

PIMCO MUNICIPAL INCOME FUND III
Form N-CSRS
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**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 811-21187
PIMCO Municipal Income Fund III
(Exact name of registrant as specified in charter)**

1345 Avenue of the Americas, New York, NY

10105

(Address of principal executive offices)

(Zip code)

Lawrence G. Altadonna 1345 Avenue of the Americas, New York, New York 10105

(Name and address of agent for service)

Registrant's telephone number, including area code: **212-739-3371**

Date of fiscal year end: **September 30, 2011**

Date of reporting period: **March 31, 2011**

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-2001. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

Item 1. Report to Shareholders

March 31, 2011

PIMCO Municipal Income Fund III
PIMCO California Municipal Income Fund III
PIMCO New York Municipal Income Fund III

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Dear Shareholder:

Municipal bonds came under significant pressure during the six-month period ended March 31, 2011. Concern over the fiscal health of state and local issuers, the end of the federal government's Build America Bonds program and a two-year extension of the Bush-era income tax rates, among other factors, combined to send prices of municipal bonds lower.

The Six-Month Period in Review

During the six-month fiscal period ended March 31, 2011:

PIMCO Municipal Income Fund III declined 11.41% on net asset value (NAV) and 3.67% on market price.

PIMCO California Municipal Fund III fell 13.42% on NAV and 9.47% on market price.

PIMCO New York Municipal Income Fund III decreased 10.71% on NAV and 8.82% on market price.

In this environment, the Barclays Capital Municipal Bond Index fell a tax-advantaged 3.68% for the reporting period, while the Barclays Capital U.S. Treasury Bond Index declined 0.98%. The broad, taxable bond market, represented by the Barclays Capital U.S. Aggregate Index, decreased 0.88% for the six months ended March 31, 2011.

The federal government discontinued its Build America Bonds program on December 31, 2010. The program, part of the Obama administration's economic stimulus package, subsidized taxable municipal securities in an effort to attract investors. As the program wound down, many state and local governments flooded the market with new bonds. This temporary oversupply exceeded demand, causing prices to fall. As 2011 began, state and local governments issued fewer new bonds helping to stabilize the municipal bond market.

The Road Ahead and the Case for Municipals

The fiscal pressures faced by many states and cities are undeniable. In fiscal year 2012, they are grappling with an expected aggregate budget shortfall of \$134 billion. In addition, cities and states also have more in excess of \$1 trillion in unfunded pension and benefit liabilities which is driving many painful decisions to raise taxes and/or reduce spending. These difficult

Hans W. Kertess
Chairman

Brian S. Shlissel
President & CEO

measures may help explain why the number of municipal bonds defaults of late is lower than in recent periods. In 2010, Standard & Poor's, reports 110 bonds totalling \$2.7 billion defaulted. This represented a decline from 2009, when 151 bonds worth a total of \$2.9 billion defaulted. These numbers, in turn, should be considered within the overall context of the \$2.7 trillion municipal bond market. In fact, since 1970, only 0.09% of municipal bonds rated by Moody's Investors Service have defaulted. States are not allowed by law to file for bankruptcy; 49 are required to have balanced budgets. As for local governments, while bankruptcy filings are permitted in 26 states, this has happened only twice in 40 years. In each of these situations, the entities continued to pay interest on their debt while their respective cases were being worked out.

Going forward, we believe states and cities will continue adjusting to their fiscal challenges. In addition, despite the extension of the Bush-era tax cuts through the end of 2012, our expectation is that taxes will trend higher at all levels of government in the years ahead. For these reasons, municipal securities, despite their recent challenges, will remain solid, long-term investments for many people.

For specific information on the Funds and their performance, please review the following pages. If you have any questions regarding the information provided, we encourage you to contact your financial advisor or call the Funds shareholder servicing agent at (800) 254-5197. In addition, a wide range of information and resources is available on our website, www.allianzinvestors.com/closedendfunds.

Together with Allianz Global Investors Fund Management LLC, the Funds' investment manager, and Pacific Investment Management Company LLC (PIMCO), the Funds' sub-adviser, we thank you for investing with us. We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess
Chairman

Brian S. Shlissel
President & Chief Executive Officer

PIMCO Municipal Income Funds III Fund Insights

March 31, 2011 (unaudited)

For the fiscal six-months ended March 31, 2011, PIMCO Municipal Income Fund III returned (11.41)% on net asset value (NAV) and (3.67)% on market price. The unmanaged Barclays Capital Long Municipal Bond Index returned (7.94)% during the reporting period.

For the fiscal six-months ended March 31, 2011, PIMCO California Municipal Income Fund III, returned (13.42)% on NAV and (9.47)% on market price. The unmanaged Barclays Capital Municipal Long California Bond Index returned (9.05)% during the reporting period.

For the fiscal six-months ended March 31, 2011, PIMCO New York Municipal Income Fund III, returned (10.71)% on NAV and (8.82)% on market price. The unmanaged Barclays Capital Municipal Long New York Bond Index returned (7.51)% during the reporting period.

It was a challenging period for certain segments of the fixed income sector. Yields across the Treasury curve moved sharply higher during the period, as two-year Treasuries rose from 0.42% to 0.80% and 10-year Treasuries increased from 2.53% to 3.47%. The rise in yields was attributable to a variety of factors, including mounting inflationary pressures due to higher oil and food prices. In addition, the economy continued to expand, manufacturing activity remained strong, and there were signs that the labor market was improving. For the six months ended March 31, 2011, the Barclays Capital U.S. Aggregate Index returned (0.88)%. Despite stabilizing somewhat toward the end of the period, the municipal market produced poor results. A confluence of events dragged down municipal bonds, including the rising interest rate environment, concerns regarding increased municipal defaults, a large increase in issuance of Build America Bonds at the end of 2010, and substantial redemptions from mutual fund shareholders. All told, the overall municipal market, as measured by the Barclays Capital Municipal Bond Index, returned (3.68)% during the six-month reporting period.

During the reporting period, the Funds exposure to the tobacco sector was a significant detractor from performance. During the fourth quarter of 2010, a number of municipal tobacco settlement trusts were downgraded to below investment grade status. This led to a sharp sell-off, which was exacerbated by forced selling into an illiquid market by mutual funds not permitted to hold non-investment grade securities. Exposure to the corporate-backed sector was also negative for performance as it underperformed the benchmark.

In contrast, exposure to the housing and power sectors was positive for performance as these sectors held up relatively well amid a weak environment in the overall municipal market. Higher credit quality biases were rewarded, as lower rated credits underperformed their higher quality counterparts as a result of concern for an increase in municipal defaults. Moreover, having a shorter duration than the benchmark was beneficial for performance, as municipal yields rose across the curve during the reporting period.

PIMCO Municipal Income Funds III Fund Performance & Statistics

March 31, 2011 (unaudited)

**Municipal III:
Total Return⁽¹⁾:**

	Market Price	NAV
Six Month	(3.67)%	(11.41)%
1 Year	5.22%	(1.54)%
5 Year	0.62%	(2.90)%
Commencement of Operations (10/31/02) to 3/31/11	2.88%	1.23%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/11

Market Price/NAV:

Market Price	\$10.58
NAV	\$8.71
Premium to NAV	21.47%
Market Price Yield ⁽²⁾	7.94%

Moody's Rating
(as a % of total investments)

**California Municipal III:
Total Return⁽¹⁾:**

	Market Price	NAV
Six Month	(9.47)%	(13.42)%
1 Year	6.14%	(3.15)%
5 Year	(4.26)%	(4.92)%
Commencement of Operations (10/31/02) to 3/31/11	0.76%	(0.07)%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/11

Market Price/NAV:

Market Price	\$9.03
NAV	\$8.01
Premium to NAV	12.73%
Market Price Yield ⁽²⁾	7.97%

Moody's Rating
(as a % of total investments)

PIMCO Municipal Income Funds III Fund Performance & Statistics

March 31, 2011 (unaudited) (continued)

New York Municipal III:

Total Return⁽¹⁾:

	Market Price	NAV
Six Month	(8.82)%	(10.71)%
1 Year	(0.49)%	(2.68)%
5 Year	(4.82)%	(5.90)%
Commencement of Operations (10/31/02) to 3/31/11	(0.29)%	(0.60)%

Market Price/NAV Performance:

Commencement of Operations (10/31/02)
to 3/31/11

Market Price/NAV:

Market Price	\$8.62
NAV	\$8.07
Premium to NAV	6.82%
Market Price Yield ⁽²⁾	7.31%

Moody's Rating
(as a % of total investments)

(1) **Past performance is no guarantee of future results.** Total return is calculated by determining the percentage change in NAV or market price (as applicable) in the specified period. The calculation assumes that all income dividends, capital gain and return of capital distributions, if any, have been reinvested. Total return does not reflect broker commissions or sales charges in connection with the purchase or sale of Fund shares. Total return for a period of less than one year is not annualized. Total return for a period of more than one year represents the average annual total return.

Performance at market price will differ from results at NAV. Although market price returns typically reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Funds, market conditions, supply and demand for the Funds' shares, or changes in Funds' dividends.

An investment in the Funds involves risk, including the loss of principal. Total return, market price, market price yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a onetime public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

(2) Market Price Yield is determined by dividing the annualized current monthly per share dividend (comprised of net investment income) payable to common shareholders by the market price per common share at March 31, 2011.

PIMCO Municipal Income Fund III Schedule of Investments

March 31, 2011 (unaudited)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
MUNICIPAL BONDS & NOTES 97.4%			
Alabama 1.3%			
\$ 5,000	Birmingham-Baptist Medical Centers Special Care Facs. Financing Auth. Rev., Baptist Health Systems, Inc., 5.00%, 11/15/30, Ser. A	Baa2/NR	\$ 4,184,650
500	Birmingham Special Care Facs. Financing Auth. Rev., Childrens Hospital, 6.00%, 6/1/39 (AGC)	Aa3/AA+	515,545
1,500	Colbert Cnty. Northwest Health Care Auth. Rev., 5.75%, 6/1/27	Ba1/NR	1,346,865
1,000	State Docks Department Rev., 6.00%, 10/1/40	NR/BBB+	975,700
			7,022,760
Alaska 1.3%			
3,900	Housing Finance Corp. Rev., 5.00%, 12/1/33, Ser. A	Aaa/AAA	3,814,902
1,000	5.25%, 6/1/32, Ser. C (NPFGC)	Aa2/AA+	997,390
3,100	Northern Tobacco Securitization Corp. Rev., 5.00%, 6/1/46, Ser. A	Baa3/NR	1,817,375
			6,629,667
Arizona 5.0%			
1,250	Health Facs. Auth. Rev., Banner Health, 5.00%, 1/1/35, Ser. A	NR/A+	1,105,800
900	5.50%, 1/1/38, Ser. D	NR/A+	855,261
2,250	Beatitudes Campus Project, 5.20%, 10/1/37	NR/NR	1,581,638
1,500	Maricopa Cnty. Pollution Control Corp. Rev., Palo Verde Project, 5.05%, 5/1/29, Ser. A (AMBAC)	Baa2/BBB-	1,408,530
13,000	Pima Cnty. Industrial Dev. Auth. Rev., 5.00%, 9/1/39 (i)	Aa2/AA	11,064,040
750	Tucson Electric Power Co., 5.25%, 10/1/40, Ser. A	Baa3/BBB-	659,550
5,000	Salt River Project Agricultural Improvement & Power Dist. Rev., 5.00%, 1/1/39, Ser. A (i)	Aa1/AA	4,867,900
5,600	Salt Verde Financial Corp. Rev., 5.00%, 12/1/37	A3/A	4,654,776
			26,197,495

California 13.8%

	Bay Area Toll Auth. Rev., San Francisco Bay Area,		
1,500	5.00%, 10/1/29	A1/A+	1,468,110
500	5.00%, 4/1/34, Ser. F-1	Aa3/AA	476,370
3,260	5.00%, 10/1/42	A1/A+	2,902,182
	Golden State Tobacco Securitization Corp. Rev., Ser. A-1,		
2,000	5.00%, 6/1/33	Baa3/BB+	1,337,300
4,600	5.125%, 6/1/47	Baa3/BB+	2,763,818
2,120	5.75%, 6/1/47	Baa3/BB+	1,417,602

PIMCO Municipal Income Fund III Schedule of Investments

March 31, 2011 (unaudited) (continued)

Principal Amount (000s)		Credit Rating (Moody s/S&P)	Value
California (continued)			
\$ 2,500	Health Facs. Financing Auth. Rev., Catholic Healthcare West, 6.00%, 7/1/39, Ser. A Sutter Health,	A2/A	2,499,725
600	5.00%, 11/15/42, Ser. A (IBC-NPFGC)	Aa3/AA-	505,152
1,500	6.00%, 8/15/42, Ser. B	Aa3/AA-	1,485,225
3,350	Indian Wells Redev. Agcy., Tax Allocation, Whitewater Project, 4.75%, 9/1/34, Ser. A (AMBAC)	A2/A	2,513,036
130	Los Angeles Unified School Dist., GO, 5.00%, 7/1/30, Ser. E (AMBAC)	Aa2/AA-	126,543
1,660	Municipal Finance Auth. Rev., Azusa Pacific Univ. Project, 7.75%, 4/1/31, Ser. B (d)	NR/NR	1,661,112
1,250	Palomar Pomerado Health, CP, 6.75%, 11/1/39	Baa3/NR	1,205,550
500	San Diego Cnty. Regional Airport Auth. Rev., 5.00%, 7/1/24, Ser. A State, GO,	A2/A	503,270
2,500	4.50%, 8/1/30	A1/A-	2,154,850
3,000	4.50%, 10/1/36	A1/A-	2,413,020
895	4.50%, 12/1/36 (CIFG)	A1/A-	714,264
3,000	5.00%, 12/1/31 (NPFGC)	A1/A-	2,865,870
5,000	5.00%, 6/1/37	A1/A-	4,432,100
250	5.00%, 11/1/37	A1/A-	221,478
5,300	5.00%, 12/1/37	A1/A-	4,740,956
1,350	5.25%, 3/1/38	A1/A-	1,249,398
1,300	5.25%, 11/1/40	A1/A-	1,197,677
3,200	5.50%, 3/1/40	A1/A-	3,083,328
2,500	5.75%, 4/1/31	A1/A-	2,562,675
6,000	6.00%, 4/1/38	A1/A-	6,121,860
Statewide Communities Dev. Auth. Rev.,			
1,000	American Baptist Homes West, 6.25%, 10/1/39	NR/BBB	935,900
2,485	California Baptist Univ., 9.00%, 11/1/17, Ser. B (a)(c)	NR/NR	