Abstract: This paper analyzes optimal monetary policy and gains from cooperation in a two country sticky price model with external habit persistence in consumption and global productivity shocks only. It shows that price stability in both countries is optimal only if time varying optimal tax on labor income is implemented to completely eliminate time-varyng distortions associated with external habit and monopolistic competition in goods market. If time-invariant tax on labor income to attain the efficient steady-state is implemented, the monetary policy authority should optimally try to undo the time-varying distortions associated with external habit and monopoly power in goods market by deviating from price stability. Under this circumstance, there are gains from cooperation for unitary elasticity of intertemporal and intratemporal elasticity, i.e. the Cole and Obstfeld case (1991). These findings sharply contrast the findings of existing literature such as Benigno and Benigno (2006, 2008), Clarida et al. (2002), Corsetti et al. (2010), and Obstfeld and Rogo§ (2002). The income and substitution effect from international relative price changes cannot exactly cancel out and the marginal cost spillover exists in the economy with external habit persistence and global productivity shocks only. The potential gains from the international policy cooperation tends to increase with the degree of habit persistence in consumption.