

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.

Form N-CSR

December 31, 2009

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 811-5497

Western Asset Municipal High Income Fund Inc.
(Exact name of registrant as specified in charter)

55 Water Street, New York, NY
(Address of principal executive offices)

10041
(Zip code)

Robert I. Frenkel, Esq.
Legg Mason & Co., LLC
100 First Stamford Place
Stamford, CT 06902
(Name and address of agent for service)

Registrant's telephone number, including area code: (888)777-0102

Date of fiscal year October 31
end:

Date of reporting period: October 31, 2009

ITEM 1. REPORT TO STOCKHOLDERS.

The Annual Report to Stockholders is filed herewith.

ANNUAL REPORT / OCTOBER 31, 2009

Western Asset Municipal High Income Fund Inc.

(MHF)

Managed by **WESTERN ASSET**

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

Fund objective

The Fund seeks high current income exempt from federal income taxes.

What's inside

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Legg Mason Partners Fund Advisor, LLC (LMPFA) is the Fund's investment manager and Western Asset Management Company (Western Asset) is the Fund's subadviser. LMPFA and Western Asset are wholly-owned subsidiaries of Legg Mason, Inc.

Letter from the chairman

Dear Shareholder,

While the U.S. economy remained weak during much of the twelve-month reporting period ended October 31, 2009, the lengthiest recession since the Great Depression finally appeared to have ended during the third quarter of 2009.

Looking back, the U.S. Department of Commerce reported that fourth quarter 2008 U.S. gross domestic product (GDP)i contracted 5.4%. Economic weakness accelerated during the first quarter of 2009, as GDP fell 6.4%. However, the economic environment started to get relatively better during the second quarter, as GDP fell 0.7%. The economy's more modest contraction was due, in part, to smaller declines in both exports and business spending. After contracting four consecutive quarters, the Commerce Department's preliminary estimate for third quarter 2009 GDP growth was 2.8%. A variety of factors helped the economy to expand, including the government's \$787 billion stimulus program and its Cash for Clunkers car rebate program, which helped spur an increase in car sales.

Even before GDP advanced in the third quarter, there were signs that the economy was starting to regain its footing. The manufacturing sector, as measured by the Institute for Supply Management's PMIⁱⁱ, rose to 52.9 in August 2009, the first time it surpassed 50 since January 2008 (a reading below 50 indicates a contraction, whereas a reading above 50 indicates an expansion). While the PMI dipped to 52.6 in September, it rose to 55.7 in October, its best reading since April 2006.

The housing market also saw some improvement during the reporting period. According to its most recent data, the S&P/Case-Shiller Home Price Indexⁱⁱⁱ indicated that home prices rose 1.2% in August 2009 versus the prior month. This marked the fourth straight monthly gain. In addition, the National Association of Realtors' Pending Home Sales Index^{iv} rose 6.1% in September, the eighth consecutive monthly increase.

One area that remained weak and could hamper the magnitude of economic recovery was the labor market. While monthly job losses have moderated compared to earlier in the year, the unemployment rate rose to 10.2% in October 2009, its highest level in more than twenty-six

years. Since

Western Asset Municipal High Income Fund Inc. **I**

Letter from the chairman *continued*

December 2007, the number of unemployed has risen by approximately 8.2 million and there have been twenty-two consecutive months of job losses.

The Federal Reserve Board (Fed)^v continued to pursue an accommodative monetary policy during the reporting period. After reducing the federal funds rate^{vi} from 5.25% in August 2007 to a range of 0 to 1/4 percent in December 2008 a historic low the Fed has maintained this stance thus far in 2009. In conjunction with its November 2009 meeting, the Fed said that it will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

During the twelve months ended October 31, 2009, both short- and long-term Treasury yields experienced periods of heightened volatility. When the period began, two- and ten-year Treasury yields were 1.56% and 4.01%, respectively. The ongoing fallout from the issues related to the subprime mortgage market, the credit crisis, forced selling by leveraged investors and a lack of liquidity triggered several flights to quality. During these periods, Treasury yields moved lower (and their prices higher), while riskier segments of the market saw their yields move higher (and their prices lower). This was particularly true toward the end of 2008, as the turmoil in the financial markets and sharply falling stock prices caused investors to flee securities that were perceived to be risky, even high-quality corporate bonds and high-grade municipal bonds. When the first half of the reporting period ended on April 30, 2009, two- and ten-year Treasury yields were 0.91% and 3.16%, respectively.

During the second half of the period, Treasury yields generally moved higher (and their prices lower) until early June. Two- and ten-year yields peaked at 1.42% and 3.98%, respectively, before falling and ending the reporting period at 0.90% and 3.41%, respectively. In a reversal from 2008, investor risk aversion faded as the twelve-month reporting period progressed, driving spread sector (non-Treasury) prices higher.

The municipal bond market performed largely in line with its taxable bond counterpart over the twelve months ended October 31, 2009. Over that period, the Barclays Capital Municipal Bond Index^{vii} and the Barclays Capital U.S. Aggregate Index^{viii} returned 13.60% and 13.79%, respectively. The municipal market was supported by strong demand, coupled with declining new issuance of tax-free bonds.

A special note regarding increased market volatility

Dramatically higher volatility in the financial markets has been very challenging for many investors. Market movements have been rapid sometimes in reaction to economic news, and sometimes creating the news.

II

Western Asset Municipal High Income Fund Inc.

In the midst of this evolving market environment, we at Legg Mason want to do everything we can to help you reach your financial goals. Now, as always, we remain committed to providing you with excellent service and a full spectrum of investment choices. Rest assured, we will continue to work hard to ensure that our investment managers make every effort to deliver strong long-term results.

We also remain committed to supplementing the support you receive from your financial advisor. One way we accomplish this is through our enhanced website, www.leggmason.com/cef. Here you can gain immediate access to many special features to help guide you through difficult times, including:

- Fund prices and performance,
- Market insights and commentaries from our portfolio managers, and
- A host of educational resources.

During periods of market unrest, it is especially important to work closely with your financial advisor and remember that reaching one's investment goals unfolds over time and through multiple market cycles. Time and again, history has shown that, over the long run, the markets have eventually recovered and grown.

Information about your fund

Please read on for a more detailed look at prevailing economic and market conditions during the Fund's reporting period and to learn how those conditions have affected Fund performance.

Important information with regard to recent regulatory developments that may affect the Fund is contained in the Notes to Financial Statements included in this report.

As always, thank you for your confidence in our stewardship of your assets. We look forward to helping you meet your financial goals.

Sincerely,

R. Jay Gerken, CFA

Chairman, President and Chief Executive Officer

November 27, 2009

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Western Asset Municipal High Income Fund Inc.

Letter from the chairman *continued*

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.
- ii The Institute for Supply Management's PMI is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies. It offers an early reading on the health of the manufacturing sector.
- iii The S&P/Case-Shiller Home Price Index measures the residential housing market, tracking changes in the value of the residential real estate market in twenty metropolitan regions across the United States.
- iv The Pending Home Sales Index is an index created by the National Association of Realtors that tracks home sales in which a contract is signed but the sale has not yet closed. The Index is a leading indicator of future existing home sales as it typically takes four to six weeks to close a sale after a contract has been signed.
- v The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- vi The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.
- vii The Barclays Capital Municipal Bond Index is a market value weighted index of investment grade municipal bonds with maturities of one year or more.
- viii The Barclays Capital U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

IV

Western Asset Municipal High Income Fund Inc.

Fund overview

Q. What is the Fund's investment strategy?

A. The Fund seeks high current income exempt from federal income taxes. The Fund invests primarily in intermediate- and long-term municipal debt securities issued by state and local governments. However, the Fund may invest in municipal obligations of any maturity. The Fund may invest in non-publicly traded municipal securities, zero-coupon municipal obligations and non-appropriation or other municipal lease obligations.

At Western Asset Management Company (Western Asset), the Fund's subadviser, we utilize a fixed-income team approach, with decisions derived from interaction among various investment management sector specialists. The sector teams are comprised of Western Asset's senior portfolio managers, research analysts and an in-house economist. Under this team approach, management of client fixed-income portfolios will reflect a consensus of interdisciplinary views within the Western Asset organization.

Q. What were the overall market conditions during the Fund's reporting period?

A. During the fiscal year, the fixed-income market was impacted by the fallout from the financial crisis in 2008 and the subsequent return to more normal conditions given the aggressive actions taken by the Federal Reserve Board (Fed), the U.S. Department of the Treasury and other government entities.

The yields on two- and ten-year Treasuries began the fiscal year at 1.56% and 4.01%, respectively. As the reporting period began, we were in the midst of a flight to quality, triggered by the seizing credit markets and a sharp drop in Treasury yields. The ten-year Treasury yield bottomed at 2.08% on December 18, 2008. At the epicenter of the turmoil were the continued repercussions from the September 2008 bankruptcy of Lehman Brothers. During this time, investors were drawn to the relative safety of shorter-term Treasuries, while riskier portions of the bond market performed poorly.

However, as the fiscal year progressed, conditions in the credit markets improved, there were signs that the economy was stabilizing and investor risk aversion abated. This led to falling demand (and higher yields) for Treasuries and a strong sharp rally in the spread sectors (non-U.S. Treasuries). Also supporting the spread sectors was strong demand from investors seeking incremental yields given the low rates available from short-term fixed-income securities.

Toward the end of the reporting period, Treasury yields continued to move higher, especially on the long end of the yield curveⁱⁱ. This was due to

Fund overview *continued*

concerns regarding the massive amount of new Treasury issuance that would be needed to fund the economic stimulus package. At the conclusion of the fiscal year, two- and ten-year Treasury yields were 0.90% and 3.41%, respectively.

While municipal bonds were not immune to the volatility in the financial markets, overall, they generated strong results during the fiscal year. As the reporting period began in November 2008, there was a great deal of uncertainty in the municipal market, as prices had fallen sharply in the previous two months. This challenging environment was triggered by a number of issues, including increased risk aversion, downgrades of monoline bond insurers, the seizing auction rate preferred market and forced selling by highly leveraged investors into illiquid markets. In addition, there were fears that the deepening recession would negatively impact municipalities, as they would generate less tax revenues.

While the fundamentals in the municipal market did not significantly change, tax-free bond prices rallied during much of the reporting period. This was due, in part, to improving technical factors, including less forced selling and better liquidity. Demand for tax-free bonds also increased, as investors were drawn to their attractive yields. All told, municipal bonds generated strong results, with the Barclays Capital Municipal Bond Index^{xiii} returning 13.60% for the twelve months ended October 31, 2009.

Q. How did we respond to these changing market conditions?

A. We made a number of tactical adjustments to the portfolio during the fiscal year. Toward the beginning of the period, we further increased the Fund's overweight exposure to essential service revenue bonds. These included securities issued by municipalities for enterprises such as Power, Water & Sewer, Health Care, Transportation and Education. Not only did these securities offer attractive yields, but we also expected that they would outperform their General Obligation counterparts given the challenging economic environment. We also further pared the Fund's exposure to General Obligation bonds. These securities are typically more economically sensitive, in that the issuing municipality repays bondholders from tax revenues.

Performance review

For the twelve months ended October 31, 2009, Western Asset Municipal High Income Fund Inc. returned 12.30% based on its net asset value (NAV) and 18.49% based on its New York Stock Exchange (NYSE) market price per share. The Fund's unmanaged benchmark, the Barclays Capital Municipal Bond Index, returned 13.60% over the same time frame. The Lipper High Yield Municipal Debt Closed-End Funds Category Average^v returned 24.22% for the same period. Please note that Lipper performance returns are based on each fund's NAV.

Certain investors may be subject to the federal alternative minimum tax, and state and local taxes will apply. Capital gains, if any, are fully taxable. Please consult your personal tax or legal adviser.

During the twelve-month period, the Fund made distributions to shareholders totaling \$0.44 per share. The performance table shows the Fund's twelve-month total return based on its NAV and market price as of October 31, 2009. **Past performance is no guarantee of future results.**

PERFORMANCE SNAPSHOT as of October 31, 2009 (unaudited)

PRICE PER SHARE	12-MONTH TOTAL RETURN*
\$7.45 (NAV)	12.30%
\$7.25 (Market Price)	18.49%

All figures represent past performance and are not a guarantee of future results.

***Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions in additional shares in accordance with the Fund's Dividend Reinvestment Plan.**

Q. What were the leading contributors to performance?

A. The largest contributor to relative performance for the period was the Fund's overweight exposure to the Industrial Development Revenue/Pollution Control Revenue (IDR/PCR) sector. Within the sector, the Fund's exposure to gas prepay securities significantly enhanced its results. These securities, which are backed by certain broker/dealers, performed poorly early in 2008 given the turmoil in the financial markets. However, as a number of broker/dealers changed their status to bank holding companies and government initiatives such as the Troubled Asset Relief Program (TARP) added confidence in the financial system, gas prepay securities rebounded sharply during the fiscal year.

The Fund's overweight position and security selection in the Health Care sector also significantly contributed to performance. Within the sector, we emphasized some of the better-quality names that we felt were more secure and less likely to experience downgrades. Elsewhere, our underweight to State and Local General Obligation bonds was beneficial, as they underperformed essential service revenue bonds. We continued to favor essential service revenue bonds as they offered higher yields and are typically less susceptible to fallout from weak economic environments.

Q. What were the leading detractors from performance?

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A. The largest detractor from performance for the period was the Fund's yield curve positioning. An underweight to the intermediate (ten-year) portion of the yield curve detracted from results as it performed well during the twelve-month period as a whole. Our exposure to cash was also a drag

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Fund overview *continued*

on performance, given the strong performance in the municipal market and the low yields available from short-term money market instruments.

Our futures trading strategy was another meaningful detractor from performance. In particular, our use of a short position in U.S. Treasury futures reduced the Fund's overall duration^{vi}. This strategy was detrimental to results as municipal yields declined over the period. Additionally, the outperformance of the U.S. Treasury market versus the municipal market, especially following the collapse of Lehman Brothers, caused this strategy to detract from results.

The Fund's exposure to Pre-refunded^{vii} securities also detracted from results. While these high-quality securities performed extremely well during the market's meltdown in 2008 and during periods of risk aversion over the fiscal year, this sector underperformed the benchmark during the twelve-month period as a whole. Elsewhere, certain IDR/PCR holdings and security selection in the Special Tax Obligation sector negatively impacted the Fund's results.

Finally, the Fund does not use leverage as compared to its Lipper peer group, which is comprised of funds that are both levered and unlevered. The levered funds within the Lipper peer group benefited from the municipal bond rally in 2009, driving up the peer group average return for the period.

Looking for additional information?

The Fund is traded under the symbol **MHF** and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under the symbol **XMHFX** on most financial websites. *Barron's* and *The Wall Street Journal's* Monday edition both carry closed-end fund tables that provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites, as well as www.leggmason.com/cef.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 5:30 p.m. Eastern Standard Time, for the Fund's current NAV, market price and other information.

Thank you for your investment in Western Asset Municipal High Income Fund Inc. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund's investment goals.

Sincerely,

Western Asset Management Company

November 17, 2009

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

RISKS: The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. High-yield bonds involve greater credit and liquidity risks than investment grade bonds. As interest rates rise, bond prices fall, reducing the value of the Fund. Certain investors may be subject to the federal alternative minimum tax, and state and local taxes will apply. Capital gains, if any, are fully taxable.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices and a sustainable pattern of international trade and payments.
- ii The yield curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.
- iii The Barclays Capital Municipal Bond Index is a market value weighted index of investment grade municipal bonds with maturities of one year or more.
- iv Net asset value (NAV) is calculated by subtracting total liabilities and outstanding preferred stock (if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is the Fund's market price as determined by supply of and demand for the Fund's shares.
- v Lipper, Inc., a wholly-owned subsidiary of Reuters, provides independent insight on global collective investments. Returns are based on the twelve-month period ended October 31, 2009, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 15 funds in the Fund's Lipper category.
- vi Duration is the measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows.
- vii A pre-refunded bond is a bond in which the original security has been replaced by an escrow, usually consisting of treasuries or agencies, which has been structured to pay principal and interest and any call premium, either to a call date (in the case of a pre-refunded bond), or to maturity (in the case of an escrowed to maturity bond).

Fund at a glance (unaudited)

INVESTMENT BREAKDOWN (%) As a percent of total investments

The bar graphs above represent the composition of the Fund's investments as of October 31, 2009 and October 31, 2008 and do not include derivatives. The Fund is actively managed. As a result, the composition of the Fund's investments is subject to change at any time.

Schedule of investments

October 31, 2009

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.

	FACE AMOUNT	SECURITY	VALUE
MUNICIPAL BONDS	98.6%		
		Alaska 0.6%	
\$	1,055,000	Alaska Industrial Development & Export Authority Revenue, Williams Lynxs Alaska Cargoport, 8.125% due 5/1/31(a)	\$ 939,699
		Arizona 1.1%	
	1,500,000	Salt Verde, AZ Financial Corp., Gas Revenue, 5.000% due 12/1/37	1,284,615
	500,000	University Medical Center Corp., AZ, Hospital Revenue, 6.250% due 7/1/29	536,675
		<i>Total Arizona</i>	<i>1,821,290</i>
		Arkansas 1.0%	
	1,000,000	Arkansas State Development Financing Authority: Hospital Revenue, Washington Regional Medical Center, 7.375% due 2/1/29(b)	1,013,330
	600,000	Industrial Facilities Revenue, Potlatch Corp. Projects, 7.750% due 8/1/25(a)	604,428
		<i>Total Arkansas</i>	<i>1,617,758</i>
		California 5.4%	
	1,500,000	Barona, CA, Band of Mission Indians, GO, 8.250% due 12/1/20	1,413,495
	2,000,000	California Health Facilities Financing Authority Revenue, Refunding, Cedars-Sinai Medical Center, 5.000% due 11/15/27	1,990,560
	2,000,000	Golden State Tobacco Securitization Corp., California Tobacco Settlement Revenue, Asset Backed, 7.800% due 6/1/42(b)	2,419,060