress in the U.S. Emerging markets assets in general came under immense pressure in September as investors shed all risk assets in favor of traditional "safe-havens," such as the U.S. dollar and U.S. Treasuries. Volatility in the emerging markets was high as the markets experienced bouts of disappointment, highlighting the need for stronger leadership and policies from the G-10 countries to lift investor confidence.
- Risk sentiment retraced in October due to signs that U.S. recession risks were receding and improved sentiment toward steps taken by European policymakers to put Europe on the path to resolving its credit crisis. Emerging market currencies reversed some of the previous month's declines versus the U.S. dollar after September's currency sell-off had battered risky assets.

- EM local currency debt, as measured by the Index, returned 1.53% for the 12 months ended October 31, 2011. Index returns attributable to foreign currency exposure were -5.20%.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

Overview

Letter to Stockholders (unaudited) (cont'd)

- The Fund benefited from overweight exposures to Brazil, Indonesia, and Venezuela. Brazil performed well amid positive economic growth and increasing demand for the nation's commodity exports, while Indonesia's robust economic growth and prudent fiscal management eased market concerns about the threat of a global slowdown. Venezuela rallied sharply in the summer months after President Hugo Chavez sought medical treatment in Cuba for cancer and investors speculated that the left-leaning president might have to leave office. Underweight exposure to Poland also lifted performance.
- Conversely, underweight exposure to Malaysia and Russia, as well as underweight exposure to South Africa early in the year detracted from performance. Malaysia benefited from resilient economic growth despite recent fears that a developed market-led recession would exhaust demand for Asian exports, while Russia was boosted by rising oil prices. Overweight exposure to Turkey also hurt performance.

Management Strategies

- We expect growth in the developed world to stabilize at a lower level in the fourth quarter of 2011 and to slowly recover in 2012. However, the risk of a recession in the developed world has increased significantly, reflecting negative external shocks and increased policy uncertainty in the U.S. and Europe. The unresolved fiscal troubles in the U.S. and in Europe, and the apparent lack of political consensus to resolve them, are likely to result in bouts of high volatility and risk aversion in the near future, while depressing economic growth in the next couple of quarters.
- We expect developed central banks to provide liquidity as needed, supporting commodity prices and capital inflows into EM countries, which we believe could somewhat offset the negative impact of heightened risk aversion and subpar growth in the developed world. We expect EM countries to show resilient, albeit lower, growth in the next couple of quarters, aided by robust domestic policies, supportive terms of trade, and capital inflows. Subsiding inflationary pressures and balanced growth will likely allow EM central banks to adopt looser monetary policies in coming months.
- In general, sovereign risk premiums are now too high relative to the fundamental macroeconomic strength of most emerging economies, in our opinion. In addition, we believe there are pockets of undervaluation in certain Asian and commodity currencies.

Sincerely,

Arthur Lev
President and Principal Executive Officer November 2011

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2011

Investment Advisory Agreement Approval (unaudited)

Nature, Extent and Quality of Services

The Board reviewed and considered the nature and extent of the investment advisory services provided by the Adviser (as defined herein) under the advisory agreement, including portfolio management, investment research and equity and fixed income securities trading. The Board also reviewed and considered the nature and extent of the non-advisory, administrative services provided by the Fund's Adviser under the administration agreement, including accounting, clerical, bookkeeping, compliance, business management and planning, and the provision of supplies, office space and utilities at the Adviser's expense. (The advisory and administration agreements together are referred to as the "Management Agreement.") The Board also compared the nature of the services provided by the Adviser with similar services provided by non-affiliated advisers as reported to the Board by Lipper, Inc. ("Lipper").

The Board reviewed and considered the qualifications of the portfolio managers, the senior administrative managers and other key personnel of the Adviser who provide the advisory and administrative services to the Fund. The Board determined that the Adviser's portfolio managers and key personnel are well qualified by education and/or training and experience to perform the services in an efficient and professional manner. The Board concluded that the nature and extent of the advisory and administrative services provided were necessary and appropriate for the conduct of the business and investment activities of the Fund and supported its decision to approve the Management Agreement.

Performance, Fees and Expenses of the Fund

The Board reviewed the performance, fees and expenses of the Fund compared to its peers, as determined by Lipper, and to appropriate benchmarks where applicable. The Board discussed with the Adviser the performance goals and the actual results achieved in managing the Fund. When considering a fund's performance, the Board and the Adviser place emphasis on trends and longer-term returns (focusing on one-year, three-year and five-year performance as of December 31, 2010, or since inception, as applicable). When a fund underperforms its benchmark and/or its peer group average, the Board and the Adviser discuss the causes of such underperformance and, where necessary, they discuss specific changes to investment strategy or investment personnel. The Board noted that the Fund's performance was better than its peer group average for the one-year period and since the end of April 2007, the month of the Fund's inception, but below its peer group average for the three-year period. The Board discussed with the Adviser the level of the advisory and administration fees (together, the "management fee") for this Fund relative to comparable funds and/or other accounts advised by the Adviser and/or compared to its peers as determined by Lipper. In addition to the management fee, the Board also reviewed the Fund's total expense ratio. The Board noted that the Fund's management fee and total expense ratio were higher than its peer group average. After discussion, the Board concluded that: (i) the Portfolio's performance was competitive with its peer group average; and (ii) the management fee and total expense ratio, although higher than its peer group average, were acceptable given the quality and nature of services provided.

Economies of Scale

The Board considered the size and growth prospects of the Fund and how that relates to the Fund's total expense ratio and particularly the Fund's management fee rate, which does not include breakpoints. In conjunction with its review of the Adviser's profitability, the Board discussed with the Adviser how a change in assets can affect the efficiency or effectiveness of managing the Fund and whether the management fee level is appropriate relative to current and projected asset levels and/or whether the management fee structure reflects economies of scale as asset levels change.

The Board considered that, with respect to closed-end funds, the assets are not likely

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2011

Investment Advisory Agreement Approval (unaudited) (cont'd)

to grow with new sales or grow significantly as a result of capital appreciation. The Board concluded that economies of scale for the Fund were not a factor that needed to be considered at the present time.

Profitability of the Adviser and Affiliates

The Board considered information concerning the costs incurred and profits realized by the Adviser and its affiliates during the last year from their relationship with the Fund and during the last two years from their relationship with the Morgan Stanley Fund Complex and reviewed with the Adviser the cost allocation methodology used to determine the profitability of the Adviser and affiliates. The Board has determined that its review of the analysis of the Adviser's expenses and profitability supports its decision to approve the Management Agreement.

Other Benefits of the Relationship

The Board considered other benefits to the Adviser and its affiliates derived from their relationship with the Fund and other funds advised by the Adviser. These benefits may include, among other things, "float" benefits derived from handling of checks for purchases and sales, research received by the Adviser generated from commission dollars spent on funds' portfolio trading and fees for distribution and/or shareholder servicing. The Board reviewed with the Adviser each of these arrangements and the reasonableness of the Adviser's costs relative to the services performed. The Board has determined that its review of the other benefits received by the Adviser or its affiliates supports its decision to approve the Management Agreement.

Resources of the Adviser and Historical Relationship Between the Fund and the Adviser

The Board considered whether the Adviser is financially sound and has the resources necessary to perform its obligations under the Management Agreement. The Board also reviewed and considered the historical relationship between the Fund and the Adviser, including the organizational structure of the Adviser, the policies and procedures formulated and adopted by the Adviser for managing the Fund's operations and the Board's confidence in the competence and integrity of the senior managers and key personnel of the Adviser. The Board concluded that the Adviser has the financial resources necessary to fulfill its obligations under the Management Agreement and that it is beneficial for the Fund to continue its relationship with the Adviser.

Other Factors and Current Trends

The Board considered the controls and procedures adopted and implemented by the Adviser and monitored by the Fund's Chief Compliance Officer and concluded that the conduct of business by the Adviser indicates a good faith effort on its part to adhere to high ethical standards in the conduct of the Fund's business.

General Conclusion

After considering and weighing all of the above factors, the Board concluded that it would be in the best interest of the Fund and its shareholders to approve renewal of the Management Agreement for another year. In reaching this conclusion the Board did not give particular weight to any single factor referenced above. The Board considered these factors over the course of numerous meetings, some of which were in executive session with only the independent

Board members and their counsel present. It is possible that individual Board members may have weighed these factors differently in reaching their individual decisions to approve the Management Agreement.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2011

Portfolio of Investments

(Showing Percentage of Total Value of Investments)

	Face Amount (000)	Value (000)
FIXED INCOME SECURITIES (99.8%)		
Brazil (18.3%)		
Sovereign (18.3%)		
Brazil Notas do Tesouro Nacional, Series F, 10.00%, 1/1/14	BRL 497,728	\$ 285,520
Chile (0.7%)		
Sovereign (0.7%)		
Chile Government International Bond, 5.50%, 8/5/20	CLP 4,665,000	10,081
Colombia (4.9%)		
Sovereign (4.9%)		
Colombia Government International Bond, 7.75%, 4/14/21	COP 29,000,000	18,319
12.00%, 10/22/15	33,000,000	22,498
Republic of Colombia, 9.85%, 6/28/27	46,000,000	34,912
		75,729
Hungary (6.9%)		
Sovereign (6.9%)		
Hungary Government Bond, 6.75%, 2/24/17	HUF 14,588,920	64,236
7.50%, 11/12/20	9,480,000	42,725
		106,961
Indonesia (14.3%)		
Sovereign (14.3%)		
Barclays Bank PLC, Indonesia Government Bonds, Credit Linked Notes, 10.00%, 7/17/17	IDR 600,000,000	81,652
Credit Suisse, Indonesia Government Bonds, Credit Linked Notes, 10.00%, 7/17/17	154,683,530	21,051
	60,000,000	8,950

Deutsche Bank AG, Republic of Indonesia Government Bond, Credit Linked Notes, 11.00%, 12/15/20		
11.50%, 9/23/19 (a)	235,000,000	35,393
12.80%, 6/22/21	150,000,000	24,742

	Face Amount (000)	Value (000)
JPMorgan Chase Bank, London, Indonesia Government Bonds, Credit Linked Notes, 8.25%, 7/17/21		
	IDR 185,000,000	\$ 23,869
10.00%, 7/19/17 (b)	192,525,000	26,200
		221,857

Malaysia (3.3%)**Sovereign (3.3%)**

Malaysia Government Bond, 3.84%, 8/12/15		
	MYR 110,000	36,557
5.09%, 4/30/14	42,152	14,391
		50,948

Mexico (15.3%)**Sovereign (15.3%)**

Mexican Bonos, 8.00%, 6/11/20		
	MXN 2,781,427	237,450

Peru (1.8%)**Sovereign (1.8%)**

Peru Government Bond, 7.84%, 8/12/20		
	PEN 37,745	16,017
Peruvian Government International Bond, 7.84%, 8/12/20		
	30,000	12,730
		28,747

Philippines (0.9%)**Sovereign (0.9%)**

Philippine Government International Bond, 4.95%, 1/15/21		
	PHP 648,000	14,666

Poland (6.2%)**Sovereign (6.2%)**

Poland Government Bond, 5.50%, 10/25/19		
	PLN 307,287	96,533

Russia (2.4%)**Sovereign (2.4%)**

Russian Foreign Bond Eurobond, 7.85%, 3/10/18 (a)		
	RUB 1,095,000	37,292

South Africa (9.1%)**Sovereign (9.1%)**

South Africa Government Bond,			
7.25%, 1/15/20	ZAR	1,021,060	123,330
8.00%, 12/21/18		140,000	18,058
			141,388

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

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2011

Portfolio of Investments (cont'd)

(Showing Percentage of Total Value of Investments)

	Face Amount (000)	Value (000)
Thailand (4.2%)		
Sovereign (4.2%)		
Thailand Government Bond, 4.25%, 3/13/13	THB 1,597,940	\$ 52,604
5.25%, 7/13/13	395,100	13,261
		65,865
Turkey (10.3%)		
Sovereign (10.3%)		
Turkey Government Bond, Zero Coupon, 1/25/12	TRY 80,000	44,285
10.00%, 2/15/12	19,578	11,580
10.50%, 1/15/20	166,750	99,858
16.00%, 3/7/12	9,340	5,395
		161,118
Venezuela (1.2%)		
Sovereign (1.2%)		
Petroleos de Venezuela SA, 8.50%, 11/2/17	\$ 25,000	18,188
Venezuela Government International Bond, 9.25%, 9/15/27	1,349	981
		19,169
TOTAL FIXED INCOME SECURITIES		1,553,324
(Cost \$1,575,697)		
	Shares	Value (000)
SHORT-TERM INVESTMENT (0.2%)		
Investment Company (0.2%)		
Morgan Stanley Institutional Liquidity Funds Money Market Portfolio Institutional Class (See Note F) (Cost \$3,822)	3,822,046	\$ 3,822
		1,557,146

TOTAL INVESTMENTS

(100.0%)

(Cost \$1,579,519) (c)

LIABILITIES IN EXCESS OF

OTHER ASSETS

(301,528)

NET ASSETS

\$ 1,255,618

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

(b) Variable/Floating Rate Security Interest rate changes on these instruments are based on changes in a designated base rate. The rates shown are those in effect on October 31, 2011.

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

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

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2011

Portfolio of Investments (cont'd)

Foreign Currency Exchange Contracts Information:

The Fund had the following foreign currency exchange contracts open at period end:

Counterparty	Currency to Deliver (000)	Value (000)	Settlement Date	In Exchange For (000)	Value (000)	Unrealized Appreciation (Depreciation) (000)
JPMorgan Chase Bank	USD 44,634	\$ 44,634	11/15/11	RUB 1,417,637	\$ 46,630	\$ 1,996
JPMorgan Chase Bank	USD 69,082	69,082	11/21/11	MYR 215,710	70,231	1,149
JPMorgan Chase Bank	USD 3,212	3,212	11/21/11	MYR 10,000	3,256	44
JPMorgan Chase Bank	USD 3,244	3,244	11/21/11	MYR 10,000	3,256	12
JPMorgan Chase Bank	USD 41,808	41,808	11/25/11	THB 1,298,000	42,128	320
JPMorgan Chase Bank	USD 3,900	3,900	11/25/11	THB 120,000	3,895	(5)
		\$ 165,880			\$ 169,396	\$ 3,516

BRL Brazilian Real

CLP Chilean Peso

COP Colombian Peso

HUF Hungarian Forint

IDR Indonesian Rupiah

MXN Mexican New Peso

MYR &n